STAY CURRENT
A Client Alert from Paul Hastings

PAUL HASTINGS

April 2012

This Trend May Not Be Your Friend: Could Catalyst Paper Spawn a New Breed of Chapter 15 Cases for U.S. Debtors?

I. Introduction

The Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") in *In re Catalyst Paper Corp., et al.* recently granted recognition of the debtors' proceedings under Canada's Companies' Creditors Arrangement Act (the "CCAA Proceeding") as a foreign main proceeding under chapter 15 of the Bankruptcy Code with respect to the Canadian parent company as well as its Canadian and U.S. debtor subsidiaries.[1] As part of the recognition order, the Bankruptcy Court found that the center of main interest ("COMI") of all debtors, including the subsidiaries incorporated under U.S. law, was located in Canada. The U.S. subsidiaries were thus able to obtain benefits under the Bankruptcy Code (including the automatic stay of enforcement against their U.S. assets), while avoiding the cost and some of the hallmark creditor protections of chapter 11. Practically, this decision means that the legal entitlements of Catalyst's U.S. creditors *vis-à-vis* the U.S. debtor subsidiaries will generally[2] be governed by the CCAA, the Canadian insolvency statute used in that case.[3]

Although the Bankruptcy Court may have correctly concluded that each of the debtors' COMI was in Canada – after all, the group's headquarters and senior management, *i.e.*, its nerve center, were located there – the recognition order may be a precursor of things to come. Notably, the U.S. subsidiaries had significant operations in the United States, were guarantors of secured and unsecured notes issued by their Canadian parent under New York law-governed indentures (which also included a New York forum selection clause), and granted liens on their U.S. assets to secure these guarantees. On these facts, a U.S. creditor may be somewhat surprised to hear that a bankruptcy court would find that a U.S. debtor's COMI could lie anywhere other than the United States. Moreover, the Bankruptcy Court recognized foreign main status as to the U.S. subsidiaries over the objection of a significant creditor constituency – here, a group of unsecured noteholders. Prior recognition orders involving U.S. subsidiaries typically either (i) granted only foreign *nonmain* status (thus not reaching the issue whether the COMI of the U.S. subsidiaries is located abroad) or (ii) granted foreign main status in the context of a consensual restructuring where recognition was ultimately not contested. The *Catalyst Paper* decision opens the door for similar chapter 15 petitions by U.S. debtors.

II. A Brief Overview of Chapter 15

The overarching purpose of chapter 15 of the Bankruptcy Code is to provide an effective mechanism for dealing with cross-border insolvencies.[4] To accomplish this goal, a foreign debtor may commence an ancillary proceeding in the U.S. under chapter 15 and thereby obtain certain of the protections available to chapter 11 debtors. Chapter 15 essentially operates in two stages: (i) recognition of the

foreign insolvency proceeding as a main or nonmain proceeding; and (ii) once the proceeding is recognized, affording certain relief available under the Bankruptcy Code to the foreign debtor.

At the first stage, a foreign representative of a debtor in a foreign proceeding files a chapter 15 petition in a U.S. bankruptcy court and seeks recognition of that foreign proceeding as either a foreign main proceeding or a foreign nonmain proceeding.[5] A foreign main proceeding is a proceeding pending in the country of the debtor's COMI.[6] A foreign nonmain proceeding is a proceeding pending in the country where the debtor has an establishment, *i.e.*, a place where the debtor carries out nontransitory economic activity.[7]

While the Bankruptcy Code does not define COMI, it provides that "[i]n the absence of evidence to the contrary" a corporate debtor's registered office is presumptively its COMI.[8] This presumption is rebuttable, and courts have looked to various factors to determine a debtor's COMI, including: (i) the location of the debtor's headquarters; (ii) the location of those who actually manage the debtor; (iii) the location of the debtor's primary assets; (iv) the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the proceeding; and/or (v) the jurisdiction whose law would apply to most disputes.[9] Importantly, COMI is located in the place where the debtor "conduct[s] the administration of [its] interests on a regular basis and is therefore ascertainable by third parties."[10] Thus, in effect, courts will look to the debtor's administrative "nerve center."[11]

At the second stage, the bankruptcy court will determine what relief will be afforded to the debtor in the foreign proceeding. Importantly, awarding foreign main status will trigger certain automatic relief, including, most significantly, the automatic stay under section 362 of the Bankruptcy Code with respect to the debtor and its property located within the territorial jurisdiction of the United States.[12] In addition, the bankruptcy court may grant any additional relief that is available to a trustee under the Bankruptcy Code, with certain limited exceptions (which include relief under the avoidance provisions in sections 547 and 548 of the Bankruptcy Code).[13] In the case of a foreign nonmain proceeding, recognition does not trigger any automatic relief; however, the bankruptcy court has discretion to grant any relief available to the trustee under the Bankruptcy Code (again, with certain limited exceptions).

