

Enforcement by US Courts of Releases Granted in Foreign Insolvency Proceedings

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Given the uncertain and relatively difficult road that debtors¹ or trustees must travel to acquire an enforceable, non-consensual, non-debtor third party release in the United States, one might expect that the path to obtaining an injunction from a US bankruptcy court in support of a third party release sanctioned by a non-US court to be littered with even more obstacles. Indeed, one has not always been able to take for granted that the release or discharge of even a *debtor* itself by a non-US court will be given effect in the United States. As explained below, however, a trend toward granting injunctive relief in support of judicial decrees releasing third parties in non-US insolvency proceedings may be emerging, at least in bankruptcy courts, such as those sitting in New York and Delaware, that have been friendlier toward non-debtor third party releases in plenary cases.

Availability of non-debtor, third party releases in US chapter 11 cases

US courts do not speak with a unified voice on the question of the scope and availability of non-debtor third party releases in

bankruptcy proceedings. The US Bankruptcy Code² itself provides that a general discharge³ of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt⁴, and courts are divided as to whether this section establishes a general prohibition on granting third party releases except in the limited circumstances where the release in question complies in all respects with the provisions of section 524(g) of the Bankruptcy Code. Section 524(g) authorises the court to grant third party releases in connection with the approval of a plan of reorganisation that establishes a special trust for the channelling of claims of present and future victims of asbestos exposure.⁵ The rather complicated legislative framework for asbestos claim channelling injunctions, which specifically provides for, among other things, the appointment of a legal representative to negotiate on behalf of 'future claimants' and requires the court to determine that any third party release is fair and equitable in light of the contribution made to the special trust by the third party, is based on the procedures developed in the *Johns-Manville Corp.* and *In re UNR Industries, Inc.* bankruptcies.⁶



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¹ In cases under chapter 11 of the Bankruptcy Code – which governs reorganisation – debtors normally remain in possession and administer the property of the bankruptcy estate, exercising, under the bankruptcy court's supervision, most of the powers otherwise wielded by a trustee.

² See 11 USC §§ 1101(1), 1107(a).

³ 11 USC §§ 101–1532 (the 'Bankruptcy Code').

⁴ In US terminology, a 'discharge' in bankruptcy (i) voids 'any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged', (ii) operates as 'an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor', and (iii) operates as an 'injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from, or offset against, property of the debtor ... that is acquired after the commencement of the case [or revested in the debtor by a plan of reorganisation]'. 11 USC § 524(a).

⁵ 11 USC § 524(e).

⁶ 11 USC § 524(g).

⁷ *Fed Ins. Co. v WR Grace*, Nos 04-844, 04-845, 2004 WL 5517843, at *4 (D. Del. 22 Nov. 2004).

⁸ See, e.g., *Feld v Zale Corp.* (*In re Zale Corp.*), 62 F.3d 746, 765–66 (5th Cir. 1995); *Resorts Int'l, Inc. v Lowenschuss* (*In re Lowenschuss*), 67 F.3d 1394, 1402 n.6 (9th Cir. 1995); *Landsing Diversified Props – II v First Nat'l Bank & Trust Co. of Tulsa* (*In re W. Real Estate Fund, Inc.*), 922 F.2d 592, 600-602 (10th Cir. 1990), modified sub nom *Abel v West*, 932 F.2d 898 (10th Cir. 1991).

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This exceptional statutory remedy for asbestos-related claims is drafted in an extremely narrow fashion. By its express terms, section 524(g) does not even apply in situations where a debtor is confronted with future mass tort claims that do not result from asbestos exposure, and there is absolutely no legislative guidance on the propriety of third party releases in situations where a debtor is not confronted with any significant future mass tort liability. Hence, the law of third party releases in US bankruptcy cases where the statutory exception does not apply remains unsettled. Some courts prohibit third party releases altogether.⁷ Other courts allow them based on principles of contract law only where they are founded on the express consent of the releasing party.⁸ Still other courts allow non-consensual third party releases, but only in narrow or 'unique' circumstances.⁹ In determining whether appropriate circumstances exist to allow non-consensual third party releases, these courts focus on the adequacy of the nexus of the release to the restructuring, the contribution of the releasing party to the restructuring, and the necessity of the release as a part thereof. The reasons for this focus are to address concerns about whether the third party release in question falls within the subject matter jurisdiction of the bankruptcy court,¹⁰ whether there is requisite statutory authority to grant such relief, and whether fair procedure, e.g., adequate notice and an opportunity to be heard, has been employed.

Enforcement by US courts of contractual rights restructured in non-US insolvency proceedings

Although it provides some guidelines for granting 'appropriate relief' to parties involved in foreign insolvency proceedings, the Bankruptcy Code does not directly address enforcement of non-US restructuring plans or insolvency discharges granted by non-US courts. Instead, a limited body of case law has provided somewhat uncertain authority for courts in the United States to enforce non-US restructurings and/or discharges.

Originally, United States insolvency jurisprudence operated under the early common law rule 'that a discharge under a foreign law was no bar to an action made in [the United States]'.¹¹ While it remains true that the laws of other countries and acts given legal significance under such laws generally have no force of their own within the United States, American courts have at times given some effect to laws and legally-binding acts of foreign authorities as a matter of comity, though traditionally only in circumstances where the rights of US citizens were not prejudiced. In a watershed 1883 decision, however, the US Supreme Court employed the concept of comity to recognise and enforce against US creditors a scheme of arrangement sanctioned by the Canadian parliament.¹² In that case, the Court held that US holders of bonds issued by the Canadian debtor were not entitled to a judgment under the original contractual terms of the bonds in the United States, even though the bonds were to be paid in New York, because under Canadian insolvency law, the bonds were good only for exchange for restructured bonds pursuant to the scheme. The court reasoned that:

'[u]nless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to have legalized, the scheme may fail. All home creditors can be bound. What is needed is to bind those who are abroad. Under these circumstances the true spirit of international comity requires that schemes of this character, legalized at home, should be recognized in other countries.'¹³

Thus, 'comity of nations', as understood in the context of American insolvency law, had been transformed to serve the cause of universalism, i.e., the idea that the home country of an insolvent debtor should take the lead in restructuring its debt or liquidating its assets, and that other countries should generally recognise and enforce the effects of the home country's insolvency proceeding.

The dissenting opinion in the *Gebhard* case drives the point home by noting that the traditional principle of comity applies 'only when

8 See, e.g., *In re Specialty Equip Cos*, 3 F.3d 1043, 1047 (7th Cir. 1993); *In re AOV Indus Inc.*, 792 F.2d 1140, 1150-1153 (DC Cir. 1986); *Munford v Munford, Inc.* (*In re Munford, Inc.*), 97 F.3d 449, 454-455 (11th Cir. 1996).

9 See, e.g., *SEC v Drexel Burnham Lambert Grp, Inc.* (*In re Drexel Burnham Lambert Grp, Inc.*), 960 F.2d 285, 293 (2d Cir. 1992); *United Artists Theatre Co. v Walton* (*In re United Artists Theatre Co.*), 315 F.3d 217, 226-229 (3d Cir. 2003); *Menard-Sanford v Mabey* (*In re AH Robins Co.*), 880 F.2d 694, 702 (4th Cir. 1989); *Class Five Nev. Claimants v Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 657-661 (6th Cir. 2001); *In re Airadigm Commc'n, Inc.*, 519 F.3d 640, 655-657 (7th Cir. 2008); *In re Ingersoll, Inc.*, 562 F.3d 856, 864-865 (7th Cir. 2009). *But see Johns-Manville Corp. v Chubb Indem. Ins. Co.* (*In re Johns-Manville Corp.*), 517 F.3d 52 (2d Cir. 2008) (holding that non-debtor third party release not available for claims that are not derivative of claims against a debtor), *rev'd on other grounds*, 129 S.Ct. 2195 (2009).

10 US bankruptcy courts, as units of US federal district courts, have original subject matter jurisdiction 'of all civil proceedings arising under [the Bankruptcy Code] or arising in or related to a case under [the Bankruptcy Code]'. 28 USC § 1334(b) (emphasis added). The jurisdictional question is whether a given non-debtor third party release is sufficiently 'related to' a bankruptcy case.

11 *McMillan v McNeil*, 17 US 209, 213 (1819).

12 *Canada S. Ry Co. v Gebhard*, 109 US 527 (1883).

13 *Ibid.* at 539.

14 *Ibid.* at 545-546 (Harlan, J., dissenting).

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neither the state nor its citizens would suffer any inconvenience from the application of the foreign law',¹⁴ and thus does no injury territorialism. Much of the dissent was focused on the legislative nature of the sanctioning of the scheme, which, had it occurred in the United States, would have violated the American constitutional principle that legislation may not impair pre-existing contractual rights. The dissent's protest was that the US bondholders had not had their day in court to oppose the scheme on the basis of fairness and were thus deprived of their rights of due process.¹⁵ The majority answered this concern by pointing out that the bondholders knew from the outset that the debtor, a Canadian railway corporation, was a creature of Canadian law, which 'carries its charter, as that is the law of its existence', wherever it does business. Thus, observed the Court:

'Whatever disabilities are placed upon the corporation at home it retains abroad, and whatever legislative control it is subjected to at home must be recognized and submitted to by those who deal with it elsewhere ... It follows, therefore, that anything done at the legal home of the corporation, under the authority of such laws, which discharges it from liability there, discharges it everywhere'¹⁶

According to the majority, the bondholders could have protected themselves from any unjust Canadian legislation 'by refusing to deal with its corporations'.¹⁷

Thus, the principle of universalism in insolvency law was extended to recognition and enforcement in US federal courts of discharges of debt of non-US corporations by home-country insolvency tribunals. Despite its age, the *Gebhard* decision remained the most important authority on enforcement of non-US plans, schemes and discharges in the United States for over a century. Former section 304 of the Bankruptcy Code, in force from 1979 until 2005,¹⁸ served to codify judicially created, comity-based guidelines to aid courts in determining whether to grant various forms of relief to foreign representatives of non-US insolvency proceedings.¹⁹

In 2005 Congress replaced former section 304 with new chapter 15 of the Bankruptcy Code, which governs US proceedings ancillary to non-US insolvency proceedings, with the express purpose of incorporating:

- 'the Model Law on Cross-Border Insolvency'²⁰ so as to provide effective mechanisms for dealing with cases of cross-border insolvency with the objectives of –
- (1) cooperation between –
 - (A) courts of the United States, United States trustees, trustees, examiners, debtors, and debtors in possession; and
 - (B) the courts and other competent authorities of foreign countries involved in cross-border insolvency cases;
 - (2) greater legal certainty for trade and investment;
 - (3) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor;
 - (4) protection and maximization of the value of the debtor's assets; and
 - (5) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.²¹

Significantly, section 1521(a) of the Bankruptcy Code provides that '[u]pon recognition of a foreign proceeding, whether main or nonmain, where necessary to effectuate *the purpose of this chapter* and to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant *any appropriate relief*'.²² This provision arguably replaces the concept of 'comity' with purer concepts of universalism, such as 'cooperation' and 'facilitation', in order to promote 'fair and efficient administration of cross-border insolvencies' and 'greater legal certainty'. In this connection, it must be remembered that chapter 15 is based on and implements the Model Law, which was made to be able to be adopted by countries whose legal systems do not prominently include comity as a basis for recognising the acts of foreign insolvency tribunals.

¹⁵ *Ibid.* at 548 (Harlan, J., dissenting).

¹⁶ *Ibid.* at 537-538.

¹⁷ *Ibid.* at 539.

¹⁸ 11 USC § 304, repealed by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 802(d), 199 Stat. 23, 146 (2005).

¹⁹ Section 304 relief could include recognition of non-US schemes of arrangement. *See, e.g., In re Bd of Dirs of Hopewell Int'l Ins. Ltd.*, 238 B.R. 25, 49-50, 66-68 (Bankr. S.D.N.Y. 1999) (Bermudan scheme of arrangement found to be a 'foreign proceeding' under former section 101(23) (defining 'foreign proceeding') after sanctioning because the Bermudan court

remained available to redress any missteps by the debtor under the scheme, distribution was not yet completed, sanctioning was the judicial act to be recognised and court involvement was adequate and similar to a pre-packaged chapter 11 case).

²⁰ UN GAOR, 52d Sess., Annex I, UN Doc. A/52/17 (1997) (the 'Model Law').

²¹ 11 USC § 1501(a).

²² 11 USC § 1521(a) (emphasis added).

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Accordingly, the US adaptation of the Model Law has largely consigned the comity concept, as codified in former section 304, to a curious and non-uniform section of chapter 15 that allows the bankruptcy court to provide ‘additional assistance’ based on ‘principles of comity’.²³ The legislative history states, however, that while the new section ‘is intended to permit further development of international cooperation begun under section 304’, it ‘is not to be the basis for denying or limiting relief otherwise available under this chapter’.²⁴ Thus, it appears that Congress wished to remove some of the judicial discretion and many of the limitations that developed under the comity rubric that might be obstacles to the goals of chapter 15 set forth above.

It should be pointed out, however, that chapter 15 has two prominent if vague limitations of its own. First, section 1522 states that ‘[t]he court may grant relief under section ... 1521 ... only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected’.²⁵ Second, section 1506 provides that ‘[N]othing in [chapter 15] prevents the court from refusing to take an action governed by [chapter 15] if the action would be manifestly contrary to the public policy of the United States’.²⁶ Additionally, chapter 15 relief may not include an injunction of a police or regulatory act of a government agency.²⁷ Neither ‘sufficient protection’ nor the ‘public policy’ exception is legislatively defined or very well developed in case law.²⁸ Whatever their precise limits, some courts may be taking the ‘sufficient protection’ and ‘public policy’ limitations to relief under chapter 15 as invitations to exercise the same discretion in determining whether to grant relief as was seen in the pre-chapter 15 cases that operated on the basis of comity.

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23 11 USC § 1507. The term ‘comity’ also appears in section 1509, where it is stated that ‘a court in the United States shall grant comity or cooperation to the foreign representative’. See 11 USC § 1509(b)(3). The mandatory language supports the idea that chapter 15 makes recognition and enforcement of non-US schemes, plans or discharges something more than purely discretionary.

24 H. Rep. No. 109–31, Pt. 1, 109th Cong., 1st Sess. 109 (2005).

25 11 USC § 1522(a).

26 11 USC § 1506.

27 11 USC § 1521(d).

28 The legislative history indicates that the public policy exception is narrow, applying only to the ‘most fundamental policies of the United States’. H. Rep. No. 109–31, Pt. 1, 109th Cong., 1st Sess. 109 (2005). One court has determined, for example, that the lack of opportunity for a jury trial is not manifestly contrary to US public policy. See *In re Ephedra Prods. Liab. Litig.*, 349 BR

Since chapter 15 passed into law, US bankruptcy courts have on at least two occasions granted requests to enforce releases of non-debtor third parties that were sanctioned by non-US insolvency courts. In *In re Grant Forest Products Inc.*,²⁹ a US bankruptcy court issued an order in the debtor’s chapter 15 case enforcing within the territorial jurisdiction of the United States a Canadian court’s order in a Canadian insolvency case granting a third party release. The Internal Revenue Service (the ‘IRS’), the primary tax collection agency of the United States Government, subsequently sought relief from the order which had released from liability a ‘filing receiver’ appointed by the Canadian court for the limited purpose of filing tax returns for the US subsidiaries of the insolvent Canadian debtor that had been sold and no longer had any officers or directors to perform that ministerial task.³⁰

The US court denied the IRS motion to vacate its order enforcing the Canadian release.³¹ In essence, the US court determined that because the filing receiver itself owed no taxes and was not required by US law to file a return, it was not liable under US law in any event.³² It followed that enforcing the release did not harm the interests of the IRS; therefore, the IRS was ‘sufficiently protected’, and enforcement of the release could not be a violation of fundamental US public policy.³³ Similarly, the third limitation imposed on chapter 15 relief, that it may not include an injunction of ‘a police or regulatory act of a government unit’, was also held inapplicable, because ‘[t]he IRS’s regulatory actions are limited to assessing and collecting legally owed taxes’ and the filing receiver had no obligation to pay any such taxes to the IRS.³⁴

Finally, the court rejected the IRS’s argument that ‘comity’ should not have been extended because the Canadian order was not a ‘final order’ and ‘there had not been a full and fair trial or other examination of the legal issues involved’.³⁵ Interestingly, the court in *Grant Forest Products* specifically acknowledged the new,

333, 335–336 (SDNY 2006).

29 440 BR 616, 618 (Bankr. D. Del. 2010).

30 *Ibid.* at 618–619.

31 *Ibid.* at 622.

32 *Ibid.* at 620.

33 *Ibid.* at 621.

34 *Ibid.* at 621–622. The court also rejected an argument that the US court order violated the Anti-Injunction Act (26 USC § 7421(a)). *Ibid.* at 621.

35 *Ibid.* at 619 n. 1.

36 *Ibid.* at n. 1 (citations omitted) (emphasis in original).

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statutory basis for relief established by the adoption of the Model Law in chapter 15, noting that '[c]hapter 15 ... is not based solely on principles of comity, and § 1521 provides that, upon an order recognizing a foreign proceeding ... the court may, at the request of the foreign representative, grant *any appropriate* relief'.³⁶

The second, more renowned case in which recognition was given to a non-US third party release in support of a foreign insolvency proceeding was *In re Metcalfe & Mansfield Alternative Investments*.³⁷ There a Canadian court approved a restructuring plan that granted releases to non-debtors as part of a multiparty compromise.³⁸ The underlying facts of the case are quite complicated, involving reportedly the largest insolvency case in Canadian history, but for purposes of analysing recognition and enforcement of the Canadian court's third party release in the United States, the important points are that the Canadian courts had determined that: (i) the third party releases were exchanged for substantial concessions given to the Debtors by the released parties who made such releases a condition to their participation in the restructuring; (ii) the participation of the released parties was necessary to effect a global settlement of what amounted to a restructuring of the entire Canadian asset-backed commercial paper market;³⁹ and (iii) the Canadian courts had jurisdiction under Canadian law to grant such release.

Interestingly, the US bankruptcy court concluded that it might not have had jurisdiction to afford relief similar to that granted by the Canadian court had the same situation come before it in a chapter 11 case.⁴⁰ The court noted, however, that the mere fact that some provisions under the plan would not have been available in a plenary case under US law did not bring recognition of the plan within the scope of the public policy exception, which applies to only the most fundamental policies of the United States.⁴¹ The US court found that the 'additional' jurisdictional limits that Congress has imposed on bankruptcy courts could not fairly be described as 'fundamental' to US public policy where similar, though perhaps somewhat more

liberal standards, were in place in the home jurisdiction, as was the case in Canada.⁴² The US opinion *does*, however, examine the jurisdiction of the Canadian courts in terms similar to the analysis of jurisdiction that is undertaken in US plenary cases considering third party releases. Reading between the lines, therefore, one senses that a US court could invoke the 'public policy' exception if the nexus between the release of third parties and the restructuring of the debtor were too attenuated. Thus, there is a risk that if a US court views a release granted abroad as extraneous to the restructuring, it will not be enforced in the United States.

The *Metcalfe* court, unlike the *Grant Forest Products* court, did not seem to consider whether chapter 15 has changed the legal basis for recognising and enforcing foreign plans and discharges from the traditional comity analysis to a more universalist approach focusing on a desire for greater legal certainty and efficiency in the administration of cross-border insolvencies. Focusing on the traditional comity analysis, the *Metcalfe* court stated that its task was to determine whether the *procedures* used in the foreign insolvency proceeding accorded with American views of fundamental fairness⁴³ and examined the plan using the traditional standards employed by American courts when considering whether foreign judgments should be recognised and enforced, viz, whether the forum provides:

'a full and fair trial abroad before a court of competent jurisdiction, conducting the trial upon regular proceedings, after due citation or voluntary appearance of the defendant, and under a system of jurisprudence likely to secure an impartial administration of justice between the citizens of its own country and those of other countries, and there is nothing to show either prejudice in the court, or in the system of laws under which it is sitting.'⁴⁴

The court also stated that there should be less hesitation in extending comity to common law jurisdictions.⁴⁵ The court noted that it 'may scrutinize the basis for the assertion of jurisdiction by

37 421 BR 685 (Bankr. SDNY 2010).

38 *Ibid.* at 687-688.

39 *Ibid.* at 692-693.

40 *Ibid.* at 694-696.

41 *Ibid.* at 697.

42 *Ibid.* at 698.

43 *Ibid.* This emphasis on procedure is consistent with the law under former section 304. See *Hopewell*, 238 B.R. at 56-61 (barring objections not raised before the foreign main court and stating, 'As long as the manner in which the scheme acquired statutory effect comports with our notions of procedural fairness, comity should be extended to it'. (citations omitted)).

44 *Metcalfe* at 698 (internal citations omitted).

45 *Ibid.* (citations omitted).

46 *Ibid.* at 699-700.

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the foreign court' both under the law of the rendering court and 'in light of international concepts of jurisdiction to adjudicate'.⁴⁶ Finding the Canadian proceedings satisfactory, the court entered an order enforcing the Canadian scheme. It should be noted, however, that unlike the *Grant Forest Products* case, the motion for enforcement in *Metcalfe* was not seriously opposed.

Conclusion

Although it is difficult or, in some courts, impossible to obtain non-debtor third party releases in chapter 11 cases in the United States, some precedent now exists to obtain enforcement of such releases ordered by non-US insolvency courts in foreign proceedings recognised in the United States under chapter 15 of the US Bankruptcy Code. Given that the precedential cases were adjudicated in the Southern District of New York (which includes Manhattan) and the District of Delaware, until courts in other jurisdictions have addressed the issue, the best hope of obtaining similar relief in the future may lie in those jurisdictions. Even there, however, the request for enforcement of such releases will likely be scrutinised for fair procedure in the foreign court and an adequate nexus between the release and the restructuring, but such scrutiny is likely to be less stringent than the US courts would employ in determining whether to grant third party releases in their own, plenary bankruptcy cases.

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