Cross-Border Bankruptcy Issues

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MEMORANDUM

Allocation Issues in *In re Nortel Networks, Inc.*, Case No. 09-10138 (Bankr. D. Del. 2009)

Company Overview/Background

- Nortel Networks Corporation was a multinational telecommunications and data networking solutions provider with its parent corporation headquartered in Ontario, Canada.
- For a period of time, Nortel was a telecommunications market leader.
- At its peak in the early 2000's, Nortel had 94,500 employees and was valued at $398 billion, approximately one-third of the value of the entire Toronto Stock Exchange.
- Nortel's value was driven in large part by its cutting edge technology.
- Five entities—Nortel Networks Limited (Canada), Nortel Networks Inc. (US), Nortel Networks United Kingdom (UK), Nortel Networks S.A. (France), and Nortel Networks Ireland—were primarily responsible for contributing to the research and development of new technology.
- The entities' obligations and rights with respect to the company's intellectual property were memorialized in a Master Research & Development Agreement (the "***MRDA***").
- Under the MRDA, Nortel Networks Limited was the registered owner of all Nortel intellectual property while each of the other four contributing entities held an exclusive, perpetual and royalty-free license to exploit the group's technology, including all patents, in a specified territory.

Bankruptcy Filing

- On January 14, 2009, in the midst of the global financial crisis, Nortel affiliates filed for bankruptcy or other similar creditor protection in the United States, Canada, and the United Kingdom.
- Initially, Nortel hoped to continue as a going concern.
    - Nortel's Canadian affiliate secured up to C$300 million in short-term financing through its existing credit facility with Export Development Canada.
    - Nortel implemented a US$45 million retention bonus plan in an effort to retain top personnel during the restructuring period.
- However, by June 2009, Nortel announced that it intended to divest its various business lines through the pursuit of a series of sales.

- In a series of transactions concluding in mid-2011, Nortel sold all of its business units (the "***Nortel Business***") and its patent portfolio (the "***Nortel IP***") for an aggregate $7.3 billion.

Allocation Fight

- At the outset of the U.S. bankruptcy case and Canadian CCAA proceeding, a cross-border protocol was established to coordinate administration of the cases pending in the U.S. and Canadian courts. The protocol provided a framework for coordination among the affiliates' proceedings in each jurisdiction. However, the protocol did not address the issue of how proceeds realized from disposition of Nortel's assets would be allocated and distributed.

- In 2011, Justice Morawetz (Canada) and Judge Gross (U.S.) approved an Allocation Protocol that was developed by the U.S. and Canadian debtors.

- The Allocation Protocol provided that coordinated cross-border trials would be held and the U.S. and Canadian courts would each determine how the $7.3 billion asset sale proceeds should be allocated among the parties.

- The protocol established a list of "core parties" (the "***Core Parties***") entitled to participate in the litigation on behalf of all interested parties. The Core Parties consisted of Ernst & Young, in its capacity as the monitor of the Canadian Debtors (as defined herein) (the "***Monitor***"), the Canadian debtors (the "***Canadian Debtors***"), the Canadian Creditors Committee ("***CCC***"), Wilmington Trust, in its capacity as indenture trustee for Nortel's 6.875% Notes due 2023 ("***Wilmington Trust***"), the European, Middle East, and Asia Debtors (the "***EMEA Debtors***"), the United Kingdom Pension Claimants ("***UKPC***"), the U.S. debtors (the "***U.S. Debtors***"), the Official Committee of Unsecured Creditors of the U.S. Debtors (the "***UCC***"), the Ad Hoc Committee of Bondholders (the "***Ad Hoc Committee***"), the Bank of New York Mellon, in its capacity as indenture trustee for various series of Nortel's senior notes due 2006 ("***BNY Mellon***"), and Law Debenture Trust Company of New York, as indenture trustee for the 7.875% notes due 2026 (the "***Law Debenture***").

- The Core Parties presented evidence and expert testimony over the course of a 21-day trial, during which four distinct allocation theories emerged. The four theories were: (i) the ownership theory; (ii) the pro rata allocation theory; (iii) the contribution allocation theory; and (iv) the fair market value theory.

- Each theory turned on a distinct interpretation of the MRDA and of each entity's rights in the company's intellectual property.

- To date, neither court has issued its opinion. However, according to the Allocation Protocol, both judges will issue their opinions on the same day.

The Ownership Theory *Monitor, Canadian Debtors, CCC, Wilmington Trust*	
Sale proceeds should be allocated in accordance with each debtor's ownership of the assets sold.	
Arguments In Favor	**Arguments Against**
• Nortel Networks Limited (Canada) owns legal title to all Nortel IP and granted licenses to certain other Nortel entities pursuant to MRDA. • Once the value of the licenses is determined, the remainder of the value derived from the patent portfolio proceeds should accrue to the Canadian Debtors. • Licenses covered only use of Nortel IP in Nortel products and were of little or no commercial interest to third parties as they did not apply to use of Nortel IP in non-Nortel products. As a result, majority of value should accrue to Canadian Debtors. • With minor exception, the value of Nortel's businesses came from its intellectual property	• Pursuant to MRDA, Nortel Networks Limited (Canada) held only legal title to Nortel IP. • Owner of legal title only is not entitled to economic benefit of assets. • Value of Nortel IP rests in exclusive licenses held by U.S. Debtors and EMEA Debtors. • Canadian Debtors could not transfer any valuable rights with respect to Nortel IP in the US to any other party because it had no such rights to transfer.

The Pro Rata Allocation Theory *UKPC, CCC, Wilmington Trust*	
Sale proceeds should be allocated in accordance with the amount of claims asserted against each debtor so all unsecured creditors receive similar treatment, regardless of which debtor the creditor is claiming against.	
Arguments In Favor	**Arguments Against**
• No credible way to unwind or retrace the historical and worldwide effort to develop the company's intellectual property. • Balance of equities weighs in favor of *pari passu* treatment of all unsecured creditors. • Alternate allocations advocated by U.S. Debtors and EMEA Debtors would result in unnecessary hardship for creditors of Canadian Debtors, which include pensioners, disabled workers, and other former employees.	• Proponents are unable to identify any precedent for such relief being applied in cross-border cases on a contested basis. • The factual record does not support this theory.

Contribution Allocation Theory *EMEA Debtors*	
Sale proceeds should be allocated in accordance with each debtor's historical contribution to research and development of the Nortel IP.	
Arguments In Favor	**Arguments Against**
• Under Canadian law, the inventor is the first owner of an invention. Where inventor is employed to invent, the employer, by operation of law, beneficially owns the resulting intellectual property. • Debtors jointly own the company's intellectual property because their employees jointly developed the intellectual property. • MRDA agreement does not create the	• Theory erroneously equates cost of developing an asset with the value of an asset. • EMEA Debtors cannot provide evidence that tracks the contributions to research and development made by various Nortel entities over the years. • Theory does not ascribe value to contribution that others, including managers, strategists, and salespeople,

ownership interest but merely reflects the joint ownership among parties that existed prior to execution of the MRDA. • MRDA stated that each Participant should benefit from its contribution to creating the company's intellectual property commensurate with the value of its contribution. • Each entity's contribution dating back to at least 2001 should be considered. 2001 marks the date when the Nortel group adopted the profit split methodology documented in the MRDA,	made to success and value of Nortel IP. • To the extent theory is adopted, should only consider contributions from 2005-2009 (which skew in favor of the Canadian Debtors).

Fair Market Value Theory *U.S. Debtors, UCC, Ad Hoc Committee*	
Sale proceeds should be allocated in accordance with value of assets sold or transferred by each debtor.	
Arguments In Favor	**Arguments Against**
• U.S. Debtors and the EMEA Debtors, as the equitable and beneficial holders of Nortel's intellectual property and other assets sold, should receive a share of the proceeds of Nortel's assets commensurate with their ownership of such assets. • Each debtor had exclusive right to exploit Nortel IP in its jurisdiction. • Value each debtor receives on account of Nortel lines of business/IP should be consistent with value of rights in business assets/IP that the debtor transferred or forfeited as part of the sale. • U.S. Debtors held greatest portion of Nortel value because the majority of Nortel's patents were only registered, and therefore only had value, in the United States, and the business revenues were predominantly generated in the U.S. • Value of U.S. intellectual property evidenced by the fact that U.S. Debtors drove revenue for the Nortel Group. • U.S. Debtors should be allocated largest share of proceeds based on value of U.S. assets.	• Nortel's revenues from the U.S. market never belonged to the U.S. Debtors and, as a result, neither should the proceeds from the sales. • Theory relies on extrinsic evidence regarding meaning of MRDA, which should be inadmissible. • Licenses had little or no value because they were not freely transferrable. • Theory is inequitable because would allocate approximately 10% of sale proceeds to Canadian Debtors, who have the largest pool of claims.

Commentary

- Of the approaches outlined above, the Fair Market Value Theory appears the most credible, although not without flaws, and the Pro Rata Theory appears the least credible.

- The Fair Market Value Theory attempts to determine what value would be available to an individual debtor's creditors if each debtor separately undertook a sale of its assets. That goal seems appropriate.

- The approach breaks down because none of the debtors would have been able to sell its rights in the Nortel IP without the cooperation and consent of the other debtors.

- Because the cooperation/consent of the other debtors is essential to recognizing any value from the assets, the other debtors should get some distribution on account of their cooperation.

- At the other end of the spectrum, the Pro Rata Theory seems inappropriate.

- The Pro Rata Theory is based on emotion. Although equitable outcomes are a goal of bankruptcy courts, there still must be some basis in law or underlying fact to support the outcome.

- The Pro Rata Theory, however, rests on the fact that the Canadian creditors are largely individuals who may suffer great financial distress if the Canadian debtors do not receive the bulk of the proceeds while U.S. creditors include banks and other financial institutions that can withstand a deeper haircut.[1]

- Personal hardship, while unfortunate, is not a basis for favoring one creditor constituency over another.

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[1] Note: the bondholders have indenture claims against Canada and claims against us debtors as guarantors, even though CCC often characterizes them as US creditors.

ABI NEW YORK CITY BANKRUPTCY CONFERENCE

CROSS-BORDER PANEL[1]

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[1] This outline is provided for informational purposes only. The opinions set forth herein do not necessarily reflect the views of the panelists, the moderator or any of their colleagues, law firms or clients, and are not necessarily applicable to any particular case.

I. Recent Developments in Chapter 15 Recognition Cases

a) In re Barnet, 737 F.3d 238 (2d Cir. 2013)

i) The Second Circuit's decision in *Barnet* reversed a bankruptcy court's ruling granting recognition to Octaviar Administration Pty Ltd., an Australian company that had not introduced any evidence of assets or operations in the United States.

ii) In July 2009, the Supreme Court of Queensland, Australia ordered that Octaviar Administration be liquidated. In August 2012, the foreign representatives petitioned the U.S. Bankruptcy Court for the Southern District of New York for recognition as a foreign main proceeding under section 1515.

iii) The Bankruptcy Court granted the recognition order in September 2012.

(1) The Bankruptcy Court concluded that no controlling precedent required a Chapter 15 debtor to satisfy the requirements in section 109(a) that the debtor have a residence, domicile, place of business or assets in the United States.

iv) On appeal, the Second Circuit vacated the recognition order.

(1) The Second Circuit held that foreign entities seeking recognition under Chapter 15 must, in addition to satisfying the requirements for recognition set forth in Chapter 15, satisfy section 109(a) of the Bankruptcy Code by demonstrating that the debtor have a residence, domicile, place of business or assets in the United States.

(2) In reaching this conclusion, the Second Court determined that all that was required was a "straightforward" statutory interpretation of the Bankruptcy Code. As the Court explained:

(a) Section 103 of the Bankruptcy Code makes all of Chapter 1 applicable to Chapter 15.

(b) "Section 109(a)—within Chapter 1—creates a requirement that must be met by any debtor."

(c) Chapter 15 governs the recognition of foreign proceedings, which are defined as proceedings in which "the assets and affairs of the debtor are subject to control or supervision by a foreign court." 11 U.S.C. § 101(23).

(d) A debtor that is the subject of a foreign proceeding, therefore, must meet the requirements of section 109(a) before a bankruptcy court may grant recognition of the foreign proceeding.

(3) "Because Foreign Representatives made no attempt to establish that OA had a domicile, place of business or property in the United States, recognition should not have been granted."

b) In re Bemarmara Consulting A.S., No. 13-13037 (KG) (Bankr. D. Del. Dec. 17, 2013)

i) In *Bemarmara*, the Bankruptcy Court for the District of Delaware considered—and expressly rejected—the Second Circuit's reasoning in *Barnet*. The Bankruptcy Court stated that Third Circuit precedent, a reading of the statute and policy considerations warranted disagreement with *Barnet*.

ii) Bemarmara Consulting A.S. ("BAEST") was a Czech company involved in a Czech insolvency proceeding that petitioned for foreign recognition under Chapter 15.

iii) The Delaware Bankruptcy Court held that a foreign debtor is not required to have assets in the United States to obtain recognition under Chapter 15.

(1) First, the Court noted that, under Third Circuit precedent, in the absence of a finding that the motion for recognition is manifestly contrary to public policy, recognition is mandatory in aid of the main proceeding. *In re ABC Learning Centers, Ltd.*, 728 F.3d 301 (3d. Cir. 2013).

(2) Bankruptcy Judge Kevin Gross expressly rejected the Second Circuit's decision in *Barnet* and declined to follow it.

(a) First, the Court noted that *Barnet* was not controlling precedent on the Bankruptcy Court in Delaware and opined that the Third Circuit likely would not agree with *Barnet*'s holding.

(b) The Court noted that section 109(a) provides for "debtor[s] under this title" whereas it is a foreign representative, not the debtor, who seeks recognition under Chapter 15.

(c) Judge Gross noted that some commentators have reflected on the possibility that section 109(a) was not intended to apply in Chapter 15, and that a scrivener's error is responsible for it being included in this section.

(d) In addition, Judge Gross noted that section 1502, the definition section of Chapter 15, defines "debtor" as "an entity that is the subject of a foreign proceeding." Nothing in that definition, he commented, requires that the debtor have assets to qualify under Chapter 15.

c) In re Suntech Power Holdings Co., Ltd., No. 14-10383 (Bankr. S.D.N.Y. 2014)

i) The U.S. Bankruptcy Court for the Southern District of New York interpreted *Barnet* as establishing a very minimal hurdle: to satisfy section 109(a), all a debtor must do is establish a bank account in New York immediately before filing bankruptcy.

ii) The debtor is a Cayman Islands holding company. It is the parent corporation for several direct and indirect subsidiaries with its main operations in Wuxi, China.

(1) Its principal American subsidiary, Suntech America, Inc., is incorporated in Delaware and has its principal place of business in California.

(2) Before the bankruptcy filing, Suntech's connections with New York were flimsy, at best.

(a) It had no New York office.

(b) It had designated CT Corporation in New York City as its agent for service of process under an indenture. Its corporate debt had been listed on the New York Stock Exchange.

(3) The day before the bankruptcy petition was filed, the Debtor transferred $500,000 from the Cayman Islands to a newly created bank account at the Bank of New York ("BONY").

iii) The Bankruptcy Court concluded that, notwithstanding the Debtor's meager contacts with New York, the BONY account was sufficient to satisfy the requirements of section 109(a) and *Barnet*.

(1) Bankruptcy Judge Stuart Bernstein first held that, under New York law, the BONY account was the Debtor's property because the account was subject to the Debtor's control.

(2) The Court then held the establishment of the BONY account in New York before the Chapter 15 case proceeding was sufficient to render the Debtor eligible under 11 U.S.C. § 109(a).

(a) Judge Bernstein noted that section 109(a) says nothing about the *amount* of the debtor's property that must be in the United States and does not establish some monetary threshold that the debtor must satisfy.

(b) Furthermore, the Court emphasized that section 109(a) does not require an "inquiry into the circumstances surrounding the debtor's acquisition of the property."

(c) Judge Bernstein additionally concluded that there was nothing improper about the debtor's conduct in this case.

(i) The Court noted the purpose of Chapter 15 is to provide relief to foreign debtors and reasoned that the Code should not be interpreted in a way that denied such relief: "Shutting the door on the Debtor, where it has no other access, will hinder the restructuring of this multi-national business as contemplated by Chapter 15."

(ii) He emphasized that Chapter 15 relief is designed to provide legal certainty, maximize value, protect creditors and other parties in interest and rescue financially troubled businesses. *See* 11 U.S.C. § 1501(a).

d) Public Policy Exception

i) Section 1506 – "Nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."

(1) In general, other than allegations that the petitioner failed to satisfy any of the three requirements under section 1517(a), the only ground to object to a foreign proceeding would be that such recognition contravened U.S. public policy.

e) The legislative history explains that the public policy exception should be narrowly construed and only invoked when the most fundamental policies of the United States are at risk.

II. Section 363 Sales in the Chapter 15 Context

a) Relevant bankruptcy code provisions:

i) Section 1520. Effects of recognition of a foreign main proceeding. "(a) Upon recognition of a main proceeding that is a foreign main proceeding . . . (2) sections 363, 549, and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to **the same extent that the sections would apply to property of the estate** . . ." (emphasis added).

ii) Section 1502. Definitions. "(8) within the territorial jurisdiction of the United States", when used with reference to property of a debtor, refers to tangible property located within the territory of the United States and intangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may properly be seized or garnished by an action in a Federal or State court in the United States."

iii) Section 363(b)(1) provides that the "trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate."

b) In re Elpida Memory, Inc., Case No. 12-10947 (CSS), 2012 WL 6090194 (Bankr. D. Del. Nov. 20, 2012).

i) Facts:

(1) In 2012, Elpida Memory, Inc. filed a petition for commencement of corporation reorganization proceedings under the Japanese Corporate Reorganization Act. Messrs. Yukio Sakamoto and Nobuaki Kobayashi were appointed as trustees and, as foreign representatives, they later filed a petition under Chapter 15 of the bankruptcy code commencing a Chapter 15 case in the United States Bankruptcy Court for the District of Delaware.

(2) The foreign representatives filed four motions under section 363 seeking approval of four related transactions, which transactions included (i) the sale of certain of

its patents, some of which were registered in the United States, to Rambus Inc. pursuant to a patent purchase agreement which had been approved by the Japanese court; and (ii) the granting of a license in the patents being sold to Rambus (again, some of which were registered in the United States) to Micron Technology Inc.

ii) The Court's analysis:

(1) The question before the bankruptcy court was: What legal standard applies in a Chapter 15 case to the transfer of assets located in the United States pursuant to a "global" transaction previously approved by another court in a foreign main proceeding?[2]

(2) The bankruptcy court found that, based upon the plain meaning of section 1520(a), it must examine the transactions under the section 363(b).

(a) The Court found that the legislative history of Chapter 15 supports this result.

(b) Further, the Court found that principles of comity do not apply or, even so, the court must defer to the plain meaning of the statute and the legislative history.

(3) The bankruptcy court relied on In re Delaware & Hudson Railway Co., 124 B.R. 169, 176 (D. Del. 1991) in stating the Third Circuit standard for approval of section 363 sales which requires satisfaction of four elements: (1) a sound business purpose exists for the sale; (2) the sale price is fair; (3) the debtor has provided adequate and reasonable notice; and (4) the purchaser has acted in good faith. See also Abbot Dairies of Pennsylvania, Inc., 788 F.2d 143 (3d Cir. 1986).

(4) The Court held that "In order for the Foreign Representatives to prevail they must prove by a preponderance of the evidence that Elpida's entry into the transactions subject to the Rambus Motion and Micron Motion as it pertains to assets located in the territorial jurisdiction of the United States was a sound exercise of the Trustees' business judgment." The bankruptcy court later approved the Ramus and Micron motions after evidentiary hearings.

c) Krys v. Farnum Place, LLC (In re Fairfield Sentry Ltd.), 768 F.3d 239 (2d Cir. 2014).

i) Facts:

(1) Fairfield Sentry is a British Virgin Islands ("BVI") investment fund that invested in Bernard Madoff's companies. It filed claims in the liquidation of the Madoff companies, which claims were allowed in the amount of $230 million, subject to payment of $70 million by Fairfield Sentry to the Madoff trustee.

[2] Prior to holding separate hearings on the merits of the Rambus and Micron motions, on request of the parties, the Court scheduled a hearing as to what legal standard would apply to the Court's review of the motions.

(2) Fairfield Sentry was placed into its own liquidation in the British Virgin Islands, which proceeding was recognized in the United States as a foreign main proceeding.

(3) Fairfield Sentry's claim in the Madoff liquidation became an asset of Fairfield Sentry's BVI liquidation proceeding.

(4) Fairfield Sentry auctioned its claim in the Madoff liquidation and ultimately sold it to Farnum Place, LLC, the appellee, for 32.125% of its allowed amount. The sale was conditioned on approval of the courts in the BVI and the United States. The Trade Confirmation documenting the transaction provided that the Fairfield Sentry liquidator "shall endeavor to obtain promptly the approval of the BVI Court of the terms and conditions of this Trade Confirmation."

(5) Three days after the Trade Confirmation was signed, the Madoff trustee announced a settlement that increased the value of the Fairfield Sentry claim in the Madoff liquidation by approximately $40 million.

(6) When the Fairfield Sentry liquidator did not seek approval of the BVI Court of the Trade Confirmation as required by the Trade Confirmation, Farnum Place filed an application with BVI Court for an order compelling specific performance of the Trade Confirmation. The liquidator argued that the Trade Confirmation was not in the best interest of creditors, given the sudden increase in value of Fairfield Sentry's claim, and asked that the BVI Court not approve the Trade Confirmation. The liquidator also asserted the Trade Confirmation needed to be approved by the U.S. bankruptcy court.

(7) The BVI Court approved the Trade Confirmation over the liquidator's objection. The BVI Court, however, directed the liquidator to "take the necessary steps to bring before the U.S. Bankruptcy Court the question of approval (or non-approval) by that Court of the Trade Confirmation" and provided that "it must be done in such a way that the U.S. Bankruptcy Court is presented with a choice whether or not to approve it."

(8) The liquidator, as foreign representative, then filed an application in the bankruptcy court requesting review of the Trade Confirmation under section 363(b) and the entry of an order disapproving the trade. The bankruptcy court characterized the application as a "last-ditch" effort to undo the transaction and found that section 363 review was not warranted because the sale did not involve a transfer of an asset in the U.S. Further, the bankruptcy court found that it needed to defer to the BVI Court's decision to approve the Trade Confirmation under principles of comity.

(9) The liquidator appealed, and the district court affirmed the bankruptcy court stating that, while it is unclear whether section 363 applies, even if section 363 applies, the bankruptcy court's denial of the liquidator's application for an order disapproving the trade was proper because "[c]ourts should be loath to interfere

with corporate decisions absent a showing of bad faith, self-interest, or gross negligence." The liquidator then appealed to the Second Circuit.

ii) The Second Circuit's Analysis

(1) The Second Circuit analyzed whether it was required to conduct a review under section 363.

(a) An asset sale in a Chapter 15 bankruptcy proceeding requires section 363 review if it involves a "transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States." 11 U.S.C. § 1520(a)(2).

(b) Because Fairfield Sentry's claim in the Madoff liquidation that it sought to transfer was subject to seizure and garnishment in the United States, the Court determined that it was an asset within the territorial jurisdiction of the United States and therefore was subject to section 363 review.

(2) The Second Circuit found that the bankruptcy court erred when it gave deference to the BVI Court's approval of the Trade Confirmation under principles of comity.

(a) The bankruptcy court was ***required*** to conduct a section 363 review when the debtor sought a transfer of an interest in property within the territorial jurisdiction of the United States.

(b) The BVI Court declined to rule on whether the Trade Confirmation required approval under section 363 and, therefore, it is not clear that the BVI Court even wanted deference in this instance.

(3) The Second Circuit remanded the case to the lower courts for section 363 review with guidance.

(a) The Second Circuit reiterated the Second Circuit standard for section 363 approval: "that a judge ... expressly find from the evidence presented before him at the hearing a good business reason" to approve the sale. In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983).

(b) The Second Circuit noted the following:

(i) All factors, including the increase and decrease in value, must be considered.

(ii) The bankruptcy court's principal responsibility is to secure the best price for the benefit of creditors.

(iii) The bankruptcy court must consider the increase in value of Fairfield Sentry's claim between signing the Trade Confirmation and approval by the bankruptcy court as part of its analysis, and nothing limits the bankruptcy court's review to the date of signing of the Trade Confirmation.

d) Conclusion:

i) When using, selling and/or leasing assets, foreign representatives should consider the standard for approval in their main proceeding and whether the use, sale and/or lease will be within the territorial jurisdiction of the United States. If it is within the territorial jurisdiction of the United States, they need to assume that the bankruptcy court will apply section 363. The Fairfield decision has been viewed by some as potentially expanding the role of U.S. courts in Chapter 15 cases as well as impacting the section 363 sale standard, generally.

III. Foreign Debtors Filing Chapter 11

a) Introduction to Foreign Debtors Using Chapter 11

i) There is a long-standing practice of foreign debtors seeking Chapter 11 protection. A recent empirical analysis by Oscar Couwenberg from the University of Groningen in the Netherlands and Stephen Lubben of Seton Hall School of Law found more than 300 foreign debtors that had filed either Chapter 7 or Chapter 11 protection between 2005 and 2012.

ii) There are many appealing advantages for debtors:

(1) Well-developed insolvency laws. Chapter 11 is the most well-developed law of any insolvency regime in the world for helping troubled companies restructure their affairs.

(2) Companies can confirm a reorganization plan with less than unanimous stakeholder support.

(3) U.S. bankruptcy courts can handle corporate groups unlike many international regimes.

(4) U.S. bankruptcy courts are more adept at handling mobile assets, and U.S. bankruptcy court orders ostensibly reach assets regardless of location.

(5) European jurisdictions, even the United Kingdom, have relatively little experience restructuring bond debt and complex capital structures. Given this and the increased use of high-yield bond debt in Europe, corporations may turn to U.S. courts more frequently for bankruptcy and restructuring. (See Lubben and Couwenberg 2014).

b) Foreign Entity Eligibility for Chapter 11

i) A person (including a corporation, see 11 U.S.C. § 101(41)) is eligible to file for Chapter 11 if it "resides or has a domicile, a place of business, or property in the United States." 11 U.S.C. § 109.

ii) "Property in the United States" is the hook for foreign debtors.

(1) While an enterprise need not have its headquarters, significant assets, or employees in the U.S., each entity seeking Chapter 11 protection must have property in the U.S.

(2) Cases have held that a U.S. bank account with as little as a few hundred or a thousand dollars would suffice.

(3) For example, in *In re Global Ocean Carries Ltd.,* 251 B.R. 31 (Bankr. D. Del. 2000), a Greek shipping company and its subsidiaries filed Chapter 11 petitions in Delaware. A small creditor and minority shareholders moved to dismiss, arguing lack of jurisdiction. The Court denied the motion, holding that a few thousand dollars in a bank account and the unearned portions of the retainers provided to local counsel was sufficient "property" to warrant filing in the U.S.

c) Considerations for Foreign Chapter 11 Filers

i) Are non-U.S. obligations being affected, and can the company enforce U.S. bankruptcy orders against creditors and assets in foreign jurisdictions? For example, the bulk of a foreign shipping company's assets are likely located outside of the U.S., and in multiple foreign jurisdictions.

ii) U.S. restructuring proceedings may not be recognized in many EU Countries. In that case, Chapter 11 may have to be combined with local proceedings

iii) The extraterritorial reach of the automatic stay of section 362 is uncertain. Debtors may want to seek authority in first day orders to pay foreign creditors who might otherwise be able to take action against a debtor in a non-U.S. jurisdiction.

iv) Despite the propriety of a foreign debtor seeking Chapter 11 protection under section 109, a creditor can file a motion to dismiss pursuant to section 305(a)(1), which provides that a court may dismiss or suspend proceedings in a case if "the interests of creditors and the debtor would be better served by such dismissal or suspension."

(1) *In re Aerovias Nacionales de Colombia S.A. Avianca*, 303 B.R. 1 (Bankr. S.D.N.Y. 2003). Aerovianca was a publicly traded online in Colombia providing passenger and cargo service. Its property in the U.S. included leased aircraft. After filing for Chapter 11 protection, a set of creditors moved to dismiss pursuant to section 305(a)(1). The court found that Avianca would not be "better served" by dismissal of the case. The creditors made no showing that Avianca could have obtained jurisdiction over its creditors were it to file in Colombia.

v) A creditor can also seek to dismiss pursuant to section 305(a)(2) if it can make a showing that (1) a petition for recognition of a foreign proceeding has been granted; and (2) the purposes of Chapter 15 would be best served by such a dismissal.

d) In re Inversiones Alsacia S.A., et al., 14-12896 (Bankr. S.D.N.Y.) (MG).

i) Alsacia is just the latest in the broad trend of foreign debtors seeking Chapter 11 protection.

ii) Facts:

(1) Alsacia is one of the largest bus operators in Santiago, Chile. All of its operations are in Chile, but it owned New York bank accounts, set up before it filed Chapter 11, established by the indenture governing the notes it sought to restructure.

(2) High levels of fare evasion and declining ridership had affected its ability to make its senior secured debt payments. The debt obligations were U.S.-dollar denominated and New York law governed. Alsacia, the issuer, and the notes' three guarantors (two Chilean, one Bermudan) filed Chapter 11 petitions.

iii) The Prepackaged Plan:

(1) Alsacia sought confirmation of a prepackaged Chapter 11 plan in the Southern District in October 2014.

(2) Solicitation of the senior secured creditors occurred before the petition date. No senior secured noteholders voted against the prepackaged plan. Qualified senior secured noteholders received new notes with adjusted repayment schedules and a catch-up interest payment in cash.

(3) Because the Plan impaired only the senior secured noteholders, no other classes of creditors needed to be solicited.

(4) This structure allowed Alsacia to continue satisfying its Chilean obligations (trade creditors, employees, etc.) and ensured that bus service was not disrupted in Santiago.

(5) Judge Martin Glenn confirmed the prepackaged plan in December 2014.

IV. Extraterritoriality Application of Bankruptcy Code Avoidance & Recovery Statutes

a) The Presumption Against Extraterritoriality: Unless a contrary intent appears, federal legislation is intended only to apply within the territorial jurisdiction of the United States. Morrison v. National Australia Bank Ltd., 561 U.S. 247, 255 (2010).

i) "When a statute gives not clear indication of extraterritorial application, it has none." Id.

ii) "Rather than guess anew in each case, this Court applies the ***presumption in all cases,*** preserving a stable background against which Congress can legislate with predictable effects." Id. at 248 (emphasis added).

iii) The presumption "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord." EEOC v. Arabian American Oil Co., 499 U.S. 244, 248 (1991).

iv) Morrison impact:

(1) Blocked large securities actions from U.S. Courts.

(2) Has been extended to apply in criminal cases.

(3) Recently interpreted in the two bankruptcy decisions discussed below.

b) Relevant Bankruptcy Statutes

i) **Section 541. Property of the estate**.

> "(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: . . . [including] (3) Any interest in property ***that the trustee recovers*** under section 329 (b), 363 (n), 543, 550, 553, or 723 of this title." (emphasis added)

ii) **Section 550. Liability of transferee of avoided transfer**.

> "(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553 (b), or 724 (a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from— (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee."

c) SIPC v. Bernard L. Madoff Investment Securities LLC, 513 B.R. 222 (S.D.N.Y. 2014), supp'd by 2014 WL 3778155 (S.D.N.Y. July 28, 2014).

i) Facts:

(1) Irving H. Picard, Trustee (the "Trustee") appointed under the Securities Investor Protection Act ("SIPA") sought to recover against various foreign subsequent transferees, including $50 million in subsequent transfers of alleged Madoff Securities customer funds received by CACEIS Bank Luxembourg and CACEIS Bank (together, "CACEIS").

(2) CACEIS had invested not directly with Madoff Securities, but with Fairfield Sentry Limited and Harley International (Cayman) Limited, two Madoff Securities feeder funds that in turn invested those funds with Madoff Securities.

(a) Fairfield Sentry is a British Virgin Islands company that had invested more than 95% of its assets in Madoff Securities. It is currently in liquidation in the BVI. The Trustee previously sued Fairfield Sentry in an avoidance action and settled his claim against Fairfield Sentry for a fraction of his demand.

(b) Harley is a Cayman Island company that was also a significant feeder fund. It is in liquidation in the Cayman Islands. The Trustee previously sued Harley in an avoidance action and obtained a default judgment against Harley for more than $1 billion in November 2010.

(3) CACEIS and others similarly situated defendants moved to dismiss the Trustee's complaints, alleging that section 550(a)(2) of the Bankruptcy Code does not apply extraterritorially and, therefore, does not reach the subsequent transfers made abroad by one foreign entity to another.

(4) The defendants moved to withdraw the reference and the District Court granted that motion on a consolidated basis to address the following issue: "whether SIPA and/or the Bankruptcy Code as incorporated by SIPA apply extraterritorially, permitting the Trustee to avoid the initial Transfers that were received abroad or to recover from initial, immediate, or mediate foreign transferees."

ii) The District Court's Analysis:

(1) Is the Trustee's use of section 550(a) here an extraterritorial application of the statute?

(a) Test: What is the "focus" of the "transactions that the statutes seek to regulate"?

(b) Under Morrison, the transaction being regulated by section 550(a)(2) is the recovery of a transfer of property (or the value therefore) to a subsequent transferee, not the relationship of that property to a perhaps-distant debtor.

(c) The court looked to the location of the transfers as well as the component events of those transactions. Here, the court noted that there are foreign feeder funds transferring assets abroad to their foreign customers and other foreign transferees and finds that these transactions are predominantly foreign. The court compared this to facts in cases where extraterritorial application of the Bankruptcy Code's avoidance statutes have been implicated.

(i) In re Maxwell Communication Corp., 186 B.R. 807, 815 (S.D.N.Y. 1995): finding application of 11 U.S.C. § 548 to be extraterritorial where "the

antecedent debts were incurred overseas, the transfers on account of those debts were made overseas, and the recipients ... [are] all foreigners."

(ii) In re Midland Euro Exch. Inc., 347 B.R. 708, 717 (Bankr. C.D. Cal. 2006): noting that the parties agreed that the trustee's "claims would result in extraterritorial application of § 548" where "[t]he transferor was a Barbados corporation, the transferee was an English corporation, the funds originated from a bank account in London and, although transferred through a bank account in New York, eventually ended up in another bank account in England."

(d) Conclusion: The property that the Trustee sought to recover was being held abroad and the component events of the transaction occurred internationally. Therefore recovery of these transfers required extraterritorial application of section 550(a).

(2) Was such extraterritorial application intended by Congress?

(a) Test: When a statute gives no clear indication of an extraterritorial application, it has none.

(b) The Court analyzed the language of section 550(a) and determined that nothing in the language suggests that this language was intended to allow the recovery of property from foreign transferee.

(c) The Court then looked to "context" including surrounding provisions of the Bankruptcy Code.

(i) The Trustee attempted to use section 541 to argue that Congress intended section 550(a) to apply extraterritorially. The District Court, however, found that "fraudulently transferred property becomes property of the estate only after it has been recovered by the Trustee, so section 541 cannot supply any extraterritorial authority that the avoidance and recovery provisions lack on their own." See section 541 (defining property of the estate to include "any interest in property ***that the trustee recovers*** under section . . . 550 of this title") (emphasis added).

(ii) The Trustee argued that public policy necessitates the extraterritorial application of section 550 to avoid situations where U.S. debtors transfer all assets offshore and then retransfer those assets to avoid the reach of U.S. bankruptcy law. The court found that a Trustee could utilize the laws of such countries to avoid an evasion.

(3) In the alternative, the District Court found that even if the presumption against extraterritoriality was rebutted, the Trustee's use of section 550(a) to reach the foreign assets would be precluded by concerns of international comity.

iii) This decision contrasts with the Bankruptcy Court's analysis and conclusions of these same issues in a different instance. In In re Securities Investor Protection Corporation v. Madoff (In re Bernard L. Madoff), 480 B.R. 501 (Bankr. S.D.N.Y. 2012), the Bankruptcy Court reached the opposite result explaining that "(i) the trustee is not seeking to apply § 550 extraterritorially, making this presumption inapplicable, and (ii) even if the trustee were seeking to apply this section extraterritorially, Congress expressed clear intent to permit such application."

(1) In so holding, the court found that the trustee's application of section 550 was domestic in nature because the focus of the avoidance and recovery sections of the bankruptcy code is on the improper depletion of the estate and, in this case, the depletion of the BLMIS estate occurred in the United States.

(2) Further, as to Congress' clear intent to permit the extraterritorial application of section 550 if that was indeed the case in this instance, the court pointed to definition of property of the estate under section 541, which extends to all property "wherever located and by whomever held", finding that the avoidance provisions of the bankruptcy code provide for the recovery of all such property and that, therefore, section 550 necessarily includes such property. As set forth above, Madoff addresses this same argument and comes to the opposite result, finding that fraudulently transferred property is not property of the estate until it is recovered.

iv) The Bankruptcy Court has subsequently relied on the District Court's ruling in Madoff in Hellas Telecommunications (Luxembourg) II SCA v. TPG Capital Management, L.P., 2015 WL 1029921 (Bankr. S.D.N.Y. March 9, 2015) in setting forth the test as to whether the presumption against extraterritoriality applies. In Hellas Telecommunications, there was a question as to whether section 546(e) applied extraterritorially to the transfers underlying the plaintiffs' unjust enrichment claim. While the Court declined to decide the issue at the motion to dismiss stage, it suggested that the presumption against extraterritoriality would apply, providing that it seemed doubtful that Congress intended section 546(e) to apply to these predominantly foreign transfers.

d) Kismet Acquisition LLC v. Diaz-Barba (In re Icenhower), 757 F.3d 1044 (9th Cir. 2014).

i) Facts:

(1) Icenhower concerns a bankruptcy filed in the Southern District of California. Prepetition, the debtors purchased property in Mexico and transferred it to a nondebtor shell company controlled by the debtors.

(2) Postpetition, the nondebtor shell company sold the property to the defendants.

(3) The bankruptcy court consolidated the nondebtor shell with the debtors and found that the sale of the property to the defendants was avoidable under section 549(a)

and the defendants were required to return their interest in the property to the estate.

(4) The district court affirmed the decision of the Bankruptcy Court.

(5) On appeal to the Ninth Circuit, the defendants argued that the bankruptcy court's application of the law was extraterritorial and improper.

ii) Analysis: The Ninth Circuit applied the same test set forth in Morrison. Did Congress intend extraterritorial application of the statute?

(1) The Ninth Circuit found that because the debtor and the nondebtor shell were substantively consolidated, the property was property of the estate as of the petition date. Therefore, in contrast to the facts in Madoff, the property at issue was property of the estate as of the petition date. The Ninth Circuit relied on previous precedent to find that "Congress intended extraterritorial application of the Bankruptcy Code as it applies to property of the estate." In re Simon, 153 F.3d 991, 996 (9th Cir.1998). The Ninth Circuit, therefore, affirmed the bankruptcy court's decision.

(2) The Ninth Circuit found that comity was not implicated, as there was no true conflict between domestic and foreign law here.

V. Are U.S. Courts Retreating from Chapter 15's Principle of Comity?

a) Chapter 15 and Comity

i) Chapter 15 codifies the cooperation that U.S. bankruptcy courts should give foreign courts and authorities:

Section 1501(a): "The purpose of this chapter is to incorporate the Model Law on Cross-Border Insolvency 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."

ii) Chapter 15 directs courts to consider its international origin and focus:

Section 1508: states "In interpreting this chapter, **the court shall consider its international origin**, and the need to promote an application of this chapter that is consistent with the application of similar statute adopted by foreign jurisdictions." (emphasis added).

iii) The "Public Policy" exception can only be invoked when aspects of the foreign proceeding are "*manifestly* contrary" to U.S. public policy. 11 U.S.C. § 1506 (emphasis added).

b) Is the principle of comity being diminished?

i) Jaffe v. Samsung Elec. Co., Ltd. (In re Qimonda AG), 737 F.3d 14 (4th Cir. 2013)

(1) Facts:

(a) Qimonda AG, a German corporation, manufactured semiconductor devices. It held over 10,000 patents, 4,000 of which were U.S. patents. Qimonda AG had cross-licensed its patents with other competitors. It then filed an insolvency proceeding in Germany.

(b) Under German law, the German insolvency administrator could declare such patent licenses unenforceable. The German debtor sought to invalidate the licenses so that they could be relicensed to raise additional funds for creditors. The insolvency administrator then filed a Chapter 15 in order to administer the debtor's U.S. assets, including the U.S. patent licenses. As part of the relief sought by the Chapter 15 petition, the administrator requested a determination that section 365(n) of the Bankruptcy Code, which provides for the continuing effectiveness of licensees' patent licenses, did not apply.

(2) Bankruptcy Court Holding:

(a) The Bankruptcy Court relied on section 1522, which protects creditors and other interested persons, and the section 1506 public policy exception to prevent the termination of the U.S. patent licenses.

(i) Section 1522(a): "The court may grant relief under section 1519 [immediate Chapter 15 relief] or 1521 [Chapter 15 relief upon recognition] . .. only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected."

(ii) Under section 1506, the Bankruptcy Court also held that allowing the termination of the patents would be manifestly contrary to the public policy of the United States.

(3) On immediate appeal to the U.S. Court of Appeals for the Fourth Circuit, the Circuit upheld the Bankruptcy Court's refusal to grant the administrator's Chapter 15 relief.

(a) The Circuit agreed with the Bankruptcy Court's section 1522 balancing-of-interests rationale, holding that section 1522 is designed to "ensure the protection of local interests" and "balance between relief that may be granted and the interests of persons affected."

(b) The Fourth Circuit did not reach the section 1506 public policy argument.

ii) Krys v. Farnum Place, LLC (In re Fairfield Sentry Ltd.), 768 F.3d 239 (2d Cir. 2014)

(1) For a description of these facts and the Second Circuit's holding, see supra § 3(c)(1).

(2) Despite section 1508's instructions to "consider [Chapter 15's] international origin]" when interpreting Chapter 15's provisions, the Second Circuit did not defer to the British Virgin Island court's approval of the sale. Citing In re Vitro S.A.B. de C.V., 701 F.3d 1031 (5th Cir. 2012), the Second Circuit in In re Fairfield Sentry noted that comity has limitations and is "not a per se rule."