INTERNATIONAL COMITY AT THE CROSSROADS: PRACTICAL IMPLICATIONS AND PUBLIC POLICY CHALLENGES

LOUIS M. SOLOMON*

The recent globalization of the debt markets has led to an ever-increasing rate of foreign company restructurings of U.S.-issued debt. When they occur in foreign countries, these restructurings arise under the auspices of actual foreign statutory insolvency regimes or, with greater frequency recently, from a foreign company's unilateral, largely out-of-court efforts. For a variety of practical reasons to be discussed in this article, aspects of these matters wind up in U.S. courts. Recently, there has been a significant increase in U.S. litigation ancillary to foreign insolvencies or foreign debt restructurings.[1]

One of the threshold issues in the U.S. litigation spawned by these foreign efforts is the degree to which a U.S. court should defer, or give comity, to in-court or out-of-court "mechanisms" or "proceedings" taking place abroad. In turn, the issue of comity implicates a host of fundamental policy questions, including, for example, what role the United States can or should play in the development of an internationally recognized body of law of financial restructurings; how much deference should a United States court accord to a foreign matter when U.S. public policies adumbrated by Congress are at risk of being trammeled; what weight should be given to interests of U.S. investors negatively impacted by a foreign restructuring; and how should U.S. courts view the possible effects their deference might have on the efficient operation of the American securities markets. A related issue is if, as it appears under

* The author was lead counsel for the defendant/respondent in the three recent cases discussed in this paper. He is a partner at the firm of Proskauer Rose LLP, which provides advice, counseling, and litigation representation to clients worldwide.

1. One measure of the increase in activity is the significant increase in the filing of ancillary proceedings under Section 304 of the Bankruptcy Code. In the nation's most active Bankruptcy Court, the Southern District of New York, more than one hundred § 304 proceedings were filed in 2003 alone.

current precedent, a "foreign" company can get better treatment than a U.S. company would get from a U.S. court in restructuring its U.S. debt, then how should we define "foreign" for these purposes?

The issue of comity arises under general principles of jurisprudence[2] as well as in the specific context of Section 304 of the Bankruptcy Code.[3] This article first addresses the general context in which these issues arise and then uses three recent cases—one each from the Southern District of New York's Bankruptcy Court, the federal District Court for the Southern District of New York, and the United States Court of Appeals for the Second Circuit—to consider the practical implications and public policy challenges. Two of the three decisions address issues of first impression that appear to be important to domestic and foreign companies with international aspects to their business.

I.
THE PHENOMENON OF U.S. LITIGATION ARISING FROM FOREIGN FINANCIAL RESTRUCTURINGS

Practical experience teaches that there are a number of reasons why "foreign" companies wind up in U.S. litigation relating to foreign restructurings. First, it is common that companies—both domestic and foreign—provide in their debenture agreements for governing law and dispute-resolution using the law and courts of the United States, or a particular state, most commonly, New York. For example, in the *Multicanal* and *Cablevision* matters discussed in this article, the respective indentures provided for New York law to govern disputes as well as a New York forum to resolve such disputes, so long as they related to the indentures, or the notes issued under them. In these cases, of course, any litigation arising out of the indenture could go forward in New York, including debt collection actions.

Second, foreign companies often come to the United States to raise debt, selling what are known as "Yankee Bonds"—U.S. dollar denominated bonds governed by U.S.

2. *See, e.g.*, Allstate Life Ins. Co. v. Linter Group Ltd., 994 F.2d 996, 999 (2d Cir. 1993); United Feature Syndicate, Inc. v. Miller Features Syndicate, Inc., 216 F. Supp. 2d 198, 211 (S.D.N.Y. 2002).

3. 11 U.S.C. § 304 (2003).

law. The companies often come back to the United States and employ tender offers to restructure their debt, and often seek to resolve any and all litigation in American courts so that they can, in the future, return to seek additional financing in the largest capital market in the world. Any of these activities may constitute enough presence sufficient to ground litigation in American courts, especially of claims that relate to these financing activities.

Third, in the debt restructuring context, U.S. creditors have quite recently attempted to invoke the jurisdiction of domestic bankruptcy courts by filing involuntary bankruptcy petitions.[4] Personal jurisdiction in such cases can be based on the very indentures or debt instruments issued to the U.S. investors. A minuscule amount of property in the U.S. is sufficient to invoke U.S. Bankruptcy Court jurisdiction.[5]

The Principle of Comity

The Second Circuit has explained that the "[a]nalysis of comity often begins with the definition proffered by Justice Gray in *Hilton v. Guyot*"[6] nearly 120 years ago:

> 'Comity,' in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens

4. *See In re* Globo Comunicacoes E Participacipacoes S.A., 04 Civ. 2818, 2004 WL 2624866, at *1 (S.D.N.Y. Nov. 17, 2004) (observing that "[t]he involuntary bankruptcy petition giving rise to the appeal represents a creative way of resorting to United States bankruptcy courts to seek repayment of funds owed by an allegedly recalcitrant foreign debtor").

5. Section 109 of the Bankruptcy Code's requirement that a debtor have property in the U.S. has been held satisfied by as little as a few hundred to a few thousand dollars. *See, e.g., In re* Global Ocean Carriers, Ltd., 251 B.R. 31, 38–39 (Bankr. D. Del. 2000); *In re* Iglesias, 226 B.R. 721, 722–23 (Bankr. S.D. Fla. 1998).

6. *In re* Maxwell Communications Corp., 93 F.3d 1036, 1046 (2d Cir. 1996).

