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Foreign Debtors Beware!

Globopar Recognizes that You May Be Hauled into a U.S. Bankruptcy Case Involuntarily

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The voluntary submission by a foreign debtor to the jurisdiction of a U.S. Bankruptcy Court in a plenary bankruptcy case under §301² or an ancillary proceeding under §304³ is not uncommon. Recently, however, creditors have sought to haul foreign corporate debtors into U.S. bankruptcy proceedings by filing involuntary petitions pursuant to §303 of the Bankruptcy Code.⁴

Globopar is the most recent example of this trend. In *Globopar*, the U.S. District Court of the Southern District of New York vacated a bankruptcy court order dismissing an involuntary petition against *Globopar* and remanded the case to the bankruptcy court for further consideration. The case is significant both because (1) it held that the “no action” clause in the applicable indenture did not clearly preclude disgruntled bondholders from commencing an involuntary proceeding, and (2) it appears to be the first higher court opinion to support the use of §303 against a foreign debtor. It also sets out clear standards for a bankruptcy court to consider when making a §303 determination in such a case. Thus, the case recognizes a potential weapon against recalcitrant foreign debtors, particularly those who submit themselves to personal jurisdiction in the United States by purposely availing themselves of the benefits of U.S. financial markets.

Background

Globopar is a Brazilian company organized under Brazilian law. *Globopar* owns, either directly or indirectly, one of the largest television production centers in the world. *Globopar*’s headquarters, employees and principal assets are located in Brazil. However, *Globopar* also owns a Delaware corporation called DTH USA Inc., a holding company that possesses a 30 percent interest in each of three Delaware general partnerships. As of the time of the involuntary filing, *Globopar* had a bank account in the United States, although whether any funds existed in that account was in dispute. *Globopar* also accessed the U.S. capital markets on several occasions and borrowed significant sums from U.S. creditors.⁵

The Filing and Bankruptcy Court Decision

At the time of the involuntary petition, *Globopar* was undergoing a consensual “out-of-court” restructuring in Brazil. Three U.S. domestic bondholder creditors, displeased with the Brazilian restructuring efforts and *Globopar*’s decision to stay all interest payments under its debt instruments, filed an involuntary proceeding against *Globopar* on Dec. 11, 2003.

Globopar filed a motion to dismiss the involuntary petition, alleging (1) the bankruptcy court lacked

subject-matter jurisdiction over the case, (2) the bankruptcy court could not assert personal jurisdiction over Globopar, (3) the venue was inappropriate and (4) *forum non conveniens*. After a hearing, the bankruptcy court dismissed the involuntary case, concluding that the involuntary petition constituted an abuse of process under §105(a) of the Bankruptcy Code because (1) an involuntary proceeding could not be initiated against a foreign debtor, (2) the bankruptcy court could not exercise jurisdiction because Globopar had few assets in the United States and Brazilian courts would refuse to recognize any judgments or orders by the bankruptcy court, and (3) the “no-action” clause in the underlying trust documents prevented the involuntary petition.

The District Court Reversal

The petitioning creditors appealed the bankruptcy court’s ruling. In sizing up the matter, the district court stated:

This appeal presents several novel questions of law concerning a domestic creditor’s ability to subject a foreign corporation to the jurisdiction of the federal bankruptcy courts. The involuntary bankruptcy petition giving rise to the appeal represents a creative way of resorting to United States bankruptcy courts to seek repayment of funds owed by an allegedly recalcitrant foreign debtor.”⁶

The district court then vacated the lower court’s decision and remanded the matter back to the bankruptcy court. The district court gave several reasons for its reversal.

The “No-action” Clause

First, the court rejected the bankruptcy court’s finding that a “no action” clause in the underlying debt instrument supported dismissal. That provision states that “[n]o noteholder shall be entitled to proceed directly against the issuer

[i.e., Globopar]...to enforce the performance of any of the provisions this trust deed of the notes” unless the trustee fails to act after receiving written request by holders of 25 percent or more of the outstanding notes.⁷ Although the 25 percent requirement had not been met, the petitioners alleged that the clause only prohibited independent suits to enforce the notes themselves, and did not restrict their ability to commence an involuntary bankruptcy case. The district court ruled that the language of the “no-action” clause was not sufficiently clear to support a dismissal of the case on the pleadings and remanded the case to the bankruptcy court to determine the scope and intent of the provision.⁸

Factors to Consider When Considering Order for Relief

The district court then addressed whether and when a bankruptcy court may issue an order of relief in an involuntary case commenced against a foreign debtor. One issue is relevant to all cases involving foreign debtors (§109 eligibility); and a second one to all involuntary debtors (§303 eligibility); a third issue, the question of personal jurisdiction, appears only to be relevant in the context of an involuntary case against a foreign debtor, and the final issue is whether a court should dismiss on the basis of abstention under §305.

