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Metcalfe: a bold reaffirmation of Chapter 15's reach

KEY POINTS

- Chapter 15 of the US Bankruptcy Code was enacted in 2005 to harmonise US bankruptcy law with the insolvency laws of foreign jurisdictions.
- In *Metcalfe & Mansfield Alternative Investments*, a US bankruptcy court recently held that when deciding whether to apply in the US the relief granted to a debtor in its foreign proceeding, a US court should analyse whether or not the procedures applied by the foreign court were fair, not whether the result reached by the foreign court was proper.
- *Metcalfe* also holds that a foreign debtor in a Chapter 15 case may receive relief that is not available to debtors under other chapters of the US Bankruptcy Code.

Metcalfe is one of the few US bankruptcy decisions that has analysed the type and extent of relief that a foreign debtor may obtain in a Chapter 15 proceeding in the US. Until *Metcalfe* was decided, it was unclear to what extent US bankruptcy courts would defer to the decisions of foreign courts. In *Metcalfe*, the US bankruptcy court awarded the Chapter 15 debtor relief that probably would not have been available had the debtor filed for relief under Chapter 11 of the Bankruptcy Code. In so doing, the court reaffirmed the universalist principles underlying Chapter 15 and indicated that Chapter 15 may provide avenues for relief that are not otherwise available in the US Bankruptcy Code.

Just in time for the fifth anniversary of the enactment of Chapter 15 of the Bankruptcy Code, which allows foreign debtors to administer assets located in the US or stay actions by US creditors – Judge Martin Glenn of the Bankruptcy Court for the Southern District of New York has issued a decision clarifying the scope of relief available under Chapter 15.

In *Metcalfe & Mansfield Alternative Investments*, Judge Glenn considered whether a Chapter 15 debtor that had obtained extraordinary injunctive and other relief in its Canadian bankruptcy proceeding was entitled to enforce that relief in the US, even though the relief likely could not have been granted under US law. *See* Case No 09-16709 (MG), 2010 Bankr LEXIS 1 (Bankr S.D.N.Y. Jan 5, 2010). Judge Glenn indicated that when considering whether to enforce a foreign court order under Chapter 15, a US court should not examine whether similar relief is available under US law, but instead whether or not principles of comity support enforcement of the foreign court order. Judge Glenn found that the Canadian proceeding in *Metcalfe* had been litigated fairly according to procedures similar to those available to US litigants, and therefore, the Canadian judgment was entitled to recognition and *res judicata* effect in the US. This decision has the potential to broaden the types of relief available to foreign debtors under Chapter 15.

CHAPTER 15 OF THE BANKRUPTCY CODE

The purpose of Chapter 15, which is based upon UNCITRAL's Model Law on Cross-Border Insolvency, is to harmonise US bankruptcy law with the insolvency laws of foreign jurisdictions. Under Chapter 15, the representative of a debtor involved in a foreign insolvency proceeding may file a petition in a US Bankruptcy Court to obtain 'recognition' of its foreign proceeding. *See* 11 U.S.C. § 1515. Under Chapter 15, a debtor's foreign insolvency proceeding may be recognised by the US Bankruptcy Court as either a 'foreign main proceeding' or a 'foreign nonmain proceeding'. If a debtor's foreign proceeding is recognised as foreign main, the debtor automatically receives a wide range of relief such as implementation of the automatic stay and authorisation to operate the debtor's business in the US. *Id* at § 1520. If a debtor's foreign insolvency proceeding is instead recognised as foreign nonmain, the debtor must specifically request such relief and it is within the discretion of the US bankruptcy judge whether to award the requested relief. *Id* at § 1521.

Following the enactment of Chapter 15 in 2005, most court opinions issued under Chapter 15 focused on whether a foreign debtor's foreign insolvency proceeding was entitled to recognition by a US Bankruptcy Court. Few courts analysed the various types of relief a Chapter 15 debtor may receive following recognition. Although Chapter 15 lists the types of relief that are automatically granted upon recognition of a foreign main proceeding and lists the relief that may be awarded upon request, and directs US Bankruptcy Courts to 'consider its international origin' and to 'cooperate to the maximum extent possible with a foreign court' when interpreting the statute, Chapter 15 also allows US Bankruptcy Courts to refuse to take an action that 'would be manifestly contrary to the public policy of the United States'. 11 U.S.C. §§ 1506, 1508, and 1525. Accordingly, although the language in Chapter 15 suggests that once a US Bankruptcy Court has recognised a foreign proceeding it should defer to the substantive legal determinations of the foreign court supervising that proceeding, until the recent decision in *Metcalfe*, it was not clear how deferential US Bankruptcy Courts would be in granting such relief.

The application of foreign law in US courts has become a controversial issue in recent years, particularly following the US

International Feature

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Supreme Court's reference to foreign law in *Roper v Simmons*, in which the court prohibited the imposition of the death penalty on juvenile offenders. See 543 US 551, 577 (2005) ('The opinion of the world community, while not controlling our outcome, does provide respected and significant confirmation for our own conclusions.'); see also Calabresi, Steven G and Stephanie D Zimdahl, 'The Supreme Court and Foreign Sources of Law: Two Hundred Years of Practice and the Juvenile Death Penalty Decision', 47 *William and Mary Law Review* 743-909 (2005) (The debate over the Supreme Court's use of foreign sources of law has not ... been relegated solely to the justices and to legal academics. The debate has grown into an issue that leads to both fear and applause in the general public at large, and it has created quite a stir in the news media and political arenas ...). US Supreme Court Justice Antonin Scalia, in his dissent to Roper, went so far as stating that 'the basic premise of the court's argument – that American law should conform to the laws of the rest of the world – ought to be rejected out of hand.' Id at 624. In light of this controversy, US bankruptcy judges applying Chapter 15 could find that foreign insolvency laws that deviate, even slightly, from widely accepted US practice are 'contrary to the public policy of the United States'. In *Metcalfe*, Judge Glenn was mindful of the concerns in enforcing a foreign nation's laws in the US. Nevertheless, after a considerable review of the central precepts of Chapter 15 and comity, Judge Glenn enforced Canadian law in full and articulated the clearest expression yet of Chapter 15's boundaries.

THE CANADIAN PROCEEDINGS

In *Metcalfe*, the debtor's Canadian insolvency proceeding was initiated to restructure CAN $32bn in Asset Backed Commercial Paper ('ABCP') notes. ABCP is short-term secured debt that generally matures in less than 270 days. ABCP was first issued by financial institutions in the mid-1980s as a convenient source of short-term funding for corporations. Because ABCP is of such short duration, many ABCP programs, including the Metcalfe debtor's program, paid the principal on maturing notes with the funds received from the issuance of new notes (otherwise known as 'rolling over' the notes) in order to delay paying the obligations in full upon maturity. However, during the week of 13 August 2007, the ABCP market froze due to fears in the US relating to the quality of residential sub-prime mortgages, which constituted a sizeable portion of the collateral backing ABCP. Investors ceased purchases of ABCP, and Metcalfe and other large issuers of ABCP were unable to rollover their ABCP obligations through the issuance of new notes. Because Metcalfe was unable to pay the principal on the ABCP notes as they matured, it faced imminent financial crisis.

Metcalfe's ABCP noteholders, most of which were large financial institutions, realised that an immediate liquidation of Metcalfe's ABCP portfolio would lead to massive value destruction. The financial markets were rapidly weakening and there were few buyers for such a large portfolio of assets. Accordingly, the noteholders agreed to waive payment in order to allow Metcalfe to develop a plan to restructure the notes. However, Metcalfe's ABCP program was particularly complicated, and it soon became apparent that a successful restructuring of the notes would require the cooperation of the noteholders and other participants in Metcalfe's ABCP programme, such as trustees, brokers, asset providers, sponsors, and conduits. After extensive negotiations, a restructuring plan was developed that, among other things:

(i) extended the maturity date for the ABCP notes;
(ii) reduced the amount of margin calls that Metcalfe would have to meet under certain derivative transactions within Metcalfe's ABCP programme; and
(iii) included a global release and injunction that would protect all plan participants from any liability stemming from their involvement in the proposed restructuring.

On 17 March 2008, Metcalfe's insolvency proceeding was commenced in the Ontario Superior Court of Justice in order to effectuate the agreed restructuring plan. The Ontario Court did not take issue with the first two elements of the plan. However, the Ontario Court carefully considered several objections indicating that it did not have the power under Canadian law to issue a global release and injunction that protected third-parties that were not creditors of the debtor. The Ontario Court noted that the plan was the product of substantial negotiations, was the only option available to restructure Metcalfe's ABCP, and was designed to benefit all noteholders, 96 per cent of which had expressed support for the plan. Even though many of the plan participants were financial institutions that were not creditors of the debtor, and therefore not normally entitled to benefit from a release and injunction, these financial institutions had made important concessions that constituted consideration for the third-party releases. Furthermore, the Ontario Court observed that the plan was needed not only to restructure MetCalfe's debts, but also to restore confidence in Canada's financial system. Accordingly, on 5 June 2008, the Ontario Court issued an order approving the plan in full. The order was affirmed on appeal by the Ontario Court of Appeal on 18 August 2008.

METCALFE'S US BANKRUPTCY PROCEEDINGS

On 10 November 2009, Metcalfe filed a petition under Chapter 15 of the Bankruptcy Code with the US Bankruptcy Court for the Southern District of New York requesting recognition of its Ontario insolvency proceeding. Metcalfe sought to implement its ABCP restructuring plan in the US – including the third-party release and injunction – in order to prevent any parties bound by the plan in Canada from attempting to avoid its terms by bringing actions in the US. After reviewing the Canadian decisions, Judge Glenn examined the availability of third-party non-debtor releases and injunctions under US bankruptcy law. Although several US courts had approved such relief, they had done so only when 'truly unusual circumstances render the release terms important to success of the plan'. *Metcalfe*, 2010 Bankr LEXIS, at *24 (quoting

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Deutsche Bank AG v Metromedia Fiber Network, Inc (*In re Metro Media Fiber Network, Inc*), 416 F.3d 136, 143 (2d Cir 2005)).

Judge Glenn noted that the standard for issuing a non-debtor release under US law had been further restricted by the US Court of Appeals for the Second Circuit in *In re Johns-Manville Corp*, which held that a 'bankruptcy court only has jurisdiction to issue a non-debtor release where the released claims "directly affect the *res* of the bankruptcy estate."' *Id* at *25 (quoting *Johns-Manville Corp v Chubb Indem Ins Co* (*In re Johns-Manville Corp*), 517 F.3d 52, 66 (2d Cir 2008), *rev'd on other grounds sub nom. Travelers Indem Co v Bailey*, 129 S. Ct. 2195 (2009)). However, *Johns-Manville* had been remanded on other grounds by the US Supreme Court and, thus, it was not clear if the portion of the opinion relating to non-debtor releases remained binding law. If it did, the Metcalfe plan and its third-party releases could not be approved because the plan would prevent an investor from asserting a claim against a plan participant that did not affect the *res* of Metcalfe's estate. Nevertheless, Judge Glenn stated that the proper issue before the court was not whether the plan approved by the Canadian courts was appropriate, but whether the Canadian proceedings were conducted in such a way that their rulings should be enforced in the US under chapter 15. Judge Glenn observed that under principles of comity '[a] U.S. bankruptcy court is not required to make an independent determination about the propriety of individual acts of a foreign court'. *Id* at *32 (citation omitted). Instead, '[t]he key determination ... is whether the procedures used in Canada meet [US] standards of fairness.' *Id*.

After analysing the Canadian decisions, which themselves were reached after an exhaustive consideration of the issues in the highly contested proceedings, Judge Glenn concluded that 'principles of enforcement of foreign judgments and comity in Chapter 15 cases strongly counsel approval of enforcement in the [US] of the third-party non-debtor release and injunction provisions included in the Canadian Orders.' *Id* at **27-28.

Had Judge Glenn stopped there, the opinion in *Metcalfe* would be notable for its pronouncement that when deciding whether to award relief under Chapter 15 of the Bankruptcy Code, a bankruptcy judge should focus on whether the foreign court employed fair procedures in reaching the determination and not on whether the result would be the same under US law. Judge Glenn went further though, and also stated that a Chapter 15 debtor could receive relief that 'could not be entered in a plenary chapter 11 case'. *Id*. This statement – sure to be cited by counsel seeking extraordinary relief under Chapter 15 in the future – reflects the essence of Chapter 15's internationalist origins and indicates that Chapter 15 may provide avenues for relief not otherwise available in the Bankruptcy Code.

THE REACH OF THE *METCALFE* DECISION

Despite the important holdings in *Metcalfe*, the court's decision conceivably could be distinguished by parties wishing to avoid its potentially broad reach. The most obvious possible distinction is the extraordinary circumstances giving rise to the case. The world-wide financial crisis that started in 2007 caused unprecedented dislocations in financial markets. The entire Canadian ABCP market had frozen and a broad and innovative solution was required to prevent billions of dollars in losses and to ensure the success of the largest restructuring in Canadian history. *Id* at *39. Accordingly, *Metcalfe's* detractors will likely argue that it is a factually unique case carrying little precedential value.

Another important aspect of *Metcalfe* that might limit its applicability to future Chapter 15 cases is that the relief requested by the foreign debtor – a third-party non-debtor release – previously had been awarded in US cases. Although third-party non-debtor releases are rare in the US, and the Second Circuit Court of Appeals has placed restrictions on their applicability, such releases do not *per se* violate US public policy. Accordingly, had the foreign debtor in *Metcalfe* requested a type of relief that was entirely without precedent in the US, it is not clear that the outcome would have been the same.

Lastly, the importance of Metcalfe's status as a Canadian debtor cannot be overstated. The doctrine of comity, as applied for many years by US courts, indicates that the decisions of Canadian courts should be accorded the utmost respect. Throughout the *Metcalfe* opinion, Judge Glenn repeatedly referred to the competence and fairness of Canadian judicial proceedings and quoted several cases repeating these sentiments. *See id* at **34-35 (quoting *Hilton v Guyot*, 159 US 113, 202-03 (1895) ('[W]hen the foreign proceeding is in a sister common law jurisdiction with procedures akin to our own, comity should be extended with less hesitation, there being fewer concerns over the procedural safeguards employed in those foreign proceedings.'); *Cornfeld v Investors Overseas Servs, Ltd*, 471 F. Supp. 1255, 1259 (S.D.N.Y. 1979) ('The fact that the foreign country involved is Canada is significant. It is well-settled in New York that the judgments of the Canadian courts are to be given effect under principles of comity'), aff'd, 614 F.2d 1286 (2d Cir 1979)). Accordingly, it is not clear the outcome of *Metcalfe* would have been the same had the foreign proceeding taken place in a country that does not employ judicial procedures mirroring those in the US.

CONCLUSION

Chapter 15 is the newest chapter of the Bankruptcy Code and decisions rendered in its infancy will shape the statute's interpretation and application for years to come. *Metcalfe* is consistent with the universalist approach underlying the purpose of Chapter 15 and UNCITRAL's Model Law on Cross-Border Insolvency. Just as the growth of national businesses in the late 19th century necessitated a comprehensive national system of bankruptcy in the US, increasing globalisation has led to a need for an international system of bankruptcy in the 21st century. Chapter 15 and similar insolvency regimes in other countries based on the Model Law help ensure that the insolvencies of international corporations are administered pursuant to a transparent and consistent set of rules. The decision in *Metcalfe* achieves a result that respects foreign law without rubberstamping it, and thus strengthens the nascent international insolvency regime embodied in Chapter 15. ■