> or of other persons who are under the protection of its laws.[7]

American courts have been careful to note that comity does not impose any limitation on the sovereign power of the United States. Rather, "[t]he doctrine of international comity is best understood as a guide where the issues to be resolved are entangled in international relations."[8] The concept of employing comity to defer to foreign proceedings is quite prevalent in our law.[9]

In the foreign insolvency or restructuring context, Section 304 of the U.S. Bankruptcy Code has been seen as a specific application of the principle of comity. Section 304 generally provides that a "foreign representative" may use the American bankruptcy courts to commence a proceeding ancillary to a "foreign proceeding," and seek to enjoin the commencement or continuation of other U.S. actions against the debtor or its property, or even the enforcement of any judgment in the U.S. against the debtor with respect to such property. The section continues that, "[i]n determining whether to grant relief" under Section 304, the Bankruptcy Court

> shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with . . . just treatment of all holders of claims against or interests in such estate; . . . protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding; . . . prevention of preferential or fraudulent dispositions of property of such estate; . . . distribution of proceeds of such estate substantially in accordance with the order prescribed in this title; . . . *comity*; . . . and if appropriate, the provision of an opportunity for a fresh start for

7. Hilton v. Guyot, 159 U.S. 113, 163–64 (1895), *quoted in In re* Maxwell Communications Corp., 93 F.3d at 1046. As the Second Circuit in *Maxwell* observed, *Hilton* addressed the degree to which foreign judgment is conclusive in a court of the United States. *Id.* Nonetheless, the principle it expressed has been used by courts in articulating the general concept of comity ever since.

8. *Maxwell*, 93 F.3d at 1047.

9. *See, e.g.*, Allstate Life Ins. Co. v. Linter Group Ltd., 994 F.2d 996, 999 (2d Cir. 1993); United Feature Syndicate, Inc. v. Miller Features Syndicate, Inc., 216 F. Supp. 2d 198, 211 (S.D.N.Y. 2002).

the individual that such foreign proceeding concerns.[10]

The Second Circuit has made clear that "comity" is a key consideration in the Section 304 analysis, stating that a court's "function under § 304 is to determine whether comity should be extended to the foreign proceeding in light of the other [§ 304] factors".[11]

Because of the various phenomena described above, there has arisen a growing practice of foreign issuers, having sold debt in the U.S. under indentures promising the application of U.S. law and forums, to nonetheless restructure their U.S. debt under foreign restructuring regimes—only to return to the U.S. and seek "recognition" of the foreign restructuring under either Section 304 or general principles of comity. Such recognition, based on notions of comity, has led courts to cut off claims and litigation by U.S. creditors in domestic courts, and also allow foreign companies to avoid U.S. judgments for collection, and hence pave the way for such companies to access the U.S. capital markets in the future.[12]

II.
THREE RECENT CASES

Multicanal

The recent *Multicanal* litigation consists of two decisions by the influential U.S. Bankruptcy Court for the Southern District of New York, one concerning the applicability of the Trust Indenture Act ("TIA")[13] to foreign restructurings and the other, a post-trial decision under Section 304.[14] Together, the decisions extend a line of Bankruptcy Court decisions approving foreign restructurings, notwithstanding their ever-increasing deviations from U.S.-creditor protections that bondholders might be said to have bargained for when they loaned

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10. 11 U.S.C. § 304(c) (2003) (emphasis added).

11. *In re* Treco, 240 F.3d 148, 156–57 (2d Cir. 2001).

12. *See generally* Allan Gropper, *Current Developments in International Insolvency Law: A United States Perspective, for 26th Annual Current Developments in Bankruptcy & Reorganization*, P.L.I. COMMERCIAL LAW AND PRACTICE COURSE HANDBOOK SERIES 3076 (2004).

13. *See* Trust Indenture Act of 1939 § 316(b), 15 U.S.C. § 77ppp(b).

14. *In re* Multicanal, 314 B.R. 486 (Bankr. S.D.N.Y. 2004) [hereinafter *Multicanal II*].

money to the foreign issuer. The post-trial decision also demonstrates how a prejudiced minority group of U.S. creditors might get a U.S. court to draw the line between "permissible" and "impermissible" foreign restructuring regimes. In *Multicanal*, for example, the Bankruptcy Court withheld recognition of a foreign restructuring that clearly discriminated against a subset of U.S. creditors, namely, retail investors. The decision signals a warning to foreign issuers against utilizing threats and intimidation tactics against U.S. creditors to secure their majorities.

The *Multicanal* case involved a cable operator headquartered in Argentina, who sought to raise more than $500 million in debt in the late 1990s.[15] Using agents, bankers, and lawyers in America, the company sought the protections of the U.S. securities market, and sold five series of bonds, more than 80% of which was purchased by U.S. investors. The bonds were governed by a choice of law provision designating New York law and even identified New York courts as a proper forum for litigation. Multicanal took advantage of the lower cost of funds available for borrowings made under New York Indentures. Similarly, it broadened investor appeal by qualifying the issues under the Trust Indenture Act, which promised that the repayment of the debt's principal or interest would never be impaired absent unanimous consent of the bondholders. Multicanal even registered some of the bonds with the SEC under the Securities Exchange Act of 1934.[16]

In the bankruptcy proceeding, evidence was introduced that the bonds would not have had such a robust market if Multicanal did not offer these procedural protections to creditors, and that there was no disclosure of any intention on the part of Multicanal that they would attempt to restructure their bonds using any proceeding other than a U.S. bankruptcy, should it become necessary.

