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Cross-Border Cooperation in the United States: A Retreat or Merely a Pause?

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Introduction

1 Professor Ian Fletcher has been a leading figure in the development of international insolvency law and is well-deserving of this festschrift in his honour. He has had a long and illustrious career as a scholar, publishing important treatises in the insolvency field and editing the *International Insolvency Review*. While that would be more than enough to justify this festschrift, Professor Fletcher was not content merely to research and write about cross-border co-operation. Instead, he has been an active participant in the movement to develop a more effective global insolvency system. His efforts range from formal processes like his work with the American Law Institute and the International Insolvency Institute on the Principles of Co-Operation in Transnational Insolvency Cases to his efforts as Chair of the INSOL International Academics Group to create informal networks of friendship and understanding among international scholars and professionals. It is in the latter capacity that I know Professor Fletcher best. He is one of the driving forces behind the INSOL Global Insolvency Practice course that helps train insolvency practitioners to handle cross-border proceedings.[1] The course not only creates a group of well-trained Fellows to support the developing international insolvency system, it also builds a network of friendship and mutual respect among them that may be even more critical to the goal of global co-operation.

Recent United States Developments

2 Professor Fletcher's focus on cross-border co-operation makes this festschrift an opportune time to reflect upon the most recent United States developments in cross-border co-operation. While the bankruptcy courts generally have been receptive to requests for assistance under the United States' version of the Model Law on

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[1] See <https://www.insol.org/INSOLfaculty/>.

Cross-Border Insolvency, enacted as Chapter 15 of the Bankruptcy Code,[2] only recently have the courts of appeal begun to address the Model Law. Two recent cases at the appellate level have focused on the extent to which United States bankruptcy courts should enforce foreign insolvency orders and the provisions of foreign insolvency law. Both cases refused to provide the assistance requested by the foreign representative, and in both cases assistance was refused largely because the requested relief was relief that would not be available under United States bankruptcy law.

3 The differences between the United States and foreign bankruptcy rules at issue in these cases do not seem to be that significant, certainly not greater than one should expect when dealing with different national insolvency systems. One case involved a request to enforce a foreign plan of reorganization that included releases for the non-debtor United States affiliates of a Mexican debtor.[3] Although there is disagreement among the United States courts, many courts interpret the United States Bankruptcy Code to permit such releases.[4] Thus, the refusal to provide assistance turned on the fact that the Mexican court used a more relaxed standard for approving the releases than would be the case in a United States bankruptcy proceeding.[5] The other case arguably involved a much smaller legal difference. There, the foreign representative of a German bankrupt sought to enforce the rejection of a large number of licenses of United States patents.[6] Both insolvency systems permit the rejection of such licenses, but, under German law, the rejection terminates the non-bankrupt licensee's rights to use the patented technology, whereas under United States bankruptcy law it does not.[7] That difference was enough to justify a refusal to co-operate.

4 Viewed in this way, these decisions represent a major shift away from co-operation. The decisions can, however, be interpreted differently. In the United States we have a saying, "Hard cases make bad law", and that may be all that is behind the refusal to grant co-operative relief to foreign representatives in these cases.

5 The Mexican case had a very bad smell, to say the least. While the United States courts sidestepped the question of corruption,[8] clearly the court of appeals was

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[2] 11 U.S.C. § 1501, *et seq.*

[3] *Ad Hoc Group of Vitro Noteholders v. Vitro S.A.B. de C.V. (In re Vitro S.A.B. de C.V.)*, 701 F.3d 1031 (5th Cir. 2012).

[4] Compare *In re Pacific Lumber Co.,* 584 F.3d 229, at 252 (5th Cir. 2009) (prohibiting non-debtor releases), with *In re Dow Corning Corp.,* 280 F.3d 648, at 658-61 (6th Cir. 2002) (permitting non-debtor releases under certain circumstances). The Bankruptcy Code expressly permits injunctions protecting non-debtor co-obligors in asbestos related cases. See 11 U.S.C. § 524(g)-(h).

[5] *Vitro*, 701 F.3d, at 1058, 1061, 1064, 1066-67, & 1069.

