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Nonconsensual Release of Claims Against Non-Debtor Guarantors Approved in Chapter 15 Case

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The courts have reached conflicting holdings over the validity of nonconsensual releases of claims against non-debtors in Chapter 11 bankruptcy cases. However, the courts have been more inclined to approve nonconsensual releases of claims against non-debtors in Chapter 15 bankruptcy cases. This most recently occurred in the Chapter 15 case of *In re Avanti Communications Group PLC (Avanti)*, pending in the United States Bankruptcy Court for the Southern District of New York (the Bankruptcy Court). The *Avanti* decision illustrates the willingness of United States courts to approve nonconsensual releases of claims against non-debtors in Chapter 15 cases that these same U.S. courts would not necessarily approve if those same releases were sought in Chapter 11 cases. However, even in Chapter 15 cases, there are limits to a court's willingness to grant such nonconsensual non-debtor releases.

Chapter 15 Overview

Chapter 15 provides rules and procedures to facilitate a foreign insolvency proceeding in the U.S. Chapter 15 cases are filed to allow a foreign debtor to obtain relief from the U.S. courts on matters relevant to its foreign insolvency proceedings and protect the foreign debtor's assets and business from creditor enforcement actions in the U.S.

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Bankruptcy Code Section 101(23) defines a foreign proceeding as a "collective judicial or administrative proceeding in a foreign country … under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control and supervision by a foreign court, for the purpose of reorganization or liquidation."

A foreign representative in a foreign insolvency proceeding initiates a Chapter 15 case by filing a petition for Chapter 15 relief with a U.S. bankruptcy court. Bankruptcy Code Section 101(24) defines a foreign representative as an agent appointed in a foreign proceeding to oversee and represent a foreign debtor in any foreign court, such as a U.S. bankruptcy court.

A foreign representative seeks recognition of a foreign proceeding to obtain Chapter 15's benefits and protections. Chapter 15 recognizes two types of "foreign proceedings" pending in another country—namely "foreign main proceedings" and "foreign nonmain proceedings." A foreign main proceeding is commenced in the country where the debtor has its center of main interest (COMI). Bankruptcy Code Section 1516(c) states, "[i]n the absence of evidence to the contrary, the debtor's registered office or habitual residence in the case of an individual is presumed to be" the debtor's COMI. A foreign nonmain proceeding is commenced in the country where the debtor has an "establishment." Section 1502(d) defines an "establishment" as "any place of operations where the debtor carries out nontransitory economic activity."

If a bankruptcy court recognizes a foreign proceeding as a foreign main proceeding, certain relief becomes automatically available. For instance, the "automatic stay" trade creditors deal with in Chapter 7, 11 and other bankruptcy cases is immediately available upon the bankruptcy court's recognition of a foreign main proceeding. The stay precludes creditors from seizing the foreign debtor's U.S. assets or otherwise continuing their litigation and other collection efforts against the debtor. No such stay automatically arises in a foreign nonmain proceeding. A foreign representative who seeks a stay of creditor actions in a foreign nonmain

proceeding must specifically request such relief from the bankruptcy court and the bankruptcy judge has the discretion to decide whether to grant such relief.

When the bankruptcy court grants recognition of a foreign proceeding, a foreign representative can obtain the categories of relief in Section 1521(a) of the Bankruptcy Code, as well as any other appropriate relief to protect the foreign debtor's assets and creditors' interests. According to Section 1521(b), that also includes entrusting "the distribution of all or part of the debtor's assets located in the United States to the foreign representative or another person, including an examiner, authorized by the court, provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected."

Courts rely on principles of comity, including deferring to a foreign court's orders, when determining whether to grant relief in Chapter 15 cases.

Section 1507(a) of the Bankruptcy Code also states the bankruptcy court may provide "additional assistance" to a foreign representative following recognition of a foreign proceeding. However, Section 1507(b) requires reasonable assurance of the: "(1) just treatment of all holders of claims against or interests in the debtor's property; (2) protection of claim holders in the U.S. against prejudice and inconvenience in the processing of claims in such foreign proceeding; (3) prevention of preferential or fraudulent dispositions of property of the debtor; [and] (4) distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by this title. …"

Courts rely on principles of comity, including deferring to a foreign court's orders, when determining whether to grant relief in Chapter 15 cases. However, Section 1506 of the Bankruptcy Code limits the comity doctrine, stating, "[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." While the Bankruptcy Code does not define "manifestly contrary to the public policy of the United States," courts have focused on whether: (i) the foreign proceeding is procedurally unfair and (ii) the application of foreign law would "severely impinge the value and import" of a U.S. statutory or constitutional right so that granting comity would "severely hinder" a U.S. bankruptcy court's ability to protect those rights.

Factual Background of *Avanti*

Avanti Communications Group plc (the "Debtor"), a provider of satellite data communications services, is a public limited company incorporated under the laws of England and Wales, headquartered in London, England, and with subsidiaries also incorporated in England, Germany, Sweden and other countries. As of Dec. 31, 2017, the Debtor's capital structure included: (i) a super-senior term loan facility with approximately $118 million outstanding; (ii) 10%/15% senior secured notes due in 2021 (the "2021 Notes") with approximately $323.3 million in outstanding principal; and (iii) 12%/17.5% senior secured notes due in 2023 (the "2023 Notes," and together with the 2021 Notes, the "Notes") with approximately $557 million in outstanding principal.

The Debtor faced substantial financial difficulties resulting from delays associated with the manufacture and launch of two of its satellites. These financial difficulties, coupled with an extremely over-leveraged capital structure, caused the Debtor to pursue a comprehensive restructuring of its indebtedness with the goal of creating a deleveraged sustainable long-term capital structure.

In December 2017, the Debtor and certain holders of the Notes entered into a restructuring agreement, referred to as a "scheme of arrangement" under U.K. Law (the "Scheme"). The Scheme included various amendments to the terms of the 2021 Notes. The Scheme also provided for an "equitizing" of the 2023 Notes by exchanging all of the Debtor's outstanding 2023 Notes for 92.5% of the Debtor's equity, to be allocated on a *pro rata* basis to the holders of the 2023 Notes. The Scheme also included broad releases with respect to the 2023 Notes that precluded creditors from asserting claims directly or indirectly arising from the 2023 Notes against the Debtor. The releases also precluded creditors from seeking to recover from the Debtor's subsidiaries that were guarantors of the 2023 Notes.

On Feb. 15, 2018, the Debtor initiated a proceeding under the U.K. Companies Act of 2006, (U.K. Insolvency Proceeding) and sought permission from the High Court of Justice of England and Wales (U.K. Court) to convene a meeting of creditors made up of the holders of the 2023 Notes, the only creditors impaired by the Scheme, to vote on the Scheme. At a meeting of creditors held on March 20, 2018, creditors representing 98.3% of the value of the outstanding 2023 Notes voted to approve the Scheme. None of the holders of the 2023 Notes voted against the Scheme. The U.K. Court approved the Scheme, finding the restructuring plan had met all of the requirements for approval of the Scheme under U.K. law. That included finding that the Scheme's classification of claims had fairly represented creditors, and the Scheme was "one that an intelligent and honest man, acting in respect of his interest as a creditor, might reasonably approve."

On Feb. 21, 2018, the Debtor, through its "Foreign Representative," filed a voluntary petition in the Bankruptcy Court for recognition of the U.K. Insolvency Proceeding as a "foreign main proceeding" under Chapter 15 of the Bankruptcy Code. The Foreign Representative sought an order from the Bankruptcy Court recognizing and enforcing the Scheme in the U.S. and enjoining creditors from attempting to thwart the relief granted as part of the Scheme. This relief included enforcing the nonconsensual releases of guaranty claims, approved by the U.K. Court as part of the Scheme, against the Debtor's subsidiaries that were not debtors in the U.K. Insolvency Proceeding.

The Bankruptcy Court's Decision

Tasked with deciding whether to enforce the Scheme, the Bankruptcy Court first addressed the threshold question of whether to recognize the U.K. Insolvency Proceeding. The Bankruptcy Court acknowledged schemes of arrangement under U.K. law have routinely been considered "foreign proceedings" in U.S. Chapter 15 cases. The Bankruptcy Court then noted the Foreign Representative had satisfied Bankruptcy Code Section 109(a)'s requirement that the Debtor have either a domicile, place of business or property in the U.S. where the Foreign Representative's counsel was holding a retainer provided by the Debtor in a U.S. bank account.

The Bankruptcy Court then turned to the issue of whether to approve and enforce the Scheme and the release of claims against the non-debtor guarantor subsidiaries that was included as part of the Scheme. The Bankruptcy Court ultimately deferred to the U.K. Court's judgment and recognized, approved and enforced the Scheme, including the release of claims against the non-debtor guarantors. The Bankruptcy Court agreed with the body of well-developed law that accords comity to a foreign court order as long as the order is the result of a full and fair proceeding before a court of competent jurisdiction and the enforcement of the order does not prejudice the rights of U.S. citizens or violate U.S. public policy.

Approval of the Third-Party Releases Despite Conflicting Chapter 11 Principles

The critical takeaway from the *Avanti* decision is that the Bankruptcy Court approved and enforced the release of claims against non-debtor guarantors in a Chapter 15 case even though such releases would not necessarily have been approved if sought in a Chapter 11 case. Though some U.S. courts have held that releases of claims against non-debtors in a Chapter 11 case may be approved without consent under limited circumstances, other U.S. courts have rejected nonconsensual releases of claims against non-debtors. U.S. courts have also reached conflicting decisions on what constitutes consent to releases of claims against non-debtors. Some U.S. courts have deemed consent to have been provided by a party's failure to object to or vote against a Chapter 11 plan that includes third-party releases. Other courts have held that a creditor must affirmatively consent to the release. In *Avanti*, while an overwhelming majority of 98.3% of the value of the 2023 Notes had voted in favor of the Scheme that included a release of claims against non-debtor guarantors, creditors holding 1.7% of the value of the 2023 Notes did not vote on the Scheme and did not affirmatively consent to the releases.

The hurdles associated with approving third-party releases in a Chapter 11 case were largely irrelevant to the *Avanti* court's analysis in the context of a Chapter 15 case. The Bankruptcy Court recognized and approved the U.K. Court's decision to approve releases of claims against non-debtor guarantors—as well as other relief—in the *Avanti* Chapter 15 case based on principles of comity and the benefit of cooperating with a foreign court. The *Avanti* court concluded the creditors that did not vote on the Scheme (and did not affirmatively consent to the release) were granted due process in the U.K. Insolvency Proceeding, consistent with the due process rights granted in the U.S. U.K. law also requires that a majority in number, representing no less than 75% in value, of each class of creditors must vote in favor of the scheme for the scheme to become legally binding. U.K. law, in contrast to U.S. bankruptcy law, also precludes approval of a scheme over the dissent of voting classes of creditors.

The *Avanti* court also relied on the fact that the holders of the 2023 Notes who were affected by the release of their claims against the non-debtor guarantors had voted overwhelmingly in favor of the Scheme. While a small number of creditors had not voted and did not expressly consent to the Scheme, they had the right to vote on and be heard with respect to the Scheme. The court also found that releases of claims against non-debtor affiliate guarantors are frequently granted in U.K. schemes and have been approved by other Southern District of New York bankruptcy judges in Chapter 15 cases involving other U.K. and Canadian foreign proceedings.

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The Bankruptcy Court also noted the failure to recognize the Scheme could prejudice creditors to the detriment of the Debtor's reorganization efforts and prevent the fair and efficient administration of the U.K. restructuring of the Debtor. The court further explained the releases were not "manifestly contrary to [U.S.] public policy" because the releases are "not categorically prohibited" in the U.S. Ultimately, a U.S. bankruptcy court's recognition, approval and/or enforcement of a foreign court order granting a release of claims against non-debtor guarantors in a Chapter 15 case would not be impacted by whether a U.S. bankruptcy court could approve nonconsensual releases of claims against non-debtors in a Chapter 11 case.

This is not to say U.S. bankruptcy courts will recognize all releases of claims against non-debtors and other forms of relief granted in foreign insolvency proceedings. The *Avanti* Court noted, in another Chapter 15 case, *In re Vitro S.A.B. DE CV*, the U.S. Court of Appeals for the Fifth Circuit had refused to approve a reorganization plan in a Mexican bankruptcy case that included non-consensual releases of guaranty claims against non-debtor U.S.-based affiliates of the debtor, Vitro. The Fifth Circuit had found a number of troubling facts that supported the bankruptcy court's refusal to approve and enforce the Mexican plan. While 75% of all voting creditors had accepted the plan, over 50% of the accepting creditors were insiders, Vitro's subsidiaries who held intercompany claims against Vitro. The Fifth Circuit was concerned the Mexican court had counted the votes of insider creditors, Vitro's subsidiaries, to gain the acceptances required by

Mexico's bankruptcy law for approval of the plan. The Fifth Circuit found this manifestly contrary to U.S. public policy because it is inconsistent with U.S. bankruptcy law that does not count the votes of insiders in determining whether an impaired class of creditors approved a Chapter 11 plan.

Conclusion

The Bankruptcy Court's decision in the *Avanti* case illustrates the important differences between the standards for obtaining a U.S. bankruptcy court's approval of releases of claims against non-debtors in Chapter 15 cases in contrast to Chapter 11 cases. While proponents of releases of claims against non-debtors in Chapter 11 cases have to satisfy potentially significant hurdles in order to obtain approval of the releases, the proponent of such releases in Chapter 15 cases has the far easier burden of arguing principles of comity justify approving the releases. However, a bankruptcy court would be less likely to approve a foreign court's order granting releases of claims against non-debtors if the bankruptcy court finds a lack of due process afforded to U.S. creditors in the foreign proceeding or determines the foreign bankruptcy law (in contrast to U.S. bankruptcy law) treats creditors in a manner that would be considered contrary to U.S. public policy.

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