Multicanal experienced financial difficulties after the devaluation of the Argentine peso in early 2002 and defaulted on all its financial debt. The company did not even seek to make partial payments of interest when it came due. Thereafter, the company's cash position improved considerably, and it became clear that the company had sufficient free cash flow to

15. *See generally id.*
16. *Id.* at 492.

repay all or substantial amounts of its overdue principal and interest.[17] Yet, the company did not attempt to pay down its existing debt.

In fact, Multicanal did not propose a workout that honored its fundamental promise to repay principal and interest. Instead, it proposed a restructuring that would replace \$527 million in debt with \$220 million, eradicating between 56% and 70% of bondholders' investments, depending on the options they were to receive. The equity made available to bondholders was capped at 35%—that is, Multicanal's corporate parent—the powerful media conglomerate Groupo Clarin—would retain control of the company with 65% of the equity. None of the equity was made available to retail U.S. holders, or investors who were not Qualified Institutional Buyers under the U.S. securities laws.[18] So, too, the \$220 million replacement debt securities were not even offered to investors from the retail sector. Groupo Clarin ended up retaining 65% of the equity in return for a mere \$15 million contribution on their part. The company offered no market test or fairness valuation for the \$15 million contribution. Indeed, the evidence at trial demonstrated that this proposed deal would work a massive wealth transfer from the U.S. creditors to Multicanal's corporate parent.

There is little doubt that if the company's creditors had protections written into the indentures and provided by U.S. federal and state law, any workout would have included making the creditors whole, or at the very least would have required equity-holders to forego a substantial portion of its ownership in favor of giving creditors a share in the restructuring. However, none of that occurred in the *Multicanal* restructuring.

Instead of adjusting its debt under a U.S. bankruptcy regime, Multicanal invoked a new and largely untested Argentine out-of-court restructuring mechanism called an "*Acuerdo Preventivo Extrajudicial*" or "APE".[19] It is interesting to note that

17. The evidence demonstrates that the company had free cash flow exceeding \$60 million annually.

18. *Multicanal II*, 314 B.R. at 495.

19. The relevant history of the APE is set forth in the *Multicanal* court's post-trial decision. *Id.* at 493–94.

the APE rules on which Multicanal relied were not even in existence when the bonds were initially issued to U.S. investors.

As a result of amendments enacted in 2002, the Argentine APE permits a vote of two-thirds of the creditors to determine the future of the entire restructuring.[20] It accords creditors very different substantive and procedural rights than they would have had under U.S. law. As a result of its provisions, creditors lack any significant amount of negotiating leverage and thus, predictably, appear to "support" economic restructurings that would be unheard of in a system of rights and protections analogous to those promised when the money was borrowed.

Under an APE, the restructuring company is not obliged to provide creditors with a liquidation analysis, give more value to creditors than they would get in a liquidation, or provide projections of its income and expenses so that creditors can assess what kind of a company it will be if they accept or reject the proposed restructuring. As if the two-thirds provision wasn't unfair enough, Multicanal designed a voting procedure that facilitated the counting of "yes" votes, and minimized and even excluded "no" votes. Similarly, the APE did not give creditors the protections of a trustee, a creditors committee, or even a single person or entity with any fiduciary duties to protect them. The grounds for creditor objection were extremely limited by statute; creditors were only able to object that the proposed restructuring misstated assets or liabilities, or that the company counted the votes incorrectly. Any hope for a broader role by a "reviewing" court in an APE was so uncertain that it was even characterized by Multicanal's own trial expert as being "enormously far from the idea of guaranteed justice."[21] Finally, to add to the list of procedural problems, *ex parte* communications between the "reviewing" court and the debtor were common.

As for the actual review, the APE court did not evaluate the economic fairness or feasibility of the transaction, and indeed, the debtor did not provide any information from which

20. *Id.* at 493.

21. A. Alonso & J. Lorente, "The Status of Conditional Credits Which are Subject to a Term and/or Not [Yet] Enforceable as Against the Proceeding for Judicial Confirmation of an APE Which Applies to Them", Resp. Trial Ex. 458, at 3.

the reviewing court could make such an evaluation. There were no rights to discovery or an evidentiary hearing; indeed, the APE creditors sought both and were granted neither. In U.S. terms, procedural due process was demonstrably lacking.

Finally, because Multicanal did not wish any scrutiny from the SEC in registering any replacement securities, it refused to offer any U.S. retail creditors any form of equity, instead offering cash. And to get that cash, the small U.S. bondholders were required to vote in favor of the restructuring or they would get nothing.

Multicanal turned to the U.S. Bankruptcy Court for "recognition" of its foreign APE under Section 304. It did so for the avowed purpose of cutting off litigation in the U.S. seeking collection on the defaulted notes. Termination of these legal proceedings would subsequently allow Multicanal to return to the United States capital markets to obtain follow-up financings. The Bankruptcy Court granted a temporary restraining order under Section 304 effectively halting the creditors' collection actions, and oversaw expedited proceedings leading to a trial on the Section 304 issue.

