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Enforcing Releases in Bankruptcy

Bankruptcy Court Determines Standard for Enforcing Non-Consensual Third-Party Releases in a Chapter 15 Case Differs From Applicable Standard in Chapter 11 Cases

On April 9, 2018, in *In re Avanti Communcs. Group Plc*, Case No. 18-10458, the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") entered an order under chapter 15 of the Bankruptcy Code enforcing a scheme of arrangement sanctioned by a court in England (the "English Court") that included non-consensual releases of non-debtor affiliate-guarantors.[1]

The Bankruptcy Court observed that third-party releases (*i.e.*, releases of non-debtor parties by other non-debtor parties) are "often problematic in chapter 11 cases – seemingly prohibited entirely in some Circuits but permitted under limited circumstances in other Circuits."[2] Absent consent of the releasing party, such releases are generally prohibited in the Fifth, Ninth, and Tenth Circuits as well as the D.C. Circuit. Courts in the Second, Fourth, Sixth, Seventh and Eleventh Circuits permit consensual releases and, in limited circumstances, have approved releases without consent. The Bankruptcy Court determined that the proper analysis for considering approval of the releases was not whether the release would have been permissible in a Chapter 11 case, but rather whether the Bankruptcy Court should recognize and enforce the foreign court order approving the release based on principles of comity.[3]

The debtor, a public limited company incorporated under the laws of England and Wales, is a satellite operator that provides fixed satellite services in Europe, the Middle East and Africa. In December 2017, after experiencing financial difficulties due to manufacturing delays and a materially overleveraged capital structure, the debtor and an ad hoc group of its noteholders entered into a restructuring agreement whereby the parties agreed to equitize notes due in 2023 and amend notes due in

2021 (the "Scheme"). The 2023 notes were originally governed by NY law and amended to change the governing law to English law. This follows a few previous examples, such as the APCOA restructuring, and the fact that none of the creditors nor the English or Bankruptcy Courts have yet raised any questions on this suggests that this is now a technique that will be followed in future cases.

The Scheme included the grant of releases to certain third-party guarantors. These releases were essential to the Scheme as they prevented dissenting holders of the 2023 notes from pursuing claims against the non-debtor guarantors. To effectuate the Scheme, the debtor applied to the English Court for permission to convene a meeting of creditors comprised of holders of the 2023 notes (the only creditor class "impaired" under the Scheme) for the purpose of considering and approving the Scheme. The English Court convened a meeting of creditors where the creditors holding 98.3% by value of the outstanding 2023 notes attended and voted in favor of the Scheme. Thereafter, the English Court sanctioned the Scheme.[4] A foreign representative then sought an order by the Bankruptcy Court recognizing the English proceeding and enforcing the Scheme, including the third-party releases.[5]

The Bankruptcy Court determined that the UK proceeding should be recognized as a foreign main proceeding and that, as such, the court had broad powers to grant appropriate relief to further the purposes of the Chapter 15 case and protect the debtor's assets and the interests of creditors.[6] Because Avanti's creditors had a full and fair opportunity to be heard in the UK proceeding in a manner "consistent with US due process standards", the Bankruptcy Court approved the releases.[7]

In doing so, the Bankruptcy Court distinguished a Fifth Circuit case, *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031 (5th Cir. 2012), where the Fifth Circuit affirmed a bankruptcy court's decision in a chapter 15 case declining to grant comity and to enforce a Mexican court's approval of a Mexican reorganization plan that released guarantors of US-based non-debtor affiliates of the Mexican debtor's debt. The Bankruptcy Court noted that in *Vitro* there were several "troubling facts" that resulted in the court's refusal to enforce the plan approved by the foreign court – the plan created only a single class of unsecured creditors and the necessary creditor support to approve the plan was only obtained by counting insider votes.[8]

In contrast to *Vitro*, the Scheme had nearly unanimous support of the only impaired class and did not rely on votes by insiders. Note also that a scheme of arrangement is not an insolvency process but a corporate process. In its Scheme submissions to the English Court, the English debtor concluded that if the Scheme were not passed, it would be forced to file for liquidation. This is an important factor in the court's assessment of the Scheme, with a significant prejudice to creditors in the event the Scheme failed to be sanctioned. One of the conditions of the Scheme was obtaining recognition from the Bankruptcy Court under Chapter 15 proceedings. If the Bankruptcy Court had not recognized the Scheme, it would have failed and the English debtor would have filed for liquidation.

The Bankruptcy Court also noted that if it did not enforce the guarantor releases prejudicial treatment of creditors could result to the detriment of the debtor's reorganization efforts and prevent the fair and efficient administration of the restructuring.[9]

Although the burden necessary for obtaining non-consensual, third-party releases in chapter 11 cases (in those jurisdictions that permit them) is substantial, this case illustrates that bankruptcy courts may use a different (and typically more permissive) standard when deciding whether to enforce third-party releases in chapter 15 proceedings. The *Avanti* decision should aid in the facilitation of cross-border restructurings of UK entities with assets in the United States. Enforcing these types of third-party releases in the US will prevent dissenting minority noteholders from extorting holdout value from other stakeholders.

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[1] *In re Avanti Communs. Group Plc*, No. 18-10458, 2018 Bankr. LEXIS 1078 (Bankr. S.D.N.Y. Apr. 9, 2018).
[2] *Id.* at *2.
[3] *Id.* at *2-*3.
[4] *Id.* at *6-*15.
[5] *Id.* at *4.
[6] *Id.* at *22-*25.
[7] *Id.* at *34-*35.
[8] *Id.* at *31-*33.
[9] *Id.* at *35-*36.