AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

Feature

By Richard Levin and Carl N. Wedoff

What Did You Expect? Insolvency Forum Clauses

Richard Levin
Jenner & Block, LLP
New York

Carl N. Wedoff
Jenner & Block, LLP
New York

Richard Levin, a member of the ABI Commission to Study the Reform of Chapter 11, is co-chair of Jenner & Block, LLP's Restructuring and Bankruptcy Department in New York and co-authored the 1978 U.S. Bankruptcy Code. Carl Wedoff is an associate in the same office.

In today's global economy, many companies on the brink of insolvency have options when choosing an insolvency forum.[1] A number of jurisdictions have relaxed their requirements for initiating an insolvency proceeding; courts may exercise jurisdiction over an insolvency proceeding based on connections to the forum as attenuated as a bank account[2] or contractual choice-of-law and jurisdiction provision.[3]

If a debtor satisfies the forum's jurisdictional requirements, U.S. courts traditionally defer to a debtor's choice-of-insolvency forum, whether or not that forum is in the U.S. Foreign entities are eligible to file "main" bankruptcy cases in the U.S. under the Bankruptcy Code,[4] as long as the Code's jurisdiction and eligibility criteria are satisfied.

However, in some instances, a debtor's satisfaction of minimum jurisdictional and eligibility requirements are not enough. When debtors and creditors initiate parallel insolvency proceedings in the U.S. and a foreign court, courts in both jurisdictions must determine the more-appropriate forum to hear the "main" insolvency case. In the U.S., this inquiry often turns on equitable factors. In *In re Northshore Mainland Services Inc.*,[5] a recent case from the U.S. Bankruptcy Court for the District of Delaware, the court was asked to dismiss voluntary chapter 11 cases where parallel insolvency proceedings had been initiated in The Bahamas. Finding that most stakeholders would have expected proceedings to be initiated in The Bahamas, the bankruptcy court dismissed the Bahamian debtors' otherwise-proper chapter 11 cases in favor of the Bahamian proceedings.

To limit the risk incurred by dueling insolvency proceedings, parties should consider including "insolvency-forum" provisions in their agreements. Such provisions, while not dispositive, would signal to reviewing courts the parties' expectations regarding an appropriate insolvency forum. Unlike two-party jurisdiction or choice-of-law clauses, insolvency-forum provisions would specifically take into account the parties' expectations regarding insolvency.

The *Northshore* Decision

Northshore illustrates the uncertainty facing courts that have been asked to exercise jurisdiction over parallel insolvency proceedings. The Delaware bankruptcy court was asked to consider a truly international case, with parties and contracts from a number of different countries, but no express indication of the parties' expectations with respect to a proper insolvency forum.

The *Northshore* debtors were formed to own, construct and manage a massive resort complex in The Bahamas.[6] One of the 15 debtors was a Delaware limited liability company (LLC); the rest were Bahamian corporations. They contracted with a Chinese construction firm to build the resort and primarily with Chinese lenders to finance the project. New York law governed the construction contracts, and the parties consented to New York jurisdiction and venue to resolve disputes. English law governed the credit

1 For purposes of this article, "insolvency" refers to insolvency, restructuring, debt-adjustment, bankruptcy or similar proceedings.

2 *See In re Aerovias Nacionales de Colombia SA*, 303 B.R. 1, 8 (Bankr. S.D.N.Y. 2003) (§ 109(a) of Bankruptcy Code permits entities with "property" in U.S. to file for chapter 11; foreign corporations and individuals have satisfied property requirement with "minimal" showing — "a few thousand dollars in a bank account and the unearned portions of retainers provided to local counsel" (citing *In re Global Ocean Carriers Ltd.*, 251 B.R. 31 (Bankr. D. Del. 2000))).

3 *See Primacom Holding GmbH and others v. Credit Agricole and others*, [2012] EWHC 164 (Ch) (English High Court sanctioned scheme of arrangement of German company that had few (if any) creditors domiciled in England and Wales, finding sufficient connection to England and Wales because intercreditor agreement and finance documents were governed by English law and parties had submitted to English courts' jurisdiction).