[6] *Jaffe v. Samsung Elect. Co., Ltd.,* 737 F.3d 14 (4th Cir. 2013), *cert. denied,* 135 S.Ct. 66 (6 October 2014).

[7] Ibid.*,* at 20.

[8] *See Vitro,* 701 F.3d at 1052 (note 22).

concerned about the fairness of the process and the excessive control exercised by insiders. Shortly before filing bankruptcy (but just long enough to be beyond the Mexican "suspicion period" that could have led to avoidance) the debtor entered into a series of undisclosed transactions that converted what had been USD 1.2 billion *owed to* the Mexican debtor by its subsidiaries into USD 1.5 billion *owed by* the debtor to its subsidiaries.[9] In the bankruptcy case, this massive amount of insider debt was voted for the plan and used to obtain the majority vote necessary to confirm the plan. Had the insider debt not been counted, the plan could not have been confirmed.[10] The *Vitro* abuses apparently were equally distasteful to the Mexican government because it amended its bankruptcy laws in early 2014 to limit insider voting and bar non-debtor releases.[11] Thus, in *Vitro's* Chapter 15 case justice was done, hopefully without too much collateral damage to the principles of cross-border co-operation.

6 The German case, in contrast, lacked any hint of improper conduct. It, however, presented an unusual factual situation where the practical effect of terminating the United States patents could have been very harmful to the nation's semiconductor industry. Because of the vast number of overlapping patents in the field, it is almost impossible to design a semiconductor that does not infringe on patents held by others and it is difficult even to determine which patents might be implicated.[12] Since this "patent thicket" would stifle innovation, the industry practice is for semiconductor firms to grant reciprocal cross-licenses, usually without the payment of royalties.[13] If the German rule were applied and rejection of a license terminated the licensee's right to use the patented technology, that could be devastating to the licensee. This is because the licensee may have designed its semiconductors in reliance on the license and it is now too late to design around the patent. Since manufacturing facilities are designed for a specific semiconductor and cost upwards of five billion dollars to construct, the "hold-up" value of the foreign representative's license rejection could be extortionate.[14] If one accepts the court's view that license termination would seriously harm the United States semiconductor industry, then *Jaffe* also presents a very hard case, with refusal to co-operate being the only way to avoid that result.

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[9] Ibid., at 1037-38.
[10] Ibid., at 1039.
[11] See Client Alert, Mitigating the "Vitro Effect": Mexican Lawmakers Approved the Most Ambitious Bankruptcy Law Reform Since Its Enactment back in 2000, Aiming to Ensure Creditors' Rights, White & Case (January 2014), at: <http://www.whitecase.com/alerts/022014/mitigating-vitro-effect-mexico-bankruptcy-law-reform/>.
[12] *Jaffe*, 737 F.3d, at 19.
[13] Idem.
[14] Ibid. The foreign representative attempted to rebut this argument by offering to relicense the technology at reasonable royalty rates, but that offer was deemed insufficient because a later assignee of the debtor's patent might file bankruptcy in Germany and reject the license again without offering a reasonable royalty (at 31). That analysis seems suspect since any such future attempt to obtain an extortionate relicense fee could be addressed in the new Chapter 15 case that the debtor's assignee would have to file in order to enforce the future German license rejection.

7 It remains to be seen whether these decisions reflect merely a pause in what had been a generally receptive United States approach to cross-border co-operation or a retreat from the principles embodied in the Model Law. If one focuses on the legal principles articulated by these courts, rather than on the application of those principles to the specific circumstances of the cases, the opinions do not foreclose broad co-operation with foreign insolvency courts. Indeed, both cases include favourable language about co-operation and both leave the bankruptcy courts with broad discretion to grant requests for co-operation. The early signs are that the bankruptcy courts continue to adopt a broad co-operative approach. For example, one recent New York bankruptcy court case enforced a Brazilian plan of reorganization, even though the standards for confirming a plan under Brazilian law were significantly different from, and less rigorous than, the confirmation standards for United States reorganization plans.[15] But, to set us firmly on the co-operation path, we need an appellate decision that uses favourable language to approve a grant of assistance in a situation where the foreign law differs significantly from United States law.

