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EMERGING TRENDS IN CHAPTER 15 CASES:

- **U.S. Creditor Rights & Protections in Chapter 15 Cases**
- **Multinational Enterprise Group Insolvency Developments**

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I. INTRODUCTION

Twenty years in the making[1], Chapter 15 of the United States Bankruptcy Code became effective October 17, 2005~ in the view of many, not a moment too soon. The ensuing five years brought increasing globalization and what the pundits rightly or wrongly characterize as the greatest global financial crisis since the "Great Depression." Whatever the reality, the perceived stakes certainly increased, and with them, if not because of them, enhanced uses of, issues flowing from, and resultant challenges presented by and for, Chapter 15.

A comprehensive analysis of the impact on international insolvency of the global financial crisis of late first decade of the 21st Century, while certain to come, is beyond the presentation time and submissions limitations of the panel on Emerging Trends in Chapter 15 Cases.

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[1] In 1985, the International Bar Association ("**IBA**") Committee on Insolvency & Creditors' Rights ("**Committee J**") embarked on developing a model law designed to "harmonize" disparate insolvency laws internationally in anticipation of the inevitable problems increasing globalization of financial transactions would present, ultimately resulting in the adopting by the IBA of the Model International Insolvency Cooperation Act ("**MIICA**"). This was soon followed by Committee J's "Concordat" ~ the precursor of the Cross-Border Insolvency Protocol employed thereafter in multi-national insolvency proceedings. In April of 1994, INSOL International and the United Nations Commission on International Trade Law ("**UNCITRAL**") held a colloquium in Vienna, Austria, where UNCITRAL is headquartered, attended as well by IBA, the World Bank, the IMF, IWIRC – the International Women's Insolvency and Restructuring Confederation, and other governmental and non-governmental organizations, to consider what the United Nations through UNCITRAL could undertake to seek to resolve the issues presented by company international financial distress in the face of incompatible, and nonexistent, national insolvency regimes. Work began soon thereafter towards what ultimately was adopted as the United Nations Model Cross-Border Insolvency Law (the "**Model Law**") and accompanying Guide to Enactment. The Model Law was minimally revised to comport with U.S. law and practice into proposed Chapter 15 of the United States Bankruptcy Code, 11 U.S.C. §§101 *et seq.* (the "**Bankruptcy Code**"), the first addition of an entirely new chapter to the Bankruptcy Code since its enactment. Itself relatively non-controversial, enactment of Chapter 15 failed on its first consideration by the United States Congress as it was submitted as part of highly controversial proposed legislation focused on consumer bankruptcy law reform. On subsequent submission, Chapter 15 was enacted with its effective set for October 17, 2005. For a comprehensive overview of the Model Law and its enactment, interpretation and application through mid-2009 within countries that have incorporated it into their insolvency systems to date, including a chapter on U.S. Chapter 15, *see* the book **Cross-Border Insolvency: A Commentary on the UNCITRAL Model Law**, **Second Edition**, general editor Look Chan Ho, published by Globe Business Publishing LTD ©2009. The Third Edition of this book is in progress, with publication anticipated during Autumn 2011.

Accordingly, this panel submission addresses merely the "tip of the iceberg" of but a few of numerous significant issues that have emerged, and continue to emerge, focusing on those presented *most* recently in the following two areas:

- The rights and treatment of local creditors in ancillary cases commenced in their jurisdiction in aid of an insolvency proceeding pending in another country; and
- The challenges presented by separate insolvency proceedings respecting individual members of a multinational corporate enterprise group pending simultaneously in multiple country jurisdictions.

II. RIGHTS AND TREATMENT OF U.S. CREDITORS IN CHAPTER 15 CASES

Representatives of non-U.S. debtors typically seek Chapter 15 relief in aid of the non-U.S. proceeding because the foreign debtor has assets or creditors or both within the territorial jurisdiction of the United States. A Chapter 15 case is not a full bankruptcy proceeding under U.S. law. Accordingly, Congress made applicable in Chapter 15 cases only certain specified sections of the U.S. Bankruptcy Code in addition to those comprising Chapter 15. *See 11 U.S.C. §103(a)*[2].

Rights and protections to which U.S. creditors legislatively are entitled in, *e.g.*, U.S. Chapter 7 and 11 cases are not *guaranteed* in a Chapter 15 case. U.S. creditor rights and protections not expressly provided within Chapter 15 are left to the "sound discretion" of the U.S. Bankruptcy Court in the exercise of its powers pursuant to Bankruptcy Code section 105(a)[3], which section *is* amongst those Congress made applicable in Chapter 15 cases.