4 11 U.S.C. §§ 101-1532.

5 537 B.R. 192 (Bankr. D. Del. 2015).

6 At $3.5 billion and 3.3 million square feet, the resort was planned to be one of the largest projects of its kind in the Western Hemisphere, including four hotels, a casino, a convention center and an 18-hole golf course, among other amenities. Once completed, the resort was expected to employ nearly 1 percent of the population of The Bahamas, with payroll in excess of $130 million, representing 12 percent of the country's gross-domestic product. *Id.* at 196.

agreement, and the parties consented to English jurisdiction and venue. Bahamian law governed the security interests.

Construction was delayed, disputes arose, and the debtors ran short of cash. After unsuccessful attempts to negotiate a consensual resolution, the Bahamian debtors opened bank accounts in New York. Ten days later, all of the debtors filed chapter 11 cases in Delaware, basing the venue for the cases on first filing the affiliate Delaware LLC's case. Shortly thereafter, they filed a petition in the Bahamian Supreme Court for recognition of the Delaware chapter 11 cases and an action against the construction company in London.

Three weeks later, the Bahamian attorney general filed winding-up petitions against the Bahamian debtors in the Bahamian Supreme Court. The Bahamian Supreme Court denied the recognition petitions and refused to enforce the chapter 11 automatic stay in The Bahamas. As the court explained:

> Where (a) the place of incorporation and domicile of the corporations; (b) the center of main interest or principal place of business; (c) the residence or domicile of the bulk of the creditors; and (d) location of the assets are in The Bahamas there can be no reason to subordinate local proceedings to proceedings in a locale with such limited connection to the subject companies.... The only insolvency proceedings, which can give true effect to the principal of modified universality, would be a unitary insolvency proceeding in The Bahamas.[7]

The Bahamian court appointed provisional liquidators to promote a plan of compromise among the parties. The construction firm and secured lender then moved to dismiss the chapter 11 cases, arguing, among other things, that (1) the debtors were not eligible for chapter 11 relief in the U.S. because all but one of the debtor corporations were organized under Bahamian law with minimal U.S. assets; (2) the debtors filed the cases in bad faith to avoid insolvency proceedings in The Bahamas; and (3) the best interests of the debtors and creditors would be better served by dismissal of the cases so that the parties could proceed with insolvency proceedings in The Bahamas, which the creditors contended was the venue with the most significant contacts and interests in the resort project, and thus, most stakeholders would expect Bahamian law to apply to any winding-up proceedings.

The Delaware bankruptcy court rejected the creditors' first two arguments. First, it determined that the debtors were eligible to file in the U.S. Although several debtors' eligibility was premised in part on U.S. bank accounts opened in the weeks leading up to the bankruptcy filing, the court explained that the relevant date for making a determination of eligibility was the petition date.

The court also found that the debtors filed their chapter 11 petitions in good faith. To determine whether the debtors filed the chapter 11 petitions in good faith, the court evaluated whether the petitions served a valid bankruptcy purpose, and whether the petitions were filed simply to obtain a tactical litigation advantage.[8] Since the debtors were "on the edge of a financial precipice" prior to bankruptcy, the filings served a valid bankruptcy purpose.[9] In addition, since the debtors contemplated using bankruptcy to reorganize their financial affairs and complete construction of the resort, which was in the best interests of all stakeholders, the court determined that they did not file the chapter 11 petitions simply to gain a tactical litigation advantage. Thus, the debtors were eligible to file for chapter 11 and had not filed in bad faith.

The Delaware court then considered the creditors' third argument: The best interests of the debtors and creditors would be better served by dismissal of these cases. Section 305(a) of the Bankruptcy Code permits dismissal if "the interests of creditors and the debtor would be better served by such dismissal."[10] Courts consider a range of nonexclusive factors to make this determination.[11]

The phenomenon of parallel insolvency proceedings is likely to grow in the coming years as the global economy becomes more interconnected and courts continue to liberalize insolvency regimes.