8 The positive view of the recent appellate cases lies less in what the courts did than in what they did not do. Most importantly, neither decision relied upon Chapter 15's public policy exception as the grounds for refusing co-operation. This is consistent with the policy of the Model Law. Section 1506 authorizes a court to refuse to provide relief that "would be manifestly contrary to the public policy of the United States."[16] In both cases, the objectors relied on this provision, and in both cases that argument was accepted by the lower courts.[17] In the United States, an appellate court need not review all of the grounds for decision that a lower court relied upon. If the appellate court wishes to affirm the ruling of the lower court, it can do so if any legal ground supports it. In both *Vitro* and *Jaffe* the courts of appeal affirmed the lower courts on grounds other than their section 1506 analysis and thus did not even need to discuss the public policy issue. Nevertheless, both courts discussed the section 1506 analysis. Language in the *Vitro* opinion provides strong support for broad co-operation in cross-border cases. The *Jaffe* opinion, on the other hand, reflects a more cautious approach to cross-border co-operation. In fact, the *Jaffe* opinion obliquely refers to public policy in a way that may limit co-operation even where only relatively minor domestic public policy is implicated. The best that can be said for the case's public policy discussion is that it does not explicitly adopt an expansive reading of section 1506.

9 In *Vitro*, the lower court had held that protection of third party claims in a bankruptcy case was a "fundamental policy of the United States" that was violated

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[15] See *In re Rede Energia S.A.,* 515 B.R. 69 (Bankr. S.D.N.Y. 2014).
[16] 11 U.S.C. § 1506. This provision incorporates Article 5 of the Model Law without any changes.
[17] See *Vitro*¸701 F.3d, at 1069; *Jaffe,* 737 F.3d, at 23.

by the Mexican plan of reorganization.[18] Of course, if a mere difference in bankruptcy law is the type of fundamental public policy that triggers section 1506, there is little room for cross-border co-operation. Fortunately, the court of appeals seems to agree. The court noted that section 1506 creates a:

> "narrow public policy exception" that "is intended to be invoked only under exceptional circumstances concerning matters of fundamental importance for the United States."[19]

10 While not explicitly limiting section 1506 to procedural matters, the court noted that:

> "the key determination is whether the procedures used [in the foreign proceeding] meet our fundamental standards of fairness."[20]

11 With respect to the question whether a substantive difference between United States bankruptcy law and the foreign bankruptcy law was sufficient to trigger section 1506, the court noted that section 1507 provides expansive relief beyond that available under the United States Bankruptcy Code[21] and cited authority stating that the foreign law need not be identical to United States bankruptcy law as long as the result was comparable and not repugnant to our laws and policy.[22] While expressly declining to decide whether enforcement of the Mexican reorganization plan would be manifestly contrary to a fundamental public policy of the United States, the court signalled its disagreement with the lower court by noting that the fact that section 1507 was intended to be read expansively and that section 1506 was intended to be read narrowly "does not sit well" with the lower court's identification of a United States bankruptcy policy against non-debtor releases as fundamental.[23]

12 Unfortunately *Jaffe* does not include similar language. The court affirmed the lower court based on its determination that the interests of the United States patent holders were not "sufficiently protected" as required by section 1522(a).[24] The court viewed that determination as involving a balance that was committed to the discretion of the bankruptcy court and thus its review of the lower court was limited to whether the bankruptcy court's conclusion was "reasonable." Having concluded

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[18] See *Vitro*, 701 F.3d, at 1052 and 1069.
[19] Ibid., at 1069.
[20] Idem, quoting *In re Metcalfe*, 421 B.R. 685, at 697 (Bankr. S.D.N.Y. 2010).
[21] Ibid.,, at 1060-61.
[22] Ibid., at 1044. The court did not discuss the quoted statements or attempt to explain the obvious difference between a standard based on comparability and one based on repugnancy.
[23] Ibid., at 1069-70.
[24] See 11 U.S.C. § 1522(a). This provision incorporates Article 22 of the Model Law with only minor changes. The United States version substitutes the term "sufficiently protected" for the Model Law's term "adequately protected" in both sections 1521 and 1522 to avoid confusion with a specialized legal term in United States bankruptcy law, "adequate protection." See H.R. Rep. No. 109-31, Pt. 1, at 115 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 178 (discussing section 1521).