Section 109

With respect to Globopar’s qualifications to be a debtor under §109, the court found that Globopar was qualified to be a debtor based on the existence of “property in the United States.” This property included Globopar’s ownership of a Delaware subsidiary, DTH USA Inc., and its U.S. bank account.⁹ In view of such property, §109 was satisfied.

Section 303

The district court then examined whether the language of §303 permitted actions against foreign entities. While recognizing that the use of the involuntary-petition provision against a foreign debtor was “novel,” the district court concluded that

such an action was statutorily permissible. The court found that the elements of §303 appeared to be met in this case because the claims against Globopar were brought by three entities, holding noncontingent unsecured claims of at least \$11,625 as required by §303(b)(1). The court also found that Globopar was not paying its debts as they came due per §303(h). Based on the facts and the plain language of §303, the court found that Globopar could be forced into a U.S. involuntary case.

Personal Jurisdiction

As the district court noted, eligibility to be a debtor in an involuntary proceeding under the Code does not conclude the analysis. Rather, in order to subject a foreign debtor to an involuntary bankruptcy proceeding, a court must find that the entity is subject to personal jurisdiction. Personal jurisdiction requires both a statutory and constitutional basis.¹⁰ The district court noted that the requisite statutory predicate for personal jurisdiction exists under 28 U.S.C. §1334, which provides that a bankruptcy court may exercise jurisdiction over a foreign debtor and affect the rights to that debtor's foreign property if the exercise of jurisdiction otherwise complies with due-process requirements. The court also found that Code §§303 and 541(a) and 28 U.S.C. §157(a) enable a bankruptcy court to exercise control over and distribute the assets of a foreign debtor located anywhere in the world, against the foreign debtor's will.¹¹ The court stated that "[s]uch exercise of extraterritorial jurisdiction over a debtor's assets, even absent the consent of that debtor, is consistent with constitutional due-process standards where the bankruptcy court has established its authority to assert *in personam* jurisdiction over the debtor and thereby take control over the worldwide *res* of the debtor's estate. Congress intended bankruptcy courts, under the supervision of the federal district courts, to exercise the full extent of *in personam* and *in rem* jurisdiction over the debtor and its bankruptcy estate in order to facilitate efficient and effective distribution of those assets."¹²

The district court then turned to constitutional due-process requirements. Although the court made

no specific findings on this matter, it suggested that sufficient contacts may exist based on the debtor's purposeful availment of U.S. law by virtue of its large borrowings from U.S. creditors and its use of the U.S. markets.

Further, the district court recognized that although potential problems exist with respect to administration of such an involuntary case that might in turn warrant dismissal of the case, these concerns are not dispositive to the issue of jurisdiction.¹³

Section 305 and Other Issues for Remand

After vacating the lower-court order, the district court identified several issues to be addressed on remand. Specifically, the district court instructed the bankruptcy court to determine whether (1) the petition should be dismissed on abstention grounds, (2) the bankruptcy court had personal jurisdiction over Globopar and (3) the petition should be dismissed on the basis of *forum non conveniens*. The district court noted that the involuntary petition represented a strong candidate for abstention under §305(a)(1) of the Code because (1) Globopar is already seeking an out-of-court restructuring and (2) Globopar's interests would be furthered by dismissal, which would enable it to avoid the risk of inconsistent judgments between the Brazilian and American courts and of foreign creditors unwilling to restructure their debt pursuant to a U.S. court's order.

Implications

The *Globopar* decision demonstrates a creative use of U.S. bankruptcy law by creditors to protect their interests. Although the existence of the pending Brazilian restructuring and other factors may ultimately warrant dismissal of the U.S. *Globopar* involuntary case, it is not difficult to imagine another involuntary case—notably one brought prior to a foreign restructuring—that is sustained. Future cases may have their own problems, including, but not necessarily limited to, (1) effectuating and imposing court orders, stays, sales, plans, claim adjudications and distributions; (2) obtaining debtor cooperation; or (3) in the alternative, effectuating appointment of a trustee or examiner. Nevertheless,

Globopar recognizes the potential use of a U.S. involuntary bankruptcy case against a foreign corporate debtor. And at minimum, an involuntary proceeding may have important practical consequences for such a debtor. As the district court stated, “[s]uffice it to note that such noncompliance is likely to adversely affect [a debtor’s] ability to procure investment within the United States, and have even more lasting effects on its reputation among holders of debt.”¹⁴ ■

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² 11 U.S.C. §301; see, e.g., *In re Aerovias Nacionales De Columbia S.A. Avianca and Avianca Inc.*, 303 B.R. 1 (Bankr. S.D.N.Y. 2003) (Columbian airline company filed voluntary chapter 11 bankruptcy); *In re Iglesias*, 226 B.R. 721 (Bankr. S.D. Fla. 1998) (foreign debtor was eligible to be a debtor under the Code). Foreign-debtor cases are predominately financial in nature; that is, restructuring debt rather than restructuring operations. See, e.g., *In re Global Ocean Carriers Ltd.*, 251 B.R. 31 (Bankr. D. Del. 2000) (multinational debtors’ reorganization plan provided for substantial restructuring of foreign debt).

³ 11 U.S.C. §304; see, e.g., *Bank of New York, et al. v. Treco, et al. (In re Treco & Hamilton)*, 240 F.3d 148 (2d Cir. 2001) (liquidators of foreign debtor brought ancillary case to obtain turnover of debtor’s property in the United States); *Haarhuis v. Kunnan Enterprises Ltd.*, 177 F.3d 1007 (D.C. Cir. 1999) (bankruptcy court had jurisdiction over ancillary case).

⁴ See *GMAM Investment Funds Trust I, et al., v. Globo Comunicacoes e Participacoes S.A. (In re Globo Comunicacoes e Participacoes S.A.)*, 317 B.R. 235 (S.D.N.Y. 2004) (“*Globopar*”); *Board of Directors of Multicanal S.A.*, 314 B.R. 486, 522 (Bankr. S.D.N.Y. 2004) (dismissing involuntary petition but allowing a voluntary ancillary proceeding to proceed); see, also, *In re Xacur*, 216 B.R. 187 (Bankr. S.D. 1997) (seven Mexican banks and one California bank filed involuntary chapter 7 petition against three Mexican citizens residing in Texas).

⁵ Specifically, *Globopar* owed approximately \$750 million in bond debt that was sold on U.S. markets and approximately \$200 million of debt under a revolving credit facility entered into with various U.S. and international banks.

⁶ *Globopar*, 317 B.R. at 240.

⁷ The “no-action” clause did not permit acceleration of the loan absent approval by at least 25 percent of the noteholders. Therefore, absent acceleration, the dissenting bondholders’ only non-bankruptcy remedy would have been to sue *Globopar* each time the company failed to make

a scheduled interest payment. Conversely, debts are automatically accelerated in a bankruptcy proceeding. This may be the reason why the involuntary bankruptcy was filed.

⁸ *Id.* at 249. “While the parties may well have intended the no-action clause to be construed broadly in order to limit appellants’ ability to bring any action ‘arising out of or relating to’ *Globopar*’s obligations to it, such language is not contained in the clause itself....”

⁹ Although not cited by the district court, under Delaware General Corporation Law §169, shares of a Delaware company are deemed located in Delaware. Therefore, any foreign corporation that owns stock of a Delaware corporation has property in the United States.

¹⁰ This issue of personal jurisdiction does not arise in a voluntary case by a foreign debtor because it purposefully avails itself of the laws of the United States.

¹¹ *Globopar*, 317 B.R. at 250-251. “Congress intended these jurisdictional provisions to have global reach.” *Id.* at 250 (citations omitted).

¹² *Id.* at 251.

¹³ “To be sure, such an exercise of jurisdiction may have drastic effects on *Globopar*’s business and operations, and...arguably would not be consistent comity considerations or due process absent significant evidence that *Globopar* purposefully availed itself of the U.S. forum and could therefore reasonably anticipate being hauled into bankruptcy court. Furthermore, potential lack of cooperation from *Globopar*, foreign creditors and Brazilian courts would certainly stand as a significant impediment to the orderly administration of *Globopar*’s bankruptcy estate.... These considerations, however, should not by themselves prevent a federal court from exercising the full measure of authority granted to it by the Constitution and by Congress to enforce federal bankruptcy law. One of Congress’s objectives in adopting the involuntary petition provision of Bankruptcy Code, 11 U.S.C. §303, was to provide a means by which U.S. creditors could have their claims to the assets of a debtor vindicated in a timely and fair manner. It would unduly frustrate this objective if a federal bankruptcy court automatically deferred even to a hypothetical prospect that foreign courts may assert exclusive jurisdiction over bankruptcy matters, no matter how much debt the prospective bankrupt raised in the United States and owed to U.S. credit ors, and no matter how extensive the foreign entity’s other contacts in United States.” *Id.* at 253-254.

¹⁴ *Id.*