The TIA Decision of the U.S. Bankruptcy Court

As a threshold pre-trial matter, the objecting creditors made a motion to dismiss the Section 304 proceeding, on the grounds that the Trust Indenture Act gave bondholders rights that could not be overridden by the APE mechanism, which they described as "majoritarian" at best, rather than rights-based. The Trust Indenture Act provides, in part, that "the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security. . .shall not be impaired or affected without the consent of such holder."[22] That right has been read to be "absolute and unconditional."[23] Indeed, Congress appears to have passed

22. Trust Indenture Act of 1939 § 316(b), 15 U.S.C. § 77ppp(b).

23. Upic & Co. v. Kinder-Care Learning Ctrs., 793 F. Supp. 448, 452, 455 (S.D.N.Y. 1992); *accord* Federated Strategic Income Fund v. Mechala Group Jam. Ltd., No. 99 Civ. 10517, 1999 WL 993648, at *4, *6, *9–*10 (S.D.N.Y. Nov. 2, 1999) (enjoining tender offer in support of restructuring due to lack of unanimous consent). *See also* Bluebird Partners, L.P. v. First Fidelity Bank, 85 F.3d 970, 974 (2d Cir. 1996) (TIA is "designed to vindicate a federal policy of protecting investors"; interpretation of TIA-mandated indenture provi-

the Trust Indenture Act in conscious rejection of majority rule in bond workouts, based on a "concern about the motivation of insiders and quasi-insiders to destroy a bond issue through insider control, and the generally poor information about a prospective reorganization available to dispersed individual bondholders."[24]

In the *Multicanal* litigation, the creditors argued that their rights to the principal and interest of their loan were "absolute and unconditional" under the TIA, and without their consent, could not be overridden by the Argentine APE, even assuming they could be overridden by a U.S. bankruptcy proceeding. The bondholders argued that the only instance in which a foreign restructuring mechanism could even arguably override federal TIA rights was where the foreign regime granted creditors the same substantive and procedural rights as Congress granted creditors in a U.S. bankruptcy. Yet, the Argentine APE did not provide the essential cornerstones of the U.S. bankruptcy proceedings, including independent judges with the means, information, and authority to ensure that the restructuring was fair and feasible.[25] There was no dispute that these substantive and procedural rights were missing from the APE.

The Bankruptcy Court rejected the bondholders' argument as a matter of law and irrespective of the particulars concerning the Argentine APE. The Court similarly rejected the

sions "does not depend on ordinary contract principles," it "depends on an interpretation of the legislation").

24. *See* Trust Indenture Act of 1939, S. Rep. No. 248, 76th Cong., 1st Sess. 26 at 452–53 (1939) [hereinafter *Senate Report*].

25. As stated in the legislative history of the TIA, absent granting unanimous creditor protection of the return of principal and interest, Congress wanted workouts to be forced into the jurisdiction of a U.S. bankruptcy court, which would shine a bright-light on the substantive fairness of the plan, and believed that "[e]vasion of judicial scrutiny of the fairness of debt-readjustment plans" would be "prevented" by the prohibition on non-consensual impairment of noteholder rights. *See Senate Report, supra* note 24; *accord Upic*, 793 F. Supp. at 453 (TIA was intended to "bring contractual recapitalizations under Bankruptcy Court jurisdiction"); Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L. J. 232, 257–58 (1987) (Under TIA, "each affected bondholder would consent. . .or a judge would value the company to determine that the firm was insolvent, eliminate the stockholders, and then reduce the express obligation to the bondholders. . .The SEC wanted [to]. . .bring contractual recapitalizations under the jurisdiction of the federal bankruptcy court").

bondholders' argument that the existence of TIA rights should inform the comity analysis under Section 304—*i.e.*, that something like a "comity plus" standard should be utilized, given the importance of the TIA rights prejudiced by the APE.

Although the Court determined that the rights granted by the TIA were federal in nature, the Court held that these rights were essentially contractual.[26] Having determined that mere contract rights were at stake, the Court relied on *Canadian S. Ry. Co. v. Gebhard*,[27] where the Supreme Court stated:

> [E]very person who deals with a foreign corporation impliedly subjects himself to such laws of the foreign government, affecting the powers and obligations of the corporation with which he voluntarily contracts, as the known and established policy of that government authorizes. To all intents and purposes, he submits his contract with the corporation to such a policy of the foreign government and whatever is done by that government in furtherance of that policy which binds those in like situation with himself, who are subjects of the government, in respect to the operation and effect of their contracts with the corporation, will necessarily bind him.[28]

The *Multicanal* Court reasoned that "if foreign law can under certain circumstances trump the U.S. Constitution and preclude bondholders from enforcing their contractual rights,"[29] then surely Section 304 could trump the contractual rights under the TIA.[30]

The Post-Trial Decision of the U.S. Bankruptcy Court Under Section 304

After trial, the Court issued a decision construing Section 304 and the prior case law as entailing a narrower scope of review than the one urged by the objecting creditors, which would have entailed examining the substantive or procedural

26. *In re Multicanal*, 307 B.R. 384, 389 (Bankr. S.D.N.Y. 2004) [hereinafter *Multicanal I*].

27. Can. S. Ry. Co. v. Gebhard, 109 U.S. 527 (1883).

28. *Id.* at 537–38.

29. *Multicanal I*, 307 B.R. at 390.

30. *Id.*

fairness under U.S. standards.[31] Instead, the Court stated that its primary function under Section 304 was to determine the most "economical and expeditious administration of a foreign estate."[32] The Court held that it did not need to examine whether the bondholders' reasonable expectations were being frustrated by Multicanal's *post hoc* refusal to accord creditors the protections it promised when it borrowed the money. Finding "comity" to the foreign regime to be an overriding factor, the Court believed that it was sufficient that, in satisfying the Section 304 factors, certain aspects of the APE were, in the Court's view, similar to U.S. pre-packaged bankruptcies, also known as "pre-packs".[33]

In its deference to principles of comity, the Court observed that many creditors voted in favor of the APE—although the Court did acknowledge that there were voting irregularities in the APE. It is important to note that these irregularities were never shown to be tolerated in a U.S. proceeding. But even the Court's finding that there was indeed disparity in the procedures for obtaining "yes" and "no" votes was insufficient to withhold recognition. The Court may have been motivated by the fact that the reviewing court in Argentina had found that Multicanal had discriminated against "no" voters. But the Argentine court did not require a re-vote to remedy the discrimination, and the U.S. Court held that it would not be appropriate for it to order that relief in a Section 304 proceeding. The Court believed that "the question here is not whether the APE should be confirmed as a U.S. Chapter 11 plan, but whether it is entitled to recognition under § 304 and fundamental principles of due process."[34] The Court answered that question in the affirmative.