Importantly, given that a chapter 15 proceeding is in the nature of an ancillary proceeding, many of the creditor protections in chapter 11 do not apply. For one, there will be no plan protections under section 1129, which can be significant. For example, under Canada's CCAA there is no cramdown of a non-accepting class (which may not be attractive for other accepting classes), and under Mexican law an impaired accepting class apparently can be comprised of intercompany claims (although that later point is now hotly contested in U.S. courts).[14] Moreover, a U.S. bankruptcy court will not subject third-party releases granted in foreign proceedings to the same exacting scrutiny as under U.S. bankruptcy law; rather, such third-party releases will be enforced as long as they do not fall within the admittedly narrow public policy exception.[15] Furthermore, many foreign insolvency statutes do not provide for the appointment of a creditors' committee to represent the interests of unsecured creditors to investigate the debtor's affairs and prepetition transactions. Nor does chapter 15 permit the avoidance of prepetition transfers, and therefore creditors need to rely on avoidance remedies (if any) provided in the foreign insolvency statute.[16] While the relief granted as part of the recognition can be tailored by the bankruptcy court, as a general matter, many of the debtors' post-petition activities, including first-day relief, DIP financing, and the assumption and assignment of contracts, will likely occur beyond the supervision of the U.S. bankruptcy court.

III. The *Catalyst Paper* Recognition Order

Catalyst Paper is one of the largest producers of mechanical printing paper in western North America. The group is headquartered in Richmond B.C., Canada, and has operations throughout British Columbia as well as in Arizona (including a paper mill and a short-line railway). Catalyst Paper's principal debt obligations are (i) senior secured notes with a principal amount of approximately US$390 million, (ii) senior unsecured notes with a principal amount of US$250 million, and (iii) a revolving credit facility for up to CAD$175 million. The notes were issued by the Canadian parent Catalyst Paper Corporation and are guaranteed by certain of its Canadian and U.S. subsidiaries. The notes were issued pursuant to indentures that are governed by New York law and that also include New York forum selection clauses.

Faced with declining revenues and EBITDA, on January 31, 2012, Catalyst Paper Corp. and its Canadian and U.S. subsidiaries (collectively, the "Debtors") commenced the CCAA Proceeding before the Supreme Court of British Columbia, Canada (the "Canadian Court").[17] The Debtors also filed chapter 15 petitions with the Bankruptcy Court and moved for recognition of the CCAA Proceeding as a foreign main proceeding with respect to all Debtors, or, in the alternative, as a foreign main proceeding as to the Canadian Debtors and as foreign nonmain proceeding as to the U.S. Debtors. As part of its recognition motion, the Debtors also requested, and obtained, certain provisional relief until the bankruptcy court issues a final ruling on recognition. Shortly thereafter, the Debtors also requested that the bankruptcy court grant provisional relief enforcing and giving effect in the United States to the Canadian court's approval of $175 million in post-petition financing and related charges on the Debtors' property. The bankruptcy court granted the requested relief on February 8, 2012 on a provisional basis. At the request of the secured noteholders, the provisional order specifically preserved the rights of the secured noteholders to request adequate protection.

Subsequently, creditors holding 52% of the unsecured notes (the "Objecting Noteholders") objected to the recognition of the CCAA Proceedings as either a foreign main or foreign nonmain proceeding. The Objecting Noteholders argued that the CCAA Proceeding was not a foreign main proceeding with respect to the U.S. Debtors because the U.S. Debtors' COMI was located in the U.S., as evidenced by, among other things, the fact that (i) substantially all of the U.S. Debtors' assets, employees, and operations were located in the United States and (ii) the notes were issued under U.S.-law governed indentures and are guaranteed by the U.S. Debtors. The Objecting Noteholders also opposed recognition of the CCAA Proceeding as a foreign nonmain proceeding on the ground that alleging that the U.S. Debtors were part of an integrated enterprise headquartered in Canada was insufficient to establish that the U.S. Debtors engaged in nontransient economic activity in Canada.