that the bankruptcy court did not abuse its discretion in determining that the interests of the patent holders was not sufficiently protected, the court did not need to address the alternative ground that enforcement of the German law's termination of patent rights would be manifestly contrary to United States public policy. Nonetheless, a few statements in the final section of the court's opinion appear to address the public policy exception and arguably adopt a much broader view of it than *Vitro*. The *Jaffe* court was a three judge panel and one of the judges refused to join in that part of the opinion and admonished the court for including that discussion "because it is unnecessary dictum".[25]

13 The United States rule that rejection of an intellectual property license does not terminate the non-debtor counterparty licensee's rights is found in section 365(n) of the Bankruptcy Code.[26] That section was added as an amendment to the Bankruptcy Code after a court held that rejection of a license did terminate the licensee's rights.[27] Section 365(n) was motivated by the same type of concerns for licensees that *Jaffe* relied upon in its balancing analysis. Thus, it does reflect the United States public policy of how licensees should be treated in bankruptcy when their licenses are rejected. However, this is no different from any other bankruptcy policy that is reflected in the statutory text – like, for example, the policy against non-debtor releases that was discussed in *Vitro.* It is not a broad general public policy like the due process and fundamental fairness concerns that *Vitro* indicated are the focus of section 1506.

14 Nonetheless, two of the *Jaffe* judges could not resist a brief reference to public policy. In the final paragraphs of the opinion, the court notes that section 1506:

> "authorizes a bankruptcy court to refuse to take an action that would be manifestly contrary to U.S. public policy."[28]

15 The court then states that by affirming the bankruptcy court's application of the section 1522(a) balancing test:

> "we also indirectly further the public policy that underlies § 365(n)."

16 The court then discussed the concerns that motivated Congress to adopt section 365(n) and noted that they were similar to those considered by the bankruptcy court in its weighing analysis. The court then stated:

> "Thus, the court's findings, which were, to be sure, focused on the Licensee's interests, nonetheless necessarily furthered the public policy underlying § 365(n). We thus recognize

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[25] *Jaffe*, 737 F.3d, at 32 (Wynn J concurring).
[26] 11 U.S.C. § 365(n).
[27] S. Rep. No. 100-506, at 2 (1988), reprinted in 1988 U.S.C.C.A.N. 3200, 3201.
[28] *Jaffe*, 737 F.3d, at 32.

> that by affirming the bankruptcy court, even though on its § 1522(a) analysis, we too necessarily further the public policy inherent in and manifested by § 365(n)."[29]

17 Thus without any analysis of what "manifestly contrary" means or what types of public policy are fundamental enough to be within section 1506, the court suggests in dicta that a mere difference in bankruptcy policy has section 1506 implications. Had the court engaged in a more careful analysis of section 1506 it may have realized that:

> "[t]he word 'manifestly' in international usage restricts the public policy exception to the most fundamental policies of the United States."[30]

18 It is not clear what the court intended by its public policy statements or how they should be interpreted, but they raise the possibility that section 1506 has broader application than *Vitro* gave it. The *Jaffe* court's statement about public policy, coupled with its rejection of Jaffe's offer of reasonable relicensing fees, suggests that it was the difference in substantive bankruptcy law, rather than a true lack of sufficient protection, that motivated both the lower court's decision and the court of appeal's affirmance of that decision. The risk presented by *Jaffe* is that by incorporating section 1506's public policy provision into the section 1522(a) sufficient protection analysis, it nullifies section 1506 by permitting weak domestic public policy concerns to block requested relief under section 1522(a) in cases where the requested relief is not manifestly contrary to a fundamental public policy.

Conclusion

19 The *Vitro* opinion is a much better written opinion than *Jaffe* and should be more persuasive to other courts facing requests for co-operation. Its approach is also more consistent with the policy of the Model Law. If *Vitro's* approach is adopted by future courts, then *Jaffe* will merely reflect a brief pause on the path to co-operation.

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[29] Ibid.

[30] H.R. Rep. No. 109-31, above note 24, at 109, 2005 U.S.C.C.A.N. 88, at 172.

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