However, the Court did hold that Section 304 permitted it to draw the line in two places. First, it found that Multicanal discriminated against U.S. retail creditors, who were unable to exercise the vote afforded other creditors and were forced to accept a type of consideration—cash—that the Court found was worth substantially less than other offered forms of consideration—namely, new notes and equity. The Court rejected

31. *See generally id.*
32. *Multicanal II*, 314 B.R. at 501.
33. *Id.* at 504–06.
34. *Id.* at 512.

Multicanal's many excuses for the discrimination, and required the company to remedy the discrimination before according the restructuring any U.S. recognition.

Second, the Court reacted to the fact that, in Argentina, Multicanal facilitated the initiation of criminal accusations against individual employees of a vocal dissenting U.S. creditor. The Court gave no weight to the incredible testimony of the Multicanal director who portrayed the incident as one he pursued in his personal capacity rather than as a director and officer of Multicanal. The Court required Multicanal to prove the "substantial justification" for its conduct,[35] which for all appearances looked like rank intimidation.

Comment on Multicanal

As it relates to the Bankruptcy Court's decision on the Trust Indenture Act, the unqualified language of the statute—that "the right to the return of principal and interest shall not be impaired absent unanimous consent"—would appear to accord bondholders unqualified rights. Indeed, because of the statute's clarity, under modern statutory interpretation, a fair question could be raised whether the TIA should yield even to the jurisdiction of a *domestic* bankruptcy court.[36]

Examining the legislative history of the Trust Indenture Act, one might argue that the statute was designed to "bring contractual recapitalizations under Bankruptcy Court jurisdiction [by] frustrating a distressed firm's efforts to successfully complete a consensual workout."[37] U.S. bankruptcy proceedings have been held, implicitly, to overcome TIA rights. One might argue this was specifically intended by Congress *because* of the requirement in a U.S. bankruptcy that there be "judicial scrutiny of the fairness of debt-readjustment plans".[38] But in ruling against the bondholders' position, the Court in *Multicanal* did not scrutinize what substantive or procedural protec-

35. *Id.* at 523.

36. *See, e.g.,* Desert Palace, Inc. v. Costa, 539 U.S. 90, 98 (2003) ("[W]here. . .the words of [a] statute are unambiguous, the 'judicial inquiry is complete'") (citation omitted).

37. *Senate Report, supra* note 24, at 453.

38. *See* UPIC & Co. v. Kinder-Care Learning Ctrs., 793 F. Supp. 448, 453 (S.D.N.Y. 1992) (referencing "Bankruptcy Court jurisdiction"); Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 257–58 (1987) (referencing "jurisdiction of the federal bankruptcy court").

tions existed in the APE, and never determined that the bondholders were given the same protections that they would have had under a U.S. bankruptcy. Rather, as a matter of law, the Bankruptcy Court concluded that "comity" embodied in § 304 demonstrated Congressional will to dispense with that entire analysis.

The Bankruptcy Court's citation to the Supreme Court decision in *Gebhard* deserves brief analysis as well. *Gebhard* involved bonds executed and issued in Canada[39] by a Canadian railroad company "created for a public purpose" and "subject to the exclusive legislative authority of the Dominion parliament."[40] After the Canadian legislature approved a plan exchanging the original bonds for new ones, New York bondholders sued to enforce the original bonds. The Canadian company argued "that the original bonds having been issued in Canada are controlled, as respects the obligation and its discharge, by the law of Canada,"[41] a position that was ultimately successful on appeal. Since the bonds apparently did not specify what law would apply, the lower court applied choice of law rules to determine the "presumed intention of the parties."[42] The Court then concluded that the Canadian legislature's discharge of the original bonds under Canadian law was entitled to comity. It is in this separate choice of law context that the Supreme Court made the statement relied on by the *Multicanal* Court, that one who contracts with a foreign corporation may be "presumed to have contracted with a view to such laws of that government."[43]

Gebhard is principally about choice of law, an issue that does not typically arise in cases involving U.S.-issued debt because of the ubiquity of New York choice of law clauses. Nor does *Gebhard* address the issue of whether the Trust Indenture Act—or any other U.S. federal statute—must give way to foreign bankruptcies. Indeed, the TIA was enacted more than 50 years after *Gebhard*. The statute endows a specific set of persons—namely, bondholders—with specific substantive rights

39. Gebhard v. Can. S. Ry. Co., 1 F. 387 (C.C.S.D.N.Y. 1880), *rev'd*, 109 U.S. 527 (1883).

40. *Id.*, 109 U.S. at 536.

41. *Gebhard*, 1 F. at 387.

42. *Id.* at 388.

43. *Id.*, 109 U.S. at 538.

that were designed to apply in the specific cases of restructurings and workouts.[44] Principles of general applicability such as those codified in Section 304 have not been read to override such specific rights. Indeed, despite the *Multicanal* court's views concerning majority action clauses, the vitality of the unanimity requirement of Section 316(b) was reaffirmed in 1990, when Congress made no substantive modifications to that section in amending the TIA.[45] At most, *Gebhard*'s statement regarding what law parties should anticipate will apply would appear to be an explanation of *why* comity may sometimes be granted where mere contractual rights are at stake. It is *not* a holding regarding *when* comity should be granted, nor a holding that foreign bankruptcy proceedings trump all U.S. federal statutory rights. It is also certainly not a holding concerning whether a "comity-plus" analysis might be warranted given the important federal rights and interests at stake.