The Debtors' responded that the COMI of all Debtors is located in Canada because Canada is the "nerve center" of the entire group, including the U.S. Debtors. Specifically, the Debtors pointed out that (i) all management decision are made in Canada, (ii) the U.S. Debtors' ultimate decision-makers are located in Canada, and (iii) tax, treasury, and cash management functions are managed from Canada. The Debtors also noted that the Canadian Court had specifically found that the center of main interest of the Debtors is located in British Columbia, Canada. With respect to the requested alternative relief for recognition of nonmain status, the Debtors argued that the U.S. Debtors have an "establishment" in Canada because significant (if not most significant) management functions of the U.S. Debtors occur in Canada.

On March 5, 2012, the Bankruptcy Court entered the Debtors' proposed order recognizing the CCAA Proceeding as a foreign main proceeding with respect to all Debtors. The recognition order also (i)

gave full force and effect in the United States to the Canadian CCAA orders, (ii) extended, on a final basis, the provisional DIP order, and (iii) granted, at the request of the secured noteholders, certain adequate protection to the secured noteholders to the extent of any diminution in value of their interest in the secured notes collateral. The Order was not accompanied by a written opinion in support of the decision. However, at the recognition hearing Bankruptcy Judge Walsh briefly remarked that he viewed this as a "very conventional recognition" given that (i) "the number and activity of the Canadian debtors outweighs the number and activity of the U.S. debtors" and (ii) "the shots that are called come out of Canada, not the United States."[18]

IV. Recognizing Foreign Insolvency Proceedings Concerning U.S. Debtors

The recognition order in *Catalyst Paper* is the latest decision in a line of recent cases recognizing foreign insolvency proceedings with respect to a foreign group including both foreign and U.S. subsidiaries.

Recognizing foreign *nonmain* status as to the U.S. subsidiaries should not be surprising where the U.S. subsidiaries form an integral part of a corporate group headquartered and managed by a non-U.S. parent company. Under these circumstances, courts have concluded that the U.S. subsidiaries engage in nontransient economic activity in the foreign jurisdiction.[19] However, a few bankruptcy courts have recognized foreign insolvency proceedings involving U.S. subsidiaries as foreign *main* proceedings. In each of these cases, the U.S. subsidiaries arguably had significant ties to the United States, including operations and guarantees of U.S. law governed debt. For example, in *In re Angiotech Pharmaceuticals, Inc.*, a Delaware bankruptcy court recognized – in what was ultimately an uncontested matter – a CCAA proceeding with respect to a Canadian parent with Canadian and U.S. subsidiaries as a foreign main proceeding.[20] As in *Catalyst Paper*, Angiotech's U.S. subsidiaries had significant U.S. operations and had guaranteed U.S.-law governed notes issued by their Canadian parent. Nevertheless, as the group's principal corporate, management, and strategic functions were undertaken in Canada, the Court found that the debtors' COMI was located in Canada.[21] *Angiotech* and other similar cases, however, arose in the context of consensual restructurings where the debtors' COMI was ultimately not contested. Accordingly, these previous recognition orders had limited precedential effect.

The *Catalyst Paper* decision, however, paves the way for a new breed of insolvency proceedings: U.S. debtors that are part of a corporate group headquartered in a foreign jurisdiction can commence a foreign insolvency proceeding together with their foreign corporate parent and then seek recognition of that proceeding as a foreign main proceeding under chapter 15. While this option may be cheaper than having the U.S. subsidiaries file separate chapter 11 cases in the United States, it also threatens to leave U.S. creditors without many of the protections afforded in a chapter 11 case (including plan protections and the appointment of a creditors' committee) and having to defend their rights in a foreign insolvency proceeding. The noteholders in *Catalyst Paper* probably have little to complain about finding themselves before a Canadian court – after all they acquired notes that were issued by the Canadian parent company. However, *Catalyst Paper* raises the specter that a bankruptcy court may grant foreign main status where the U.S. subsidiaries had directly issued or incurred debt to U.S. creditors (including employees and trade creditors), who may have had no reason to anticipate being dragged into a foreign insolvency proceeding.[22] Thus, the real concern about *Catalyst Paper* is its potential for wide-ranging applicability to situations where the facts supporting the debtor's choice of COMI are perhaps not as clear cut as in *Catalyst Paper*.

Moreover, the *Catalyst Paper* decision underlines the potential for abuse. Some courts have already raised the real concern that a debtor may attempt to opportunistically shift COMI prior to the chapter 15 filing, thereby thwarting third-party expectations.[23] Accordingly, one of the critical considerations in determining COMI is whether it is ascertainable by third parties.[24] Focusing exclusively on ascertainable facts at the time of the insolvency filing, however, may lead to unexpected results.