The creditors focused on the "legitimate expectations" of the creditor base. A majority of the parties-in-interest were either incorporated in or located in The Bahamas. In addition, most of the money invested in the resort was "put at risk" under Bahamian and other non-U.S. laws, and the parties had legitimately expected that Bahamian law would apply.[12]

The debtors strenuously objected and pointed out that much of the creditor base was not Bahamian, including the movants, which were Chinese entities. The debtors also pointed to choice-of-law and venue provisions selecting New York, Texas, English or British Columbia law.

The Delaware court determined that it should abstain and recognized that it was faced with a "truly ... international case" with parties from Delaware to Beijing to Nassau, but found that the "central focus of this proceeding" was the unfinished resort in The Bahamas.[13] It determined that "many stakeholders" in the resort project would expect that any insolvency proceedings would likely take place in The Bahamas, the location of the project. The court "perceive[d] no reason — and [was not] presented with any evidence — that the parties expected that any 'main' insolvency proceeding would take place in the [U.S.]."[14] The court added an important caveat: "This is not to say that parties, such as the Movants, would not expect to be subject to jurisdiction in another forum for disputes concerning contracts with provisions submitting to venue in the [U.S.] or elsewhere":[15]

7 *Id.* at 198 (quoting Bahamian Court Ruling ¶¶ 62-63, Aug. 25, 2015, ECF No. 435-1).
8 *Id.* at 202-03 (citing *In re 15375 Mem'l Corp. v. Bepco LP*, 589 F.3d 605, 618 (3d Cir. 2009)).
9 *Id.* at 203.
10 11 U.S.C. § 305(a).
11 The nonexclusive factors include "(1) the economy and efficiency of administration; (2) whether another forum is available to protect the interests of both parties or there is already a pending proceeding in state court; (3) whether federal proceedings are necessary to reach a just and equitable solution; (4) whether there is an alternative means of achieving an equitable distribution of assets; (5) whether the debtor and creditors are able to work out a less-expensive out-of-court arrangement [that] better serves all interests in the case; (6) whether a non-federal insolvency has proceeded so far in those proceedings that it would be costly and time-consuming to start afresh with the federal bankruptcy process; and (7) the purpose for which bankruptcy jurisdiction has been sought." *Northshore*, 537 B.R. at 203-04 (citing *In re AMC Investors LLC*, 406 B.R. 478, 488 (Bankr. D. Del. 2009)).
12 *Id.* at 204.
13 *Id.* at 205.
14 *Id.* at 206.
15 *Id.* at 206, n.10.

> In business transactions, particularly now in today's global economy, the parties, as one goal, seek certainty. Expectations of various factors — including the expectations surrounding the question of where ultimately disputes will be resolved — are important, should be respected and [should] not [be] disrupted unless a greater good is to be accomplished.[16]

Thus, it dismissed the chapter 11 cases of the 14 Bahamian debtors.[17] However, the court did not dismiss the Delaware LLC's case. Since the company was incorporated and conducting business in the U.S., its counterparties expected its "financial difficulties" to be addressed in a proceeding in the U.S.

Insolvency-Forum Clause

In limiting the effect of the parties' contractual venue provisions, the Delaware court recognized that insolvency is different than other disputes. As one commentator noted:

> [A] freely negotiated forum-selection clause in an international contract unaffected by fraud, undue influence or one-sided bargaining power should be given full effect, absent a strong showing that it should be set aside. However, in the insolvency context, such provisions often must yield to considerations of comity. After an insolvency proceeding has been commenced, comity and the interests of all creditors may require that the rights of the parties be determined by the insolvency court rather than in the venue chosen by the parties.[18]

However, the *Northshore* court did not foreclose the possibility that a contractual-venue provision could be effective in the insolvency context; it simply held that a standard two-party venue provision did not constitute evidence of the parties' expectations regarding insolvency venue.[19] Parties should consider including the following language into their credit agreements that states their expectations regarding choice of insolvency forum:

> The Parties intend that any insolvency, restructuring, debt adjustment, or bankruptcy proceeding for the Borrower ("Insolvency Proceeding") shall be [filed/commenced/opened] only in the courts of _____. The Parties agree that the courts of _____ are the most appropriate and convenient courts to consider an Insolvency Proceeding, expect that any Insolvency Proceeding will be [filed/commenced/opened] solely in _____, and accordingly agree that they will not argue to the contrary in any Insolvency Proceeding [filed/commenced/opened] in such jurisdiction. Each of the Parties consents to the jurisdiction of such courts and agrees not to challenge jurisdiction or venue or to seek dismissal of an Insolvency Proceeding in such courts on the ground that the Insolvency Proceeding should proceed in a different jurisdiction.

In cases like *Northshore*, where courts are faced with parallel insolvency proceedings and wish to consider the parties' expectations, an insolvency-forum clause would constitute strong evidence. While the parties' expectations might not be dispositive because an insolvency case typically involves more creditors and other parties than the parties to the principal financing or construction agreements, they might also weigh heavily on a court's decision to abstain from hearing a case filed in an unexpected forum where the principal dispute in the case is between parties to the insolvency-forum clause. At a minimum, this language might serve as a helpful starting point to frame the court's analysis.

One concern with an insolvency-forum clause is the parties' asymmetric incentives. At first blush, such a clause would appear to be more attractive to creditors. Since debtors generally choose where to file an insolvency proceeding — and because their options are greater than ever — creditors would seem to have more to gain not only in the predictability such a clause might offer, but also in selecting a forum that might be considered more friendly to creditors. A borrower would seem to have little reason to limit its options, particularly a borrower who does not foresee any financial turbulence on the horizon. Although a distressed borrower might understand the comparative advantages of different insolvency regimes, a healthy company might not.

Nevertheless, an insolvency-forum clause could help debtors as well. The clause would provide a borrower some defense against a premature involuntary proceeding in an inconvenient forum. A distressed debtor attempting a consensual workout could point to the insolvency-forum clause to challenge an involuntary proceeding in a nonspecified jurisdiction, or at least could use the provision as an argument to forestall such a filing.

The limitation on filing would also not be absolute; a court would be less likely to enforce an insolvency-forum clause absent a parallel insolvency proceeding. Thus, if an agreement specifies England as an insolvency forum and a debtor files its case in Delaware, the Delaware court might not abstain unless and until the parties initiate an English proceeding.

Conclusion

The phenomenon of parallel insolvency proceedings is likely to grow in the coming years as the global economy becomes more interconnected and courts continue to liberalize insolvency regimes. Including an insolvency-forum clause is a simple tool that could aid courts in understanding the parties' expectations and increasing predictability when courts must choose an appropriate forum. abi

16 *Id.* at 206.

17 *Id.* The Delaware court also determined that abstention was appropriate under general principles of comity. "The proceedings that have occurred to date in the Bahamian Supreme Court demonstrate that the Debtors are being treated fairly and impartially. Although there are clear differences between the Bahamian insolvency proceedings and the United States' chapter 11 process, there has been no evidence that the Bahamian laws contravene the public policy of the United States." *Id.* at 207-08.

18 Samuel L. Bufford, Louise DeCarl Adler, Sidney B. Brooks and Marcia S. Krieger, "International Insolvency," Federal Judicial Center (2001), at 43 (footnotes omitted), *available at* www.fjc.gov/public/pdf.nsf/lookup/IntlInso.pdf/$file/IntlInso.pdf (last visited Feb. 29, 2016).

19 Another difficulty with the *Northshore* venue and choice-of-law provisions may have been their inconsistency. The debtors simply argued that the contracts chose law and venue other than The Bahamas. However, because the contracts variously selected New York, Texas, England and British Columbia, they did not — as a whole — present a plausible alternative to The Bahamas and certainly did not confirm that the parties expected that the Delaware bankruptcy court would be the insolvency forum.

Reprinted with permission from the ABI Journal, Vol. XXXV, No. 4, April 2016.