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Client Alert: Cross-Border Insolvency: English High Court Ruling Impacts Delaware Chapter 11 Case

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INTRODUCTION

A ruling by the English High Court in late 2018 impacted a U.S. Chapter 11 proceeding in Delaware. The case involved Videology Limited, an English and Wales Company (“Limited”) and a wholly-owned subsidiary of Videology Inc., a Baltimore-based Delaware corporation. The Videology Group including Limited developed and sold video advertising technology. The Videology Group filed Chapter 11 in Delaware. The English Court ruling refused to grant Chapter 11 debtor Limited’s request to automatically enjoin individual or collective creditor actions against Limited in the UK. Rather, the English Court compelled the Chapter 11 debtor to prove grounds for the injunction against creditors.

THIS IS IMPORTANT BECAUSE ...

In a Chapter 11 case of a U.S. company group that includes its foreign subsidiaries, the ability to enjoin creditor action against the foreign subsidiaries or their assets outside the U.S. is essential to preserve the value of the global business enterprise for a successful restructuring or Section 363 sale of assets. The ruling by the English Court makes this goal less clear.

CROSS-BORDER INSOLVENCY: A STEP BACK

A company doing business globally will inevitably encounter issues with its foreign customers or counterparties in the supply chain. Such issues include a foreign insolvency proceeding of such customer or counter-party in their “home” country. Since there is no uniform global insolvency law, the outcome for the company is primarily dependent on the insolvency law in the foreign jurisdiction.

Global companies are likely to have assets, liabilities, contracts, property, or employees throughout the world. If such a company initiates an insolvency proceeding in its home country, it is likely the company will also need to address issues in other countries. In recognition of this, and to promote comity and

“universalism” among countries, in 1997, the United Nations Commission on International Trade Law (UNCITRAL) published its Model Law on Cross-Border Insolvency. To date, 44 countries have adopted the Model Law, including the U.S., which adopted the Model Law in 2005 as Chapter 15. The UK’s version of the Model Law is The Cross-Border Insolvency Regulations 2006 (the CBIR).

A principal tenet of the Model Law is for each adopting country to recognize and cooperate with insolvency proceedings in a home country. In Videology, the home country insolvency proceeding was the Delaware Chapter 11 proceeding. As part of its Chapter 11 restructuring, Videology sought to simultaneously protect Limited, its UK subsidiary, from individual or collective creditor action against Limited or its assets in the UK.

To achieve the injunction, Limited followed the normal procedure to open an ancillary insolvency proceeding for Limited in the UK by filing a petition for recognition of the Chapter 11 case as a “foreign main proceeding”, defined in the Model Law and CBIR as a proceeding by a debtor in the jurisdiction where its “center of main interest” (COMI) is located. Had the UK Court accepted that the U.S. was Limited’s COMI, the Model Law automatically grants a broad injunction against creditor action. No doubt that was the outcome Videology expected.

However, the English Court refused to recognize the Chapter 11 case as a foreign main proceeding, after concluding that Limited’s COMI was not in the U.S., rather it was in the UK. Under the Model Law, and the CBIR, there is a rebuttable presumption that COMI is where a company is registered or incorporated, which in this case was England and Wales. The English Court found that Videology did not rebut that presumption even though it showed that Limited was 100% owned and controlled by its U.S. parent, the sole director of Limited was the co-founder and CEO of the U.S. parent, all the software used by Limited (by license) is owned by the U.S. parent, and that Limited was “essentially an American company, run by American management, based in America.”

Following the cases of Eurofood IFSC Ltd (ECJ 2006) and Interedil Srl v Fallimento Interedil Srl (ECJ 2011), the English Court rejected Videology’s position and concluded Limited’s COMI was in the UK based in part because “in addition to being the place of its registered office, the UK is where the Company’s trading premises and staff are located, where its customer and creditor relationships are established, where it administers its relations with its trade creditors on a day-to-day basis using those premises and local staff, and where its main assets...are located.”

A DISTINCTION WITH A DIFFERENCE

Despite its conclusion, the English Court nevertheless granted Videology substantially similar relief: an injunction against creditor action. Specifically, rather than automatic application of an injunction, the Court exercised its discretion to enjoin individual and collective creditor action against Limited, after considering factual support from Videology.

Even though Limited’s COMI was not in the U.S., the English Court concluded that Limited had an “establishment” in the U.S., allowing the Court to recognize the Chapter 11 proceeding of Limited as a “foreign non-main proceeding.” An ancillary insolvency proceeding in the UK based on a “foreign non-main proceeding” does not automatically enjoin creditors as it would in the case of a foreign main proceeding. Rather, the UK Court retains the discretion to enjoin creditors, or not, based on the facts and circumstances of the case.

The English Court took note that the Chapter 11 proceeding was in the advanced stages of a Section 363 sale, including the assets of Limited, which would result in the disposition of the Group’s assets and distribute the proceeds and assets of the Group to its creditors.

Appropriately noting its duty to protect the interests of creditors of Great Britain, the Court needed to determine whether the U.S. Section 363 sale would do so. Ultimately, the Court was satisfied that the Section 363 sale would fairly distribute the proceeds of sale amongst the Group's creditors, who would have a meaningful voice and role in the U.S. Section 363 sale process. By declining recognition of Limited's U.S. Chapter 11 proceeding as a foreign main proceeding, the Court reserved for itself the discretion and ability to evaluate whether the Section 363 sale was fair to the creditors located in Great Britain. Section 363 sales can occur at warp speed, are often engineered by pre-petition lenders as an exit strategy, and do not always protect the interests of all stakeholders. Particularly vulnerable are foreign creditors.

TAKEAWAYS

- The English Court ruling should encourage U.S. Chapter 11 debtors to address the interests of stakeholders worldwide in pursuing its goals and strategies in the Chapter 11 case, such as a Section 363 sale, which is the intent of the Model Law.
- The factual analysis by the English Court provides guidance to restructuring companies on when recognition of ancillary insolvency proceedings in the UK will be based on a foreign main proceeding or a foreign non-main proceeding. This in turn impacts whether restructuring companies will obtain the relief needed to effectuate their business goals.
- The ruling also provides a roadmap for restructuring companies (and their lenders) on the requirements to present foreign recognition petitions that will succeed initially, which will avoid risks and costs to the process and their business objectives.
- The ruling likewise provides creditors of restructuring companies, especially foreign creditors, a roadmap to oppose petitions for recognition, which could prohibit or limit creditors from pursuing claims against their contract counter-parties. Though the English Court determined creditor injunctions were appropriate in this case, under different factual circumstances, it may not enjoin creditors.

GLOBAL IMPLICATIONS

The Videology case happened to involve a restructuring in the U.S. pursuant to Chapter 11 which included its UK subsidiary. The issues addressed by the English Court's ruling were based on the CBIR and the Model Law. Because the Model Law has been adopted by 44 countries to date, the same issues could arise in many other jurisdictions. The thorough analysis of the English Court in Videology could be guidance for courts in other Model Law jurisdictions in considering similar issues.

We hope you found this useful and informative. Please contact us if you have any questions about this or any other matter.

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