An expansive view of *Gebhard* would appear to prove too much; such a reading could not be squared with settled law that American courts often deny comity to foreign insolvencies even when a U.S. party has contracted with a foreign corporation.[46] So too, it cannot be squared with the fact that U.S. courts will deny comity when U.S. law or policy is eroded.[47]

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44. *See* Morton v. Mancari, 417 U.S. 535, 551 (1974).

45. *See* Trust Indenture Reform Act of 1990, Pub. L. No. 101-550, 104 Stat. 2713, 2721; Cook County v. United States, 538 U.S. 119, 132–33 (2003) (refusing to read in exclusion where Congress mentioned none in amending statute).

46. *See, e.g., In re* Treco, 240 F.3d 148 (2d Cir. 2001) (agreement with Bahamian bank); Pravin Banker Assocs., Ltd. v. Banco Popular Del Peru, 109 F.3d 850 (2d Cir. 1997) (loan to Peruvian bank); *In re* United Pan-Europe Communications N.V., No. 03 Civ. 1060(DC), 02-16020(BRL), 2004 WL 48873 (S.D.N.Y. Jan. 9, 2004) (contract with Dutch company); *In re* Hourani, 180 B.R. 58 (Bankr. S.D.N.Y. 1995) (notes guaranteed by Jordanian bank).

47. Comity cannot be exercised without "due regard" for U.S. laws. Hilton v. Guyot, 159 U.S. 113, 164 (1895) (U.S. courts must give "due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws"). "[D]eference should be withheld where appropriate to avoid the violation of the laws, public policies, or rights of the citizens of the United States." *Treco*, 240 F.3d at 157 (emphasis added); Pravin Banker Assocs., 109 F.3d at 854 ("courts will not extend comity to foreign proceedings when doing so would be contrary to the policies or prejudicial to the interests of the United States"). Federal courts do not allow aliens to violate U.S. federal statutes and then avoid their enforcement through a request for comity. *See, e.g.,*

As it relates to the Bankruptcy Court's post-trial decision, it might be fair to observe that the promise of predictability and the clear procedural and substantive rules protecting U.S. investors/creditors have led to the extraordinary success of U.S. capital markets over the last seven decades. Building on Congressionally inspired protections passed during the 1930s—namely the Securities Exchange Act of 1934 and the Trust Indenture Act of 1939—America has developed the world's most efficient capital market system, one that has benefited not only U.S. companies and investors, but also foreign companies desiring to raise capital as economically as possible. Indirectly, this has benefited foreign nations and citizens where these foreign issuers of debt are domiciled.

When U.S. companies face severe and enduring economic hardship, U.S. courts have observed that these fundamental rules of the game might change. The U.S. Bankruptcy Code also reflects these changes.[48] But the U.S. Code still accords creditors a valuable set of substantive and procedural protections in their place, including three worthy of brief mention here. First, the U.S. Code promotes the importance of uniformity and predictability, which has as its corollary, a built-in suspicion of retroactively-applied changes in law.[49] Second, the U.S. Code provides procedural due process, mandating a system of full disclosure; the ability of creditors to participate in the process of restructuring; the existence of a neutral and independent third party with fiduciary duties to all creditors, be it a committee, trustee, or debtor-in-possession; and includes the promise of a reviewing court, before which

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Eaglet Corp. Ltd. v. Banco Central de Nicaragua, 839 F. Supp. 232, 236 n.7 (S.D.N.Y. 1993), *aff'd*, 23 F.3d 641 (2d Cir. 1994) (rejecting argument that federal "statutory mandate" is outweighed by comity).

48. *See, e.g.*, 11 U.S.C. § 365(a)-(b)(1) (treating executory contracts); § 362 (staying creditor actions).

49. *See In re* Hourani, 180 B.R. at 58; Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039, 1048 (2d Cir. 1982) ("Uniformity in interpretation is important to the efficiency of capital markets. . .[T]he creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets"). For an example of U.S. judicial resistance to retroactive application of law, see U.S. v. Security Industrial Bank, 459 U.S. 70 (1982) (construing provision of the bankruptcy code to apply prospectively only where retroactive application to liens predating the provision would involve court in addressing constitutional questions of takings).

creditors may bring a complaint, and are entitled to broad and meaningful rights to obtain discovery, object, cross-examine, and appeal. Also, unlike the Argentine system, this means a general resistance to *ex parte* communications between the debtor and the reviewing court.[50] Finally, the U.S. Code establishes certain unalterable, inalienable substantive rights. Indeed, even a majority of creditors may not impair an individual creditor's right to the return of his principal and interest, absent a Bankruptcy Court's determination that the transaction is fair. So, too, similarly-situated creditors must be treated equally and non-discriminatorily. All creditors must be shown financial projections, so that they can be in a better position to assess the debtor's position were it to claim that it cannot pay any more money. The creditors are entitled to receive at least what they would get in a liquidation, irrespective of the fact that other creditors, for whatever reason, are willing to take less.[51]

In the case of a U.S. company, these protections create a framework in which both debtors and creditors appreciate the rules of the game and exercise such leverage as the system gives them. However, when a foreign company invokes a wholly different set of *post hoc* rules, the complex mosaic morphs into something quite different. Does the mere fact of the debtor's foreign incorporation justify the magnitude of the changes in the rules and differences in economic results given those changed rules? Does it matter that a debtor deliberately came to U.S. to raise the funds in the first place? Does it matter how many times the foreign company promised to treat creditors just like a U.S. company would?

