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Feature

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"Confessions" of a Forum-Shopper, Part II: Debtors Without Borders

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Over the past several decades, two legal developments have enabled cross-border restructurings that would have been impossible a generation ago. The first is the partial replacement of a territorial system (in which each country's insolvency laws deal independently with assets within its borders) with an approach often called "modified universalism" and reflected in, among other things, the UNCITRAL Model Law on Cross-Border Insolvency.[1] The premise of modified universalism is that if a debtor commences a restructuring proceeding in its home country (where the debtor has its "center of main interest"), courts in other jurisdictions should defer to that proceeding and be ready to conduct ancillary proceedings to assist. The U.S. adopted the Model Law in the form of chapter 15 of the Bankruptcy Code in 2005.[2] Using chapter 15, a foreign debtor can "import" into the U.S. the restructuring laws of its home country for the purpose of disposing of assets in the U.S. and enforcing orders against U.S. persons.

The second development works in the opposite direction and superficially appears to contradict the premise of modified universalism. It is the use of chapter 11 proceedings by foreign debtors with no center of main interest in the U.S. when the debtor determines that the restructuring laws of its home country are suboptimal for its restructuring purpose. In these chapter 11 cases, a foreign debtor can "export" U.S. restructuring law and apply it around the world, often without ever seeking recognition in its home country. There is no name for this second practice in the academic literature. In fact, caught up in the general criticism of forum-shopping are allegations that this type of extraterritorial chapter 11 is somehow unfair or inappropriate because it defeats the sovereignty of the debtor's home country or contradicts the general deference of U.S. courts to foreign lawmakers and foreign courts on matters relating to foreign companies.

Modified universalism is on its way to becoming a viable approach for most cross-border bankruptcy cases — but not all. This article explains why the ability to deviate from modified universalism and "forum shop" into a chapter 11 proceeding in the U.S. will always be necessary for a special subset of international debtors — and why non-U.S. courts, companies and creditors should not be concerned that anything is lost when such a chapter 11 proceeding occurs.

The Limits of Modified Universalism

U.S. bankruptcy courts have shown steadfast commitment to the principles of comity behind chapter 15. Non-U.S. debtors have sought recognition of hundreds of foreign proceedings and court orders under chapter 15 for the purposes of freezing and disposing of U.S. assets, enjoining U.S. claimants, creditors, trustees and agents, and otherwise assisting with the implementation of a restructuring under foreign law. U.S. courts have virtually always granted recognition of the primary relief requested to assist the foreign proceeding, even when the foreign court alters contractual, statutory or common law rights of U.S. persons using less robust procedures than would apply in the U.S.[3]

It is important to remember that chapter 15 and the underlying principles of comity are U.S. domestic law, not international law.[4] The U.S. has no treaty that compels recognition of foreign insolvency

1 At least 45 countries have adopted the Model Law. *See* "Insolvency," UNCITRAL, *available at* uncitral.un.org/en/texts/insolvency (last visited Aug. 30, 2021).
2 11 U.S.C. §§ 1501-32.

proceedings. What the U.S. does have is a national interest in its courts facilitating international restructurings, which often affect the U.S. Successful international restructurings encourage cross-border investment. If we want strong cross-border financial markets, we must have a viable approach to cross-border restructurings.

However, modified universalism and chapter 15 do not work for many international cases. The debtor's home country may not have a court system that produces results consistent with international standards of due process, or it may not have insolvency laws conducive to the type of going-concern reorganization modern creditors expect. Even when the court system and the restructuring laws in the home jurisdiction are appropriate, courts in the home country may not have sufficient experience with similar cases for skeptical international investors to underwrite the time-sensitive financial commitments necessary for successful multinational reorganization.

In other situations, problems arise because of the number of jurisdictions involved in a multinational corporate group. The parent's home country laws may not extend a debt moratorium or other needed protection to assets in non-U.S. jurisdictions, or there may be uncertainty at the commencement of a case as to whether a non-U.S. jurisdiction will recognize the parent's home country proceeding in a timely manner. Many corporate groups have subsidiaries and material assets in dozens of non-U.S. jurisdictions, each of which may require prompt recognition of the parent's home country proceeding under local law in order to protect the relevant assets. Many non-U.S. jurisdictions have not adopted the Model Law at all, and others have adopted it with potentially broader interpretations of the public policy exceptions to recognition. Indeed, some corporate groups have no obvious home jurisdiction at all, risking fights about the location of the 'center of main interest' as a condition to recognition. Other corporate groups may have multiple 'centers of main interest,' up to one for each group member of significance. For the practitioner, *every additional jurisdiction beyond the home country and the U.S. increases the challenge of modified universalism exponentially*.

