

Bankruptcy Law
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Foreign Proceedings Heat Up Bankruptcy Liability Release Debate

By Alex Wolf

Deep Dive

- Chapter 15 bankruptcies to test reach of Purdue Pharma ruling
- Nonconsensual third-party releases permitted in other nations

The US Supreme Court's ruling this year prohibiting companies from using Chapter 11 bankruptcy to forcibly strip creditors of legal claims against company insiders is prompting concerns over the effect on cross-border insolvency cases.

Left out of the high court's June decision in *Harrington v. Purdue Pharma LP*, which banned nonconsensual third-party litigation releases in corporate bankruptcies, was any discussion of how to approach cases brought to the US by foreign companies seeking federal court recognition under Chapter 15 of the US Bankruptcy Code. The chapter is meant to promote comity by letting international businesses give effect in the US to restructuring plans and proceedings centralized elsewhere in the world.

The Justice Department's bankruptcy monitoring division, the US Trustee, is now challenging whether principles of comity are satisfied if a cross-border reorganization scheme includes nonconsensual releases for nonbankrupt parties.

Laying out its opposition in the pending Chapter 15 case for Yuzhou Group Holdings Co., the US Trustee argued that a Hong Kong-based plan for the Chinese real estate developer includes liability releases for insiders that are "manifestly contrary to public policy," a key consideration for judges hearing Chapter 15 recognition requests.

The case presents a test for the US Bankruptcy Court for the Southern District of New York, which has become an authority for case law on what is and isn't permitted under Chapter 15. A ruling will be informative for distressed multinationals hoping to obtain a US court's blessing of nonconsensual releases, which are permitted in the UK, Canada, and other large restructuring hubs.

"It is a pretty important case for those who are tracking this type of discussion," said corporate restructuring attorney David Shim of Morgan Lewis & Bockius LLP. "It really depends on how broadly the court views the public policy exceptions in Chapter 15."

'Narrow' Holding

In its 5-4 ruling, the Supreme Court said Purdue's plan violated bankruptcy law by permanently discharging all opioid-related legal claims against the company's billionaire owners without the full consent of affected claimants.

"The Supreme Court was quite surgical in the *Purdue Pharma* decision," said Clifford Chance corporate restructuring attorney Michelle McGreal. "The Supreme Court did not talk about Chapter 15, and it did not talk about the Constitution. It really talked about Chapter 11."

But in the government's telling, as laid out in the US Trustee's objection to Yuzhou's Chapter 15, the justices' opinion has changed "fundamental standards of fairness" regarding third-party releases in bankruptcy.

The developer's reorganization scheme, which hasn't been approved yet in Hong Kong, calls for releasing claims against company directors, fiduciaries for creditors, and restructuring professionals involved in the proceedings.

"As the objection made clear, the US Trustee's position is going to be that post-*Purdue*, this is no longer allowed," McGreal said.

Just two days after the objection was filed in September, the company's foreign representative indefinitely postponed a recognition hearing. Lawyers for Yuzhou haven't yet filed a response to the government's challenge, and didn't respond to a request for comment on the case.

Now in a holding pattern, Yuzhou's proceedings have attracted the attention of bankruptcy practitioners curious to see how New York's Southern District will view the issue.

"There will be interesting things happening in Chapter 15 practice post-*Purdue* based on the objection the US Trustee filed," said Reed Smith LLP restructuring attorney Aaron Javian. Before *Purdue*, "the practice of obtaining recognition of nondebtor releases in schemes of arrangement had become a noncontroversial practice that practitioners had taken for granted," he said.

Former bankruptcy judge Robert D. Drain, who approved Purdue's Chapter 11 plan before leaving the bench in 2022, said at a Dec. 4 conference for distressed investors that the public policy exception for Chapter 15 recognition is "very narrow." The Supreme Court's ruling in *Purdue* ought not impact that analysis, said Drain, now a restructuring lawyer with Skadden, Arps, Slate, Meagher & Flom LLP.

Facts and Circumstances

The Yuzhou case isn't the first to spark debate over nonconsensual third-party releases in plans brought to the US under Chapter 15.

Bankruptcy courts have in years past recognized schemes containing controversial release provisions in the name of international comity when those plans were approved with a thorough evidentiary record by foreign courts with due process standards consistent with the US.

“Most bankruptcy courts are inclined to approve such releases based on those factors,” said Dentons corporate bankruptcy attorney Lynn P. Harrison III.

But judges have also rejected efforts to enforce releases in other cases that had troubling facts or failed to meet certain standards of procedural fairness. In 2021, Southern District of New York bankruptcy Judge Sean H. Lane refused to grant post-recognition releases in the case for Indonesian telecommunications company PT Bakrie Telecom Tbk, finding that there was nothing in the record to justify the releases or demonstrate “whether or how the foreign court considered the rights of creditors.”

Since the Supreme Court’s ruling in *Purdue*, Brazilian retailer Americanas SA had a cross-border proceeding recognized in the US. Although the foreign plan contained varying degrees of treatment for creditors depending on whether they consented to nondebtor releases, there were no objections filed in the Chapter 15 proceeding.

With the government’s challenge in the Yuzhou case, the issue post-*Purdue* is now front and center. The case drills down to interpretations of US public policy and it’s hard to say there will be a uniform approach to the issue in Chapter 15, said Shim of Morgan Lewis.

“It could depend on which judge you have in your case and the facts and circumstances,” he said.

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