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[2] "**§103 Applicability of chapters**
(a) Except as provided in section 1161 of this title, ….this chapter [chapter 1], sections 307, 362(n), 555 through 557, and 559 through 562 apply in a case under chapter 15."

[3] "**§105 Powers of court**
(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the

U.S. creditors of a foreign debtor have the right to contest the U.S. bankruptcy court's *recognition* of the foreign proceeding, the jurisdictional predicate for the U.S. bankruptcy court's capacity to entertain the Chapter 15 petition in the first instance and thereafter grant relief sought in aid thereof from the U.S. Court via Chapter 15. Indeed, the bankruptcy court is required to act as "objector in fact" even in the absence of formal objection to recognition, as the court has an independent duty to assess whether each element required for recognition has been satisfied.

In addition, Chapter 15 expressly protects the rights and interests of local creditors in a number of ways including, among others, by:

- Permitting the U.S. bankruptcy court to refrain from taking any action otherwise permitted under Chapter 15, including the grant of relief, if taking such action "would be manifestly contrary to the public policy of the United States." *11 U.S.C. §1506.*

- Prohibiting the U.S. bankruptcy court from granting any relief prior to determining whether the foreign proceeding is entitled to recognition, and from granting relief to which the representative of the foreign proceeding is not *automatically* entitled upon recognition, *unless* the interests of creditors and other interested entities, including the debtor, are *sufficiently protected*. *11 U.S.C. §1522.*

- Requiring a U.S. bankruptcy court asked to grant assistance to which the representative of the foreign proceeding is not *automatically* entitled upon recognition to consider whether such additional assistance, consistent with the principles of comity, will *reasonably assure*:

    - Just treatment of all holders of claims against or interests in the debtor's property;

    - Protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;

    - Prevention of preferential or fraudulent dispositions of property of the debtor;

    - Distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by the U.S. Bankruptcy Code; and

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provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."

- If appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns (in the case of a consumer proceeding).

11 U.S.C. §1507.

- Conditioning the Bankruptcy Code section 362(a) stay that obtains automatically upon recognition of a foreign main proceeding respecting property of the debtor located within the territorial jurisdiction of the United States on the provision of *adequate protection* of a creditor's rights and interests respecting such property, pursuant to Bankruptcy Code section 361. *11 U.S.C. §1520(a)(1).*

In addition, Chapter 15 expressly provides certain protections to *non*-U.S. creditors made applicable not only in Chapter 15 cases but in *all* cases commenced under any chapter of the U.S. Bankruptcy Code. These protections include, among others, the following:

- When notice is to be given to creditors in a case under *any* chapter of the U.S. Bankruptcy Code, such notice *must* be given to creditors with foreign addresses. *11 U.S.C. §1514(a)*.

- If a foreign creditor's address is not known, the U.S. court may order that appropriate steps be taken to notify such creditor. *11 U.S.C. §1514(a)*.

- Any rule or court order as to notice of filing of proofs of claim *shall* provide such additional time to foreign creditors as is reasonable under the circumstances. *11 U.S.C. §1514(d)*.

- Foreign creditors have the same rights as U.S. creditors in cases under all chapters of the Bankruptcy Code. *11 U.S.C. §1513(a)*.

- Claims of foreign creditors should not be given a lower priority solely because they are held by foreign creditors. *11 U.S.C. §1513(b)*.

The express inclusion of these and other foreign creditor protections in Chapter 15, and their applicability in *all* chapters of the Bankruptcy Code, not only Chapter 15, further evidences express U.S. public policy respecting just treatment of all creditors and Congress' intent that such policy be legislatively and judicially enforced. A foreign proceeding that fails to afford *United States* creditors similar just treatment and protection of rights and interests arguably may

be found anathema to U.S. public policy and, hence, at risk of failing to be recognized at all or, if recognized, at risk of being denied certain relief to the extent such relief may impair creditor rights and protections, pursuant to *11 U.S.C. §1506*.

III. ENFORCING U.S. CREDITOR RIGHTS IN CHAPTER 15 CASES

The protections discussed above were directly in issue in the recent Chapter 15 case filed in aid of *Mexicana Airlines'* Mexico insolvency proceeding.[4]

On August 2, 2010, Mexicana Airlines commenced a voluntary insolvency proceeding in Mexico under Mexico's *Ley de Concursos Mercantiles*. That same day, a Chapter 15 petition was filed on behalf of Mexicana seeking recognition as a foreign main proceeding, along with a motion for provisional relief pursuant to Bankruptcy Code section 1519 seeking *ex parte* a temporary restraining order pending hearing on preliminary injunctive relief pending recognition of the Mexico insolvency proceeding.

The *Declaration of Foreign Representative in Support of Motion for Recognition as Foreign "Main" Proceeding*[5], filed simultaneously with the Chapter 15 Petition, asserted among the reasons for seeking Chapter 15 recognition and relief Mexicana's concern that certain creditors in the United States would take actions against Mexicana's assets located in the United States, including airport terminal operations and equipment.

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[4] *In re Compania Mexicana de Aviacion S.A. de C.V.,* Chapter 15 Case No. 10-14182 (MG), United States Bankruptcy Court for the Southern District of New York. (Hereinafter, "**Mexicana Airlines**" or "**Mexicana**"). Note: Pleadings filed on docket of the Mexicana Chapter 15 case are available for public viewing via PACER account on the Court's website, www.nysb.uscourts.gov, as well as through Donlin Recano at www.donlinrecano.com.

[5] Docket Item No. 3, filed August 2, 2010, Case No 10-14187(MG), United States Bankruptcy Court for the Southern District of New York. Docket Item entries in the Mexicana Chapter 15 case hereinafter are designated by "**D.I.**".

The provisional and permanent relief sought impacted the rights and protections of U.S. creditors, expressly including airports at which Mexicana operated who claimed over the course of the proceeding[6], *inter alia,* that they:

- did not receive notice of request for injunctive relief prior to the preliminary injunction hearing, thereby denying them due process in violation of the most fundamental public policy of the United States, invoking Bankruptcy Code section 1506; and

- were entitled to sufficient protections – as required by Bankruptcy Code sections 1506, 1507, 1520(a)(1), 1522, all as described above -- among other ways, through

    - timely payment of post-petition obligations;

    - timely receipt of notice of all actions in the Mexico Court proceeding impacting their rights and interests (which they claimed they were not being provided at all);

    - posting of all pleadings, notices and actions in the Mexico Court proceeding on the website established for Mexicana's Chapter 15 proceeding through Donlin Recano;

    - relief from the injunction to enable any airport whose post-petition obligations are not timely paid to cease doing business with Mexicana, including, without limitation, through termination of leases and, where necessary, commencement of eviction process under applicable U.S. State law;

    - enforcement of the right to draw down on letters of credit contractually payable by a bank in the United States issued for the benefit of the airport authority; and

    - a claims adjudication mechanism within the Chapter 15 proceeding in the U.S. that would prevent the prejudice and inconvenience presented by compelling such governmental and quasi-governmental creditors to process their claims in the foreign proceeding.

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[6] *See, generally, Consortium of Airport Authorities' Due Process Objection Respecting Relief Not Previously Noticed Sought by Debtor's August 16, 2010 Proposed Preliminary Injunction Order*, filed August 17, 2010 [**D.I.** 135] (the "**Airports Provisional Relief Objection**"), *Joinder of the Greater Orlando Airport Authority* to the Airports Provisional Relief Objection, filed August 18, 2010 [**D.I.** 136], and subsequent filings in the case by these and other airport authorities objecting to provisional and permanent relief under Chapter 15 absent sufficient protections for airports and airport authorities.

Moreover, the procedures inherent to the Mexico Concurso proceeding raised additional issues for U.S. creditor rights and protections. Unlike in the United States where the filing of a voluntary petition immediately acts as entry of an order for relief under the U.S. Bankruptcy Code, the voluntary initiation of a case under the Ley Concurso Mercantil apparently launches a "gap period" prior to entry of an order adjudicating the debtor an appropriate candidate for relief. During that "gap period" an investigation transpires to determine, among other things, whether or not the debtor is insolvent as defined under the applicable law.

Thus, for the first several weeks following commencement of Mexicana's Chapter 15 proceeding, the U.S. court was dealing with a *provisional* foreign proceeding. During such a period, the potential impairment of creditor rights and protections obviously is particularly sensitive as restraints imposed on them may cause harm and expense not capable of being remedied in the even the foreign proceeding is *not* recognized by the foreign court. Thus, in the view of U.S. creditors, stronger justification for imposing injunctive and other restraints as well as stronger protections of U.S. creditor rights and interests were required to be afforded by the U.S. court.

The requested protections were the subject of numerous competing pleadings and several court hearings in the Mexicana case. Ultimately, the majority of the protections sought by the airport authorities and other creditors were agreed through settlement and expressly incorporated in the Order granting recognition of the Chapter 15 case entered by the Court November 8, 2010 [D.I. 261]. While not adjudicated to decision in this case, at some point in the future, the thorough prosecution and court determination of each such protection may well occur, including adjudication of whether a U.S. court *must* provide such protections, to what extent it may, and its

authority to do so, particularly in the face of actual or potential competing foreign court or proceeding interests. All of this is part of what this author anticipates will be an ever-increasing debate over the breadth and the limitations of the power and authority of U.S. courts under Chapter 15.

Two significant issues remained unresolved as of entry of the *Mexicana* recognition order, and thus were preserved.

The first was the request that a claims adjudication mechanism for U.S. creditors be established within the U.S. Chapter 15 proceeding enabling the U.S. bankruptcy court to determine claims arising under U.S. law that were disputed by Mexicana and not resolvable by the parties consensually. This request invoked Chapter 15's requirement that the U.S. court reasonably assure protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding, *11 U.S.C. §1507.*

Before such mechanism could be put before the U.S. Court, the Mexico Court issued an order requiring all creditors wherever located to file their claims in the Mexico proceeding on official forms presented for that purpose for receipt by the "trustee" of the Mexico proceeding in Mexico no later than December 4, 2010. Shortly thereafter, Mexicana published a list of all claims and amounts it agreed to recognize. To date, no request has been made to the U.S. Court to resolve a disputed claim.

The issue thus remains undecided whether a U.S. court has the power to adjudicate allowance as to validity and amount of disputed U.S. creditor claims against a foreign debtor which claims are clearly governed by U.S. law. The foreign debtor's court obviously can issue an order authorizing the foreign representative to agree to claims adjudication in the United

States. And the mechanism sought does not seek to alter priority of distribution, solely to determine whether the claim asserted is valid and its allowable amount. While this would facilitate the work of the foreign jurisdiction, as well as assist U.S. creditors, the issue remains whether a Chapter 15 U.S. court has the power to so involve itself in a foreign proceeding absent an order of the non-U.S. court. Or, even with such order.

The second "tabled" issue of significant import in the *Mexicana* Chapter 15 case was the Debtor's position that a U.S. creditor holding a letter of credit payable by a U.S. bank securing its claims against Mexicana legally is prevented from drawing on such letter of credit under the law of Mexico, and thus risks prosecution in the Chapter 15 proceeding as well as in Mexico for such draw. Under U.S. law, the proceeds paid upon proper draw on a letter of credit are not property of the debtor, but property of the paying bank. Apparently, under the law of Mexico, such proceeds are considered the debtor's property. The preliminary injunctive order issued by the Mexico Court purported to prohibit letter of credit draws. However, the Mexicana foreign representative never sought in the Chapter 15 case enforcement of the Mexico Court's orders; it sought only basic injunctive relief pursuant to Chapter 15. Moreover, the Mexico Court order was not served on creditors who sought to draw on their letters of credit and such creditors had not appeared in the Mexico case.

The uncertainty of repercussions if a U.S. creditor exercised its right under U.S. law to draw on a letter of credit created significant difficulty for numerous creditors, including governmental entities.

Must a U.S. creditor who contracted with a non-U.S. entity *in* the United States under an agreement expressly governed by U.S. law be forced to incur the expense of hiring counsel in the

foreign jurisdiction to adjudicate issues of U.S. law? Is the U.S. creditor protected if it has not appeared in the foreign proceeding in the foreign court, but only in the foreign debtor's Chapter 15 proceeding? Must a foreign debtor expressly seek enforcement by the U.S. Chapter 15 court of the foreign insolvency court's order to effect the relief granted by the foreign court?

These and other issues respecting protection of the rights of U.S. creditors under U.S. contracts in the context of Chapter 15 cases will continue to generate significant litigation going forward, including in the context of multiple insolvency proceedings pending in multiple countries with respect to entities within a global enterprise group.

III. RECENT DEVLOPMENTS IN MULTIPLE INSOLVENCY PROCEEDINGS WITHIN MULTINATIONAL CORPORATE ENTERPRISE GROUPS

Insolvency proceedings commenced for individual members of a multinational corporate enterprise in a number of countries present unique challenges for all involved. The UNCITRAL Model Cross Border Insolvency Law and U.S. Chapter 15, and the principles of coordination of multi-jurisdiction proceedings and judicial cooperation and court-to-court communication central to them, focus on multiple proceedings involving a *single* entity. They fall short of offering a solution in the more complicated multiple-but-related-entities situation, where one must deal with multiple courts in multiple countries with disparate insolvency systems and cultures, and different laws and rules governing, *inter alia,* claim priorities, avoidance actions, veil-piercing, security interests, guarantees, prepetition and post-petition financing, indentures and bond debt, etc etc, the list goes on.

Absent a single governing law and single court of ultimate jurisdiction over the full breadth of all such cases, parties appear left to either creative resolution adopted through global

settlement or years of litigation in multiple fora with no certainty that any one court will recognize and enforce the determination of another.

UNCITRAL, the World Bank, the major insolvency organizations, and others have been addressing insolvency of multinational corporate enterprise groups during the past few years. Their publications on the topic provide a wealth of information and analysis on the challenges presented and attempts at resolution.[7] The reader is highly commended to such publications, as a comprehensive recitation of the challenges presented and resolutions proposed to date is beyond the limits of this paper, and anything far short of same does not do the issues justice. Public reports on the efforts in this area undertaken in particular by UNCITRAL's Working Group V (Insolvency Law), the working group that developed, *inter alia,* the Model Cross-Border Insolvency Law, are particularly instructive and are accessible at the UNCITRAL Working Group V website, www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html.

Very recent events in highly public multinational cases involving global corporate enterprise groups not only illustrate some of these challenges, but have brought them to the forefront, including with respect to Chapter 15. Most notable are the currently pending multiple country proceedings involving entities within the Nortel Networks and Lehman Brothers multinational enterprise groups.

The major issue on the front burner in both instances is the allocation of assets and liabilities within and among the entities comprising the corporate enterprise, an issue that clearly must be resolved before any entities can emerge from their respective insolvency proceeding.

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[7] *See* websites of, e.g., UNCITRAL (www.uncitral.org) , the World Bank (www.worldbank.org) , INSOL International (www.insol.org) , the International Bar Association Section on Insolvency & Creditors' Rights (SIRC) (www.ibanet.org) , the International Insolvency Institute (www.iiiglobal.org).

As in most multinational enterprise group situations, the identification of the "owner" of certain specific assets and liabilities within the group is often not easily determinable, if at all.

Nortel Networks involves cases commenced by the enterprise group parent located in Canada and by numerous subsidiaries located throughout the world, with formal insolvency proceedings pending in Canada, the U.S., the U.K., France, Israel and elsewhere. Sales of substantially all of the group's assets were undertaken during the course of the cases with banking and allocation of proceeds dealt with through a series of protocols, largely tabling to a later date specific allocation. Unable to reach consensus independently, representatives of the various debtors and their major creditor constituencies are participating in mediation of the allocation issues.

In the case of Lehman Brothers, the U.S. debtors filed a proposed Chapter 11 plan. A group of bondholders recently filed a competing plan predicated on the substantive consolidation of the assets and liabilities of multiple debtors within the group. A status conference on the plan process in the U.S. case has been set for mid-January 2011, the results of which, along with events flowing thereafter, will be reported at the ABI Caribbean Insolvency Symposium in early February.

Complicating the landscape in *both* the Nortel and Lehman situations is a recent decision by the High Court in England essentially holding that under certain circumstances particular to U.K. law and regulatory authority, pension liabilities of a U.K. entity in insolvency must be borne by the *broader* enterprise. The decision has been characterized by some as supporting, if not effectively prescribing, partial if not complete substantive consolidation of the enterprise group.

Substantive consolidation has been described as the pooling of assets and liabilities of separate but related legal entities to effect an equitable distribution of value to stakeholders. Internationally, it is recognized in certain jurisdictions, new as a concept in some, and previously unheard of by many. Courts which have considered substantive consolidation, particularly in the United States, have invoked it sparingly given its restructuring of corporate formalities and other legal predicates, typically sustaining it where the court finds that the entities' assets and affairs are so intermingled that it is difficult if not impossible to separate and identify them, and doing so would cause disproportional expenditure or delay to the detriment of the parties.

As UNCITRAL has identified, a determination that substantive consolidation of entities within a multinational enterprise group is sustainable does not resolve how to effectuate it given pendency of the insolvency proceedings in multiple countries and courts. Which, if any of them, has primary jurisdiction? Does the determination rest on where the center of main interest ('COMI") of the enterprise sits? Is it possible to effectuate such consolidation under the circumstances without a legally binding international instrument regulating issues of applicable law and jurisdiction? Can it be achieved through coordinated reorganization plans? Is it prudent, if possible, to appoint a single insolvency representative or firm to oversee the consolidation and its effectuation?

The courts in various countries increasingly will be asked to address and determine these and other questions and issues encountered in parsing out realization of resolution of the challenges presented by insolvency of multinational enterprise groups, whatever its form or forms.

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