Courts in Europe have been grappling with "shifting" COMI issues for several years. For example, in *Eurofood*[25] the European Court of Justice held that in order to rebut the presumption in favor of a debtor's COMI being the place of its registered office, the factors relied on must be "both objective and ascertainable to third parties." This test was subsequently applied in *Re Stanford International Bank Ltd*,[26] where the English High Court interpreted the decision in *Eurofood* to mean that COMI must refer to where the company's head office functions are carried out. The rationale in *Eurofood* was extended by the English High Court when it granted the application to place Hellas Telecommunications (Luxembourg) II SCA into administration after holding that the Luxembourg debtor's COMI was located in England — even though the debtor was formed under Luxembourg law and most its operations were based in Greece.[27] The court concluded that the debtor's COMI was located in England because of objective ascertainable facts: the company had moved its head office and principal operating address to London three months prior to filing. It is notable that the court considered one of the most important features for determining COMI in this case to be the fact that restructuring negotiations between the debtor and its creditors took place in London.[28]

The decision in *Hellas Telecommunications* may not be surprising in the context of a consensual restructuring where all creditors are represented at the negotiation table. However, where this is not the case, a debtor's opportunistic shift of its COMI shortly before an insolvency filing would likely thwart the creditors' reasonable expectation at the time they extended credit. Indeed, in cases such as *Coeur Défense*[29] and *Eurotunnel*[30] foreign creditors have found themselves involved in often lengthy and expensive insolvency proceedings in jurisdictions that may not have been reasonably anticipated at the time credit was extended. For instance, in *Coeur Défense*, the French courts determined that the COMI of a company with its registered office in Luxembourg was situated in France for the purposes of the EC Insolvency Regulation. As a consequence, a CMBS borrower and its Luxembourg parent company were entitled to Court protection in France under so-called safeguard proceedings (the French pre-bankruptcy process resembling a U.S. Chapter 11 case).

V. Countermeasures Against Opportunistic Shifts in COMI

Faced with the real possibility of opportunistic COMI shifts, U.S. creditors should consider measures to protect themselves. Of course, a chapter 15 filing that is pursued in an effort to game the system could be challenged as a bad faith filing. Such a fight, however, could be costly and time-consuming. It may be more effective to attempt to restrain a debtor from shifting COMI in the first place through requiring appropriate representations and negative covenants in the credit documents. In Europe, these types of provisions are not uncommon. For example, creditors under revolving credit agreements should consider requiring a representation at the outset of the lending relationship as to the debtor's location of their COMI (including a representation as to the center of the debtor's administration). This representation would then have to be renewed upon each borrowing request, each borrowing date, and the first day of each interest period. In addition, creditors should consider requiring a negative covenant that the debtor will not change its COMI and its center of administration without prior notice and consent of the creditors. In that context, it is important to focus, at the outset, on the applicable lender consent threshold for amendments to such provisions, because a

change of COMI as part of a pre-negotiated restructuring may be desirable to assist in the implementation of such restructuring.

A debtor that is already in default may not be deterred by the breach of another covenant. Moreover, it is, at best, unclear whether a bankruptcy court would consider denying relief under chapter 15 on the basis of a violation of such a covenant. However, such a covenant may, at a minimum, put creditors on notice that something is afoot. It may also force a debtor to think twice where it seeks an organized, pre-negotiated restructuring.

VI. Conclusion

The *Catalyst Paper* recognition order should stand as a reminder that U.S. creditors should anticipate that U.S. subsidiaries of foreign parent companies may avoid filing chapter 11 cases in the United States, in favor of joining their foreign parent company in foreign insolvency proceedings and then seeking recognition of such proceeding as a foreign main proceeding under chapter 15. As in *Catalyst Paper*, recognition may even be granted where the U.S. subsidiaries have substantial ties to the United States, provided that the group's nerve center is located in the foreign jurisdiction. Moreover, when looking beyond the fact pattern in *Catalyst Paper*, the recognition order raises the specter that a U.S. debtor may attempt to avoid chapter 11 altogether by manipulating its COMI (including by reshuffling its holding company structure) in anticipation of an insolvency filing in a foreign jurisdiction and seeking foreign main status under chapter 15.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Los Angeles

John F. Hilson
1.213. 683.6300
JohnHilson@paulhastings.com

Washington, D.C.