As a result, in many large international reorganizations, it is impossible to obtain sufficient comfort that the key judicial relief will be available prior to the public announcement of the reorganization. This lack of certainty can be existential for a multinational corporate group if the preservation of the going concern depends on preserving the confidence of creditors, business partners, employees and subsidiary directors around the world.

When an Extraterritorial Chapter 11 Is Consistent with Comity

Facing similar problems in recent years, we often have turned away from modified universalism and advised clients centered outside of the U.S. to file plenary chapter 11 proceedings.[5] Why? What can chapter 11 do for this subset of challenging international cases that modified universalism cannot?

For the practitioner, the obvious answer is that many of the most significant creditors of a multinational corporation will comply with an order of a U.S. bankruptcy court, even if other jurisdictions do not recognize the order. Few banks, investors or businesses active internationally will knowingly violate the order of a U.S. federal court; they simply have too many U.S. contacts.

This is the single fact that makes chapter 11 an essential tool for the practitioner when modified universalism cannot protect a going concern in distress. At the beginning of a case, the Bankruptcy Code's automatic stay provides the debtor meaningful protection around the world immediately upon filing the chapter 11 petition — *i.e.*, simultaneously with the public announcement of the reorganization. With "first day" orders respected by financial institutions around the world, the debtor can preserve liquidity by continuing its global cash-management system, shoring up valuable subsidiaries that otherwise could fail and sparing the cost of maintaining separate pools of working capital. If additional liquidity is helpful to preserve the going concern, the debtor can obtain orders permitting debtor-in-possession financing and asset sales. At the end of the case, depending on the nature of the creditors ultimately affected by the reorganization plan, the debtor often can obtain a confirmation order that is sufficient on its own to ensure the effective discharge of debts. In all of these circumstances, the debtor may never need to seek recognition in a non-U.S. jurisdiction, or it may do so merely on a prophylactic basis, where the incremental benefit merits the expense.

If one were to stop here, all of this would sound like the worst sort of U.S. legal imperialism. However, it is nothing of the sort. The magic that makes such an extraterritorial chapter 11 case possible is comity — in particular, U.S. courts' deference to foreign law and foreign courts, and a prioritization of the claims of non-U.S. creditors against whom the exercise of U.S. jurisdiction would be inappropriate.

Comity in a cross-border chapter 11 appears in many different ways. First, employee, trade and other creditors outside of the U.S. with few or no U.S. contracts, as well as non-U.S. governmental creditors, are unlikely to honor U.S. court orders without recognition locally. U.S. bankruptcy practice has turned this defect into one of its most important features. The debtor generally can differentiate from the outset of the chapter 11 case between international creditors (whom the debtor expects to follow U.S. court orders) and local creditors outside of the U.S. (whom the debtor expects will not). With the right facts, and with the right amount of creditor support, courts have permitted this distinction, even when the local creditors rank junior to financial creditors in a strict liquidation waterfall.[6] This principle of restraint — that the U.S. court should not affect the rights of purely local creditors without the involvement of courts in the home coun-

3 The limited number of exceptions to recognition prove the rule. *See In re Qimonda AG Bankr. Litig.*, 433 B.R. 547 (E.D. Va. 2010) (declining to enforce foreign order stripping U.S. patent licenses from U.S. licensee); *Vitro, SAB de CV v. ACP Master Ltd.*, 473 B.R. 117 (Bankr. N.D. Tex 2012) (declining to enforce foreign order approving restructuring plan with nonconsensual releases of claims against certain insiders); *In re Toft*, 453 B.R. 186 (Bankr. S.D.N.Y. 2011); *In re Irish Bank Resolution Corp. Ltd.*, 559 B.R. 627 (Bankr. D. Del. 2016) (declining to enforce foreign orders to turn over email in violation of U.S. law); *In re Gold & Honey Ltd.*, 410 B.R. 357 (Bankr. E.D.N.Y. 2009) (declining to recognize foreign proceeding filed in violation of chapter 11's automatic stay).

4 For an excellent overview of comity in U.S. jurisprudence, *see* William S. Dodge, "International Comity in Am. Law," 115 *Colum. L. Rev.* 2071 (2015).