It does not seem unfair that a "foreign" company should find itself in a U.S. court when it agrees to be sued here, engages in activities triggering U.S. jurisdiction, deliberately avails itself of U.S. law and benefits in selling its debt in the first place. It appears that what we mean by "foreign" itself is an amorphous concept, and may have to be revised to accommodate the increased complexity of modern finance. It was easy enough to suggest that "foreign" means a company incorporated in a country outside the territorial boundaries of the United States of America. That notion may have force in the

50. *See, e.g.*, 11 U.S.C. §§ 1125, 1126(b), 1129 (2004).
51. *See, e.g.*, 11 U.S.C. §§ 1123(a)(4), 1145 (2004).

event a foreign country or its sovereign power is implicated in an insolvency or restructuring, as where, for example, foreign employees are losing their jobs, foreign assets are being sold, etc. But should meaningful distinctions be made between a corporation incorporated in, say, Delaware or New York and one incorporated in Argentina, where the company has American controlling stockholders and avails itself of the U.S. capital markets? Is it meaningful to call that company "foreign" when all that is at stake is the restructuring of debt sold to American creditors in the U.S. utilizing domestic brokers, agents, instrumentalities, and where no foreign sovereign interests are implicated?

When a company comes to the U.S. to raise debt, then invokes a foreign restructuring system when it cannot or does not wish to pay the debt, and then seeks to return to the U.S. for recognition and extinguishment of the claims of U.S. creditors, three important groups of questions thus remain. First, is this a proper use of Section 304?[52] Second, should the law permit, require, or, alternatively, condemn the practice? Would it be fair to describe the substantive and procedural protections embodied in the U.S. Bankruptcy Code as reflecting American notions of due process? When a foreign restructuring regime consistently falls short of providing these protections, can it be said nonetheless to satisfy the standard for recognition by a U.S. court under Section 304? And, finally, once the case is before an American court, should it have the authority fully to remedy a wrong to its citizens that it finds?

SHL v. Cablevision

The general factual background in *Cablevision* bears some similarity to *Multicanal*. Both cases involved attempts to stop U.S. litigation relating to out-of-court restructurings going on in Argentina. The differences bearing note relate to how the U.S. courts reacted to the federal issues raised.

Cablevision is a multi-system cable operator in Argentina. The company is owned by two U.S. entities: a Texas buy-out firm and a Colorado cable firm. As in *Multicanal*, Cablevision issued notes under indentures governed by U.S. and New York

52. *See In re* Koreag, Controle et Revision S.A., 961 F.2d 341, 348 (2d Cir. 1992) ("The purpose of a § 304 petition is to prevent the piecemeal distribution of assets in the United States").

law, including the mandatory provisions of the Trust Indenture Act.

Like Multicanal, Cablevision stopped making interest and principal payments in early 2002. Cablevision then sought to restructure its debt by using the Argentine APE in conjunction with a U.S. tender offer. As in *Multicanal*, the Cablevision tender offer promised a wholly lopsided financial restructuring whereby more than $1 billion in principal and interest would be restructured for less than $300 million in debt, while the U.S. entities controlling Cablevision had their equity share reduced minimally from 100% to 80%.

The U.S. litigation spawned by the restructuring included creditor claims based on Cablevision's alleged violation of the federal tender offer rules, and claims under the Trust Indenture Act. Litigation commenced in the federal district court in the Southern District of New York when, without notice, Cablevision sought and obtained an emergency temporary restraining order from the U.S. Bankruptcy Court, effectively halting the district court litigation. The restraining order was issued under Section 304.

At this point, the creditors sought to withdraw the matter from the Bankruptcy Court and put it back before the district court. The grounds for withdrawal arose under the mandatory and permissive withdrawal statute, 28 U.S.C. § 157(d), which provides:

> The district court shall on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.[53]

Under settled principles, withdrawal is mandatory under § 157(d) in cases "where substantial and material consideration of non-Bankruptcy Code federal statutes is necessary for the resolution of the proceeding."[54] Withdrawal is also mandatory where matters to be decided "require the bank-

53. 28 U.S.C. §157(d).
54. Shugrue v. Air Line Pilots Assoc., 922 F2d 984, 995 (2d Cir. 1990).

ruptcy court to substantially interpret federal statutes which affect interstate commerce."[55]

After an expedited briefing, the District Court withdrew the matter both on mandatory and permissive grounds. The Court reasoned that the creditors claimed that the foreign APE violated the federal tender offer rules and the Trust Indenture Act. Unlike the decision in *Multicanal*, where the Bankruptcy Court determined as a matter of law that no conflict existed, the District Court in *Cablevision* ruled that:

> The very existence of a dispute as to whether the rights of [the creditor] under the [TIA] and Williams Act supersedes § 304 or whether the Bankruptcy Code overrides the [TIA], regardless of the ultimate resolution of such dispute, mandates withdrawal.[56]

As the District Court reasoned, to determine whether non-bankruptcy federal statutes take precedence would itself require substantial and material consideration of non-bankruptcy federal statutes, including the TIA and Williams Act, as well as "the interaction of those statutes with the Bankruptcy Code."[57]

Comment on Cablevision

Prior to *Cablevision*, a Section 304 case had never beene withdrawn from the bankruptcy court. Nonetheless, the current dispute concerning the role of U.S. federal statutes and the rights of U.S. citizens in the face of foreign restructuring mechanisms would appear to be one satisfying the mandatory withdrawal requirement. In the context of our discussion of comity, the question is whether *Multicanal* and *Cablevision* are reconcilable. *Multicanal*, as a matter of law, held that the existence of U.S. federal rights did not change the analysis under Section 304 at all. *Cablevision*, on the other hand, stands for the premise that courts need to determine the prioritization of the TIA, the federal tender offer rules, and Section 304.