Robert E. Winter
1.202. 551.1729
robertwinter@paulhastings.com

London

Karl J. Clowry
44.20.3023.5167
karlclowry@paulhastings.com

Milan

Bruno Cova
39.02.30414.212
brunocova@paulhastings.com

Atlanta

Jesse H. Austin, III
1.404. 815.2208
jessaustin@paulhastings.com

Chicago

Marc J. Carmel
1.312. 499.6040
marccarmel@paulhastings.com

Paris

Lionel F. Spizzichino
33.1.42.99.04.03
lionelspizzichino@paulhastings.com

Frankfurt

Dr. Christopher Wolff
49 69 907485.113
christopherwolff@paulhastings.com

New York

Luc A. Despins
1.212. 318.6001
lucdespins@paulhastings.com

Leslie A. Plaskon
1.212. 318.6421
leslieplaskon@paulhastings.com

James T. Grogan
1.212. 318.6696
jamesgrogan@paulhastings.com

G. Alex Bongartz
1.212. 318.6472
alexbongartz@paulhastings.com

Bryan R. Kaplan
1.212. 318.6339
bryankaplan@paulhastings.com

[1] *In re Catalyst Paper Corp., et al.*, Case No. 12-10221 (PJW) (Bankr. D. Del. March 5, 2012).

[2] Despite recognition as a main proceeding under chapter 15, a secured creditor's adequate protection rights with respect to the debtor's U.S. assets will still be governed by the Bankruptcy Code. *See* 11 U.S.C. § 1520(a)(1).

[3] Foreign insolvency practitioners will no doubt point out that U.S. bankruptcy courts have for years approved reorganizations involving one or more foreign debtors filing for chapter 11 as part of a global restructuring involving one or more U.S. debtors. The *Catalyst* decision, however, now opens the door for the reverse pattern.

[4] *See* 11 U.S.C. § 1501(a).

[5] *See* 11 U.S.C. §§ 1504, 1515, 1517.

[6] *See* 11 U.S.C. § 1502(4).

[7] *See* 11 U.S.C. §§ 1502(2), 1502(5).

[8] *See* 11 U.S.C. §§ 1516(c).

[9] *See In re SPhinX, Ltd.*, 351 B.R. 103, 117 (Bankr. S.D.N.Y. 2006).

[10] *See In re Bear Stearns*, 374 B.R. 122, 129 (Bankr. S.D.N.Y. 2007).

[11] *See In re Fairfield Sentry Limited, et al.*, 440 B.R. 60, 66 (Bankr. S.D.N.Y. 2010). *See also Bear Stearns*, 374 B.R. at 129 (noting that courts have also equated COMI to the "principal place of business" under U.S. law).

[12] *See* 11 U.S.C. § 1520(a). Other automatic relief includes the application of sections 363, 549, and 552 to a transfer of any interest of the debtor in property that is within the territorial jurisdiction of the United States.

[13] *See* 11 U.S.C. § 1521(a).

[14] *See In re: VITRO, S.A.B. de C.V.*, No. 38/2010-IV (United Mexican States, District Court of Nuevo León Filed Dec. 13, 2010) (Commercial Reorganization).

[15] *See In re Metcalfe & Mansfield Alternative Investments, et al.*, 421 B.R. 685 (Bankr. S.D.N.Y. 2010) (recognizing and giving effect to Canadian sanctions order that provided for, among other things, third party non-debtor releases that likely would not pass muster under the Bankruptcy Code); *In re Muscletech Research and Development Inc., et al.*, Case No. 06-Civ-538 (JSR) (S.D.N.Y. March 9, 2007) (same).

[16] Yet another example of creditor protection that may not be available in non-U.S. jurisdictions is the mandatory subordination of damages claims arising from the purchase or sale of securities of the debtor or an affiliate of the debtor. *See* 11 U.S.C. § 510(b), although the CCAA, since 2009, contains an analogous provision.

[17] Prior to the commencement of the CCAA Proceeding, on January 17, 2012, the Debtors filed for protection under the Canada Business Corporations Act, having reached a preliminary consensual agreement with certain holders of the secured notes and the unsecured notes. However, the Debtors were ultimately unable to obtain the requisite support by the deadline set forth under the restructuring support agreement, and therefore commenced the CCAA Proceeding on January 31, 2012.

[18] March 5, 2012 Hearing Transcript at 28, *In re Catalyst Paper Corp. et al.*, Case No. 12-10221 (PJW) (Bankr. D. Del. March 5, 2012).

[19] *See In re Rock Well Petroleum (U.S.), Inc.*, Case No. 08-20797 (Bankr. D. Wy. Feb. 27, 2009) (finding foreign nonmain status as to U.S. subsidiaries because management and business operations were conducted at foreign parent company, but declining to grant foreign main status as to U.S. subsidiaries); *In re Mega Brands*, Case No. 10-10485 (Bankr. D. Del. Mar. 23, 2010) (finding foreign nonmain status as to U.S. subsidiