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Modification of Chapter 15 Recognition Order Warranted to Avoid Prejudice to U.S. Creditors

By Veerle Roovers and Mark G. Douglas*

In a recent decision, the U.S. Bankruptcy Court for the Western District of Texas held that, because the statute of limitations governing claims against a Canadian debtor's officers and directors under the Fair Labor Standard Act might expire, the order recognizing the debtor's Canadian bankruptcy proceeding under Chapter 15 and enforcing the Canadian court's stay of actions against the debtor's officers and directors should be modified to allow U.S. creditors to assert their claims. In this article, the authors explain the decision and the outlook.

Eleven years after it was enacted in 2005, Chapter 15 of the Bankruptcy Code has proven to be an effective, if not foolproof, mechanism for coordinating and harmonizing cross-border bankruptcy cases. An important aspect of Chapter 15 and other laws patterned on the 1997 UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law") is the flexibility given to bankruptcy and insolvency courts in applying the sometimes markedly different insolvency laws of the multiple international jurisdictions involved in cross-border cases. A ruling recently handed down by the U.S. Bankruptcy Court for the Western District of Texas is emblematic of this principle. In *In re Sanjel (USA) Inc.*,[1] the court held that, because the statute of limitations governing claims against a Canadian debtor's officers and directors under the Fair Labor Standard Act might expire, the order recognizing the debtor's Canadian bankruptcy proceeding under Chapter 15 and enforcing the Canadian court's stay of actions against the debtor's officers and directors should be modified to allow U.S. creditors to assert their claims.

PROCEDURES AND RELIEF UNDER CHAPTER 15

Under Chapter 15, the representative of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding."

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[1] 2016 Bankr. LEXIS 2771 (Bankr. W.D. Tex. July 28, 2016).

"Foreign representative" is defined in Section 101(24) of the Bankruptcy Code as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

"Foreign proceeding" is defined in Section 101(23) of the Bankruptcy Code as:

> [A] collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.

More than one bankruptcy or insolvency proceeding may be pending with respect to the same foreign debtor in different countries. Chapter 15 therefore contemplates recognition in the U.S. of both a foreign "main" proceeding—a case pending in the country where the debtor's "center of main interests" ("COMI") is located—and foreign "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment."

The Bankruptcy Code does not define COMI. However, Section 1516(c) provides that, "[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. An "establishment" is defined in Section 1502(2) as "any place of operations where the debtor carries out a nontransitory economic activity."

Section 1517 of the Bankruptcy Code provides that, subject to Section 1506, "an order recognizing a foreign proceeding shall be entered" if the proceeding qualifies as a foreign main or nonmain proceeding, the foreign representative is "a person or body," and the petition itself complies with the evidentiary requirements set forth in Section 1515. Section 1506 states that "[n]othing 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."

If a U.S. bankruptcy court recognizes a foreign main proceeding under Chapter 15, Section 1520(a)(1) of the Bankruptcy Code provides that actions against the "debtor and the property of the debtor that is within the territorial jurisdiction of the United States" are stayed under Section 362—the Bankruptcy Code's "automatic stay." Under Section 1521, upon the recognition of a foreign nonmain proceeding, the stay does not automatically apply, but the foreign representative may request, and the bankruptcy court may impose, the stay.

Furthermore, following recognition of a foreign main or nonmain proceeding, a bankruptcy court is authorized under Section 1521 to grant, among other things, injunctive relief, the authority to distribute the proceeds of the debtor's U.S. assets and, with certain exceptions, any additional relief available to a bankruptcy trustee "where necessary to effectuate the purpose of [Chapter 15] and to protect the assets of the debtor or the interests of the creditors."

Moreover, Section 1507 provides that, if recognition is granted, the court may provide "additional assistance"—a term that is not defined—to a foreign representative under Chapter 15 or other U.S. laws. However, in granting such relief, the court must conclude, "consistent with the principles of comity," that such assistance will reasonably assure, among other things, the just treatment of creditors and other stakeholders, the protection of U.S. creditors against prejudice and inconvenience in pursuing their claims in the foreign proceeding, and the prevention of fraudulent or preferential dispositions of the debtor's property. Section 1507 reflects lawmakers' recognition that Chapter 15 otherwise may not anticipate all the types of relief that a foreign representative might require.[2]

During the gap period between the filing of a Chapter 15 petition and the entry (or denial) of a recognition order, Section 1519(a) of the Bankruptcy Code authorizes a bankruptcy court to grant provisional injunctive relief and certain other forms of relief "where relief is urgently needed to protect the assets of the debtor or the interests of the creditors." In addition to an order staying execution against the debtor's U.S. assets, such relief can include an order that entrusts the administration of assets to the foreign representative (Section 1519(a)(2)), provides for the examination of witnesses and the taking of evidence regarding the debtor's affairs (Sections 1519(a)(3) and 1521(a)(4)), or grants additional relief (other than avoidance of transfers) available to a bankruptcy trustee (Sections 1519(a)(3) and 1521(a)(7)).