A discussion of one more case will, by contrast, help guide this analysis.

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55. City of New York v. Exxon Corp., 932 F.2d 1020, 1026 (2d Cir. 1991).

56. *In re* Cablevision S.A., No. 04 Cov. 7278, 2004 WL 2274793, at *4 (S.D.N.Y. Oct. 6, 2004).

57. *Id.* at 4.

Compañia Embotelladora del Pacifico, S.A. ("CEPSA") v. Pepsi Cola Company

The third recent example of court's exercise of comity comes from a Summary Order of the United States Court of Appeals for the Second Circuit, which disagreed with in part and approved in part a decision of the Southern District of New York. CEPSA, a Peruvian entity, held a bottling appointment for Pepsi-Cola products for approximately 50 years. Its failure to perform under its contract led to the termination of the bottling appointment. After CEPSA went into insolvency and liquidation under Peruvian law, both civil and criminal actions commenced in Peru. CEPSA also commenced a $300 million lawsuit against PepsiCo in the Southern District of New York.

PepsiCo moved for dismissal, and the motion was granted by the district court based on its determinations of Peruvian law. Interestingly, the District Court relied extensively on affidavits of foreign law submitted pursuant to Fed. R. Civ. P. 44.1, which permits matters of foreign law to be adjudicated as questions of law based even on otherwise inadmissible hearsay. Based on the use of Rule 44.1, the parties were able to obtain a determination of foreign law, without having to go through extensive and costly discovery before a motion for summary judgment was ripe.

The District Court held for PepsiCo on two issues: first, that as a matter of Peruvian law, the liquidator did not have authority to commence the lawsuit, and, second, as a practical matter, CEPSA was not authorized to bring the action since a Special Creditors Committee of the full committee of creditors (called a *Junta*) in Peru had disapproved of the lawsuit's continuation. That is, the court found that CEPSA appeared to be on a "vendetta" against PepsiCo, and that the lawsuit was not controlled by the creditors that then owned the company, but rather by former management.[58]

On appeal, the Second Circuit disagreed with the District Court's legal determination concerning the authority of the liquidator, reviewing that issue *de novo*. The Second Circuit supported the District Court's practical approach requiring a

58. *Compania Embotelladora Del Pacifico, S.A.*, 249 F. Supp. 2d 339 (S.D.N.Y. 2003).

determination of whether CEPSA in fact had any authority from the *Junta* to commence and continue the lawsuit based on Peruvian legal and regulatory principles. The Second Circuit reaffirmed that it has "repeatedly noted the importance of extending comity to foreign bankruptcy proceedings."[59] As a result, it was the Court's view that more information was needed to decide "the ultimate question. . .whether the creditors of CEPSA, in whose interest the liquidation proceedings are being conducted and this action was brought, have validly authorized the continuation of this litigation."[60] In order "to assure ourselves that this lawsuit is being maintained by CEPSA with the approval of CEPSA's creditors, the Junta itself. . .must, within a short but reasonable period of time to be established by the district court, formally give its approval in order for it to continue this lawsuit."[61]

Comment on CEPSA

Unlike *Multicanal* and *Cablevision, CEPSA* did not involve federal issues. There were no U.S. federal rights at stake in the matters presented for determination. There was, however, the specter of abuse by a foreign company coming to the United States without authority and pursuing major litigation against a U.S. entity.

In *CEPSA*, the exercise of comity led the Second Circuit to announcing that it would dismiss a U.S. lawsuit that was contrary to foreign law and principles, and permit a lawsuit if it was supported by these laws and principles.

III.
CONCLUSION

An analysis of these three recent cases gives some indication of how courts are considering the issue of deference, or comity, to foreign "proceedings", in particular foreign restructurings. Two of the cases address matters of first impression. *Multicanal* is based on a reading of Section 304 that gives no additional weight to the federal rights embodied in the Trust

59. *Compania Embotelladora Del Pacifico, S.A.*, No. 03-7979, 2004 U.S. App. LEXIS 20115, at *4 (2d Cir. 2004) (*quoting* Finanz AG Zurich v. Banco Economico S.A., 192 F.3d 240, 246 (2d Cir. 1999)).

60. *Id.*

61. *Id.*

Indenture Act and requires U.S. recognition of foreign restructurings that provide fewer substantive and procedural creditor protections than a U.S. company would have to provide. Yet the decision also stands for the propositions that there are limits to what a foreign company can do and that there remain some protections that U.S. creditors can insist on, even in restructuring taking place off of American soil. *Cablevision* determined that the issue of priority between the Trust Indenture Act and tender offer rules on the one hand and the comity inherent in Section 304 on the other hand do in fact present significant and unanswered questions of federal law. And *CEPSA* envisaged proof of foreign law and the practice of a foreign regime to act as the gate to whether a foreign litigant could have access to U.S. court.

As the law develops further, important policy questions will have to be answered, most probably by American federal courts. If it becomes easier for foreign companies having issued U.S. debt to U.S. creditors to restructure their obligations using foreign regimes, and if U.S. creditors cannot rely on the promises made in the indentures and notes issued by these foreign companies, the markets for foreign-issuer U.S. securities as well as domestic issuer debt will undoubtedly be affected.