5 Since the financial crisis, the author's firm has filed plenary chapter 11 proceedings for clients in Australia, British Virgin Islands, Cyprus, Gibraltar, Hungary, Ireland, Italy, Japan, Kyrgyzstan, Liberia, Luxembourg, Mexico, Romania, Russia, Slovakia, Switzerland and the U.K. The firm has also prepared many other non-U.S. companies for chapter 11 in circumstances where the board ultimately pursued another restructuring path (such as an out-of-court reorganization).

6 Financial creditors typically support this approach because they understand the risks and costs of incremental non-U.S. insolvency proceedings.

try — can be framed as a matter of pragmatism or comity. Either way, it has been essential to the viability of many cross-border chapter 11 cases.

Second, U.S. bankruptcy courts follow principles of comity in chapter 11 by applying foreign substantive law in essentially the same manner as they apply U.S. state law under principles of federalism. U.S. bankruptcy courts respect home country law as the governing law for contracts and claims and, whenever possible under the rules of chapter 11, have shown sympathy for home country priorities in favor of employees and other special creditors. U.S. deference to foreign law also includes respect for the fiduciary duties of the directors of the non-U.S. debtor. Chapter 11 leaves foreign directors in charge of their corporations and requires no insolvency determination (which can deprive directors of power under the laws of many countries outside of the U.S.). As such, chapter 11 allows non-U.S. debtors to remain seated to pursue corporate objectives that are appropriate under home country law, subject to the minimum requirements of chapter 11, just as a U.S. debtor can use chapter 11 to pursue objectives that are appropriate under the laws of its home state.

Third, a chapter 11 case can be combined with other proceedings if comity requires. In many situations, the debtor cannot possibly know the precise implementation path for the restructuring on the petition date. That path may depend on the views of asset-purchasers, exit financiers and major customers, as well as the state of the business at the time of emergence. For example, if the requisite classes of international creditors approve a plan that pays local creditors in full, there may be no need to involve courts in non-U.S. jurisdictions.

On the other hand, if local creditors must be impaired, it might be prudent to combine, or comity may require the combination of, chapter 11 with ancillary proceedings or concurrent plenary proceedings in one or more other jurisdictions. In extreme cases, comity could even require the passing of the baton from a chapter 11 case to courts in the home country for implementation after using chapter 11 to stabilize global operations. A filing for chapter 11 precludes none of these subsequent combinations.

The U.S. Interest in a Balanced Approach

Why should the U.S. extend the availability of chapter 11 to non-U.S. corporations so broadly? As previously mentioned, the U.S. benefits immensely from the smooth functioning of international debt markets and the availability of going-concern restructuring solutions. Yet, even with wholehearted U.S. support, the Model Law version of modified universalism has its limits. It would not be efficient (or even realistic) for every jurisdiction in which a multinational could be centered to offer debtors the type of court system, depth of precedent, professional community and market acceptance available in the U.S. or a handful of other financial centers.[7] Moreover, even if every jurisdiction did build such a restructuring capability, larger cross-border restructurings outside of the U.S. still would likely fail before they start because the court could not order essential relief with the requisite effectiveness across the world.

The U.S.'s interest is a balanced interest. Chapter 11 is not about to become a "race to the bottom" jurisdiction in which foreign debtors come to the U.S. to deprive creditors of essential rights for the simple reason that so many creditors are based in the U.S. Indeed, the growing need for new tools to restructure multinationals may itself derive in large part not from simple "globalization," but from the export from Wall Street of new financial products, fund structures and leveraged balance sheets. When modern international financial obligations must be impaired in a restructuring, chapter 11 will always be one of the more predictable forums in the eyes of international creditors.

Conclusion

Like the sub-investment-grade bond, the institutional term loan and the credit derivative, chapter 11 over the coming years will continue to develop as a global phenomenon originating in the U.S. but available for use by large multinationals worldwide. It will not, and should not, be used in the majority of international cases. Modified universalism works and should be encouraged to grow into the dominant system for cross-border restructuring. However, practitioners will need access to chapter 11 in some cases, typically those that involve the most difficult capital structures and the largest number of jurisdictions. As long as U.S. bankruptcy courts continue to be committed to international comity, the availability of chapter 11 to help in these special situations is good news for every stakeholder, both within and outside of the U.S. abi

7 Other international legal arrangements of complexity generally develop one or two central nodes, such as the major centers for arbitration, the International Criminal Court or even the ubiquitous use of New York and English contract law for international financing documentation.

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