Section 1522(c) provides that a bankruptcy court "may, at the request of the foreign representative or an entity affected by relief granted under section 1519 or 1521, or on its own motion, modify or terminate such relief." However, under Section 1522(a), the court may grant relief under Sections 1519 or 1521, or may modify or terminate relief under Section 1522(c), "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected." The purpose of Section 1522 is "to ensure a balance between the relief that may be granted to the foreign representative and the

[2] *See* 8 Collier on Bankruptcy ¶ 1507.01 (16th ed. 2016).

interests of the persons potentially affected by such relief."[3] The legislative history of the provision indicates that Congress intended to give bankruptcy courts "broad latitude to mold relief to meet specific circumstances . . ."[4]

SANJEL

Sanjel (USA) Inc. (together with its affiliates, "Sanjel") is a Canada-based oil and gas industry acidizing and cementing services provider. Certain former Sanjel employees were the named plaintiffs in class action litigation filed in the U.S. District Court for the District of Colorado in September 2015 and February 2016 against Sanjel and its officers and directors, alleging violations of the Fair Labor Standards Act of 1938 ("FLSA").[5]

On April 4, 2016, a Canadian court granted Sanjel's petition for bankruptcy relief under the Companies' Creditor Arrangement Act (the "CCAA"). Among other things, the court's order (the "CCAA Order") stayed all actions against Sanjel's officers and directors, including its chief restructuring officer. Also on April 4, 2016, Sanjel's foreign representative filed a petition in the U.S. Bankruptcy Court for the Western District of Texas seeking recognition of the Canadian CCAA case as a foreign main proceeding under Chapter 15. The representative filed an emergency motion for provisional injunctive relief under Sections 105(a), 1519, and 1521 of the Bankruptcy Code.

After granting a temporary restraining order under Section 1519 prohibiting any actions during the gap period against Sanjel or its U.S. assets, the U.S. bankruptcy court entered an order on April 29, 2016 recognizing Sanjel's CCAA case as a foreign main proceeding. Among other things, the recognition order provided that, with certain exceptions, "the terms of the [CCAA Order] are given full force and effect in the United States." It further provided that Sanjel and its foreign representative were granted all relief afforded under Section 1520, including the imposition of the automatic stay with respect to U.S. assets. Finally, the recognition order provided additional relief under Section 1521 of the Bankruptcy Code, including a stay of all actions "concerning the assets, rights, obligations or liabilities" of Sanjel to the extent such actions were not already stayed under Section 1520.

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[3] *See* 8 Collier on Bankruptcy ¶ 1522.01 (16th ed. 2016) (citing Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency (1997) ¶ 161 (amended in 2013) and various court rulings, including *Jaffé v. Samsung Elecs. Co. (In re Qimonda)*, 737 F.3d 14 (4th Cir. 2013)).

[4] H.R. Rep. No. 109-31, at 116.

[5] 29 U.S.C. ch. 8.

One month afterward, the class action plaintiffs filed a motion with the U.S. bankruptcy court seeking relief from the automatic stay to continue the Colorado FLSA litigation against Sanjel's officers and directors. According to the plaintiffs, although the recognition order did not specifically bar the continuation of litigation against the officer and director defendants, the order nevertheless gave full force and effect to the CCAA Order, which included such a stay. In addition, the plaintiffs claimed that, because the FLSA statute of limitations for causes of action against officers and directors is not tolled during the pendency of a debtor employer's Chapter 15 case, their FLSA claims could be extinguished if the stay against pursuing claims against the officers and directors remained in effect in the U.S.

Sanjel countered that U.S. courts have "universally upheld" stays of actions against officers and directors issued by Canadian courts under the CCAA. In addition, Sanjel argued that the request for stay relief was misguided because the automatic stay issued pursuant to the recognition order did not apply to Sanjel's officers and directors. Finally, Sanjel asserted that: (i) the plaintiffs would not be prejudiced by the stay because they could ask the Canadian court to modify the stay in the CCAA Order; and (ii) Sanjel itself would be prejudiced by relief from the stay because continuation of the FLSA litigation would subject its limited personnel to onerous discovery demands and damage Sanjel's ability to restructure in Chapter 15 and the CCAA case.

THE BANKRUPTCY COURT'S RULING

At the outset, the bankruptcy court found that, in accordance with Section 1520 of the Bankruptcy Code and the explicit terms of the recognition order, the automatic stay did not apply to Sanjel's officers and directors and, moreover, that modifying the automatic stay would "have no bearing" on the stay in the CCAA Order that prevented the plaintiffs from continuing the FLSA litigation.

However, the court concluded that, even though the plaintiffs did not specifically request such relief, it had the authority to modify the recognition order under Section 1522(c) to the extent that the order implemented the stay contained in the CCAA Order. According to the court, despite the absence of a request to do so by the plaintiffs, Sanjel was afforded sufficient notice to raise arguments against modification and actually did so.

In balancing the hardships under Section 1522, the court wrote, "a court may refuse to recognize specific orders in a foreign proceeding when those orders unjustifiably harm an interested party."[6] By contrast, the bankruptcy

[6] Citing *Jaffé*, 737 F.3d at 29 (affirming bankruptcy court order applying Section 365(n) of

court noted, when a party seeking modification of a Chapter 15 recognition order would not be "severely prejudiced" by recognition of a foreign court's order and granting such relief would prejudice the debtor, a bankruptcy court has discretion to deny the requested modification under Section 1522(c).[7]

The bankruptcy court explained that, in *Nortel*, the district court upheld a bankruptcy court's denial of a motion to modify a recognition order to pursue securities litigation against the debtor's officers and directors. Pursuant to Section 1521 of the Bankruptcy Code, the *Nortel* bankruptcy court had given full force and effect to a stay of such litigation previously issued by the Canadian court overseeing the debtors' CCAA cases. The district court ruled that the bankruptcy court "properly relied heavily on principles of comity, concluding correctly that the request for relief sought by Appellants could have and should have been brought before the Canadian court."[8] The bankruptcy court in *Sanjel* disagreed with *Nortel* on this point, concluding that the balance of hardships favored the FLSA plaintiffs.

Because Section 108(c) of the Bankruptcy Code automatically tolls only the deadline by which a debtor must commence litigation in another court, the bankruptcy court explained, absent modification of the stay or expiration of the stay in the CCAA Order, the plaintiffs could not petition the Colorado district court to seek an order tolling the deadline for other potential class members to assert FLSA claims. Thus, the court concluded, without modification of the recognition order, the plaintiffs "risk losing their FLSA claims in the entirety during the pendency of [Sanjel's] CCAA proceeding."

The bankruptcy court rejected Sanjel's argument, bolstered by the court's ruling in *Nortel*, that the FLSA plaintiffs would not be prejudiced because they "have an appropriate avenue to seek relief from the [stay in the CCAA Order] in the form of the Canadian Court." The *Sanjel* bankruptcy court noted that the *Nortel* court provided no reasoning as to why it believed the Canadian court to be the proper venue for seeking such relief. According to the bankruptcy court, "it would be unreasonable and exceedingly burdensome to require [the FLSA plaintiffs] to go to Canada and request that the Canadian Court lift the [stay in the CCAA Order] to allow [the plaintiffs] to pursue claims in Colorado based wholly on a statutory right created by United States law to protect employees within the United States."

Given the absence of any "incredible burden or threat" to Sanjel and its

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the Bankruptcy Code in a Chapter 15 case to protect licensees of a German debtor's U.S. patents even though no such protections existed under the insolvency law of Germany).

[7] Citing *In re Nortel Networks Corp.*, 2013 BL 317273, at *3–4 (D. Del. Nov. 15, 2013).

[8] *Nortel*, 2013 BL 317273, at *3.

restructuring, the bankruptcy court ruled that its recognition order should be modified "for the specific purpose of preserving [the FLSA plaintiffs'] and potential opt-in plaintiffs' FLSA claims given the running statute of limitations," including the ability of other plaintiffs to opt in to the litigation and limited discovery to determine the identity of the officer and director defendants.

OUTLOOK

Chapter 15 has now entered its second decade as a vehicle for coordinating and harmonizing cross-border bankruptcy and insolvency cases. *Sanjel* highlights an important feature of Chapter 15 and other versions of the Model Law that have now been enacted in 41 countries—namely, flexibility. If the insolvency laws of a foreign nation where a main proceeding has been commenced are contrary to domestic law or public policy and, if applied extraterritorially, would prejudice domestic creditors, a court can recognize the foreign proceeding under principles of comity, but exercise its discretion to refuse recognition of the repugnant foreign laws or court orders implementing them.

Sanjel is an interesting, albeit somewhat unusual, example of how this principle works in practice. U.S. bankruptcy law permits injunctive relief effectively to expand the scope of the automatic stay to cover non-debtors—such as officers and directors—under narrowly defined circumstances that involve, among other things, an examination of the prejudice to creditors and other parties who would be affected by the expansion. Canadian practice under the CCAA is more flexible in this regard.

Thus, the bankruptcy court in *Sanjel* confronted a situation where, although the automatic stay imposed upon Chapter 15 recognition of Sanjel's CCAA case did not expressly prevent litigation against Sanjel's officers and directors pursuant to Section 1520(a)(1), the court, perhaps unwittingly, imposed such a stay by giving "full force and effect" to the CCAA Order including the officer and director stay.

Concluding that the FLSA plaintiffs could be severely prejudiced without relief, the bankruptcy court exercised its discretion under Section 1522(c) to modify the recognition order.

Interestingly, however, notice of Sanjel's CCAA case and the entry of the CCAA Order including the stay covering both Sanjel and its officers and directors was filed in the Colorado district court. Thus, even though the U.S. bankruptcy court modified its recognition order to provide the FLSA plaintiffs limited ability to prosecute their claims, it appears that the plaintiffs will still need to obtain the Colorado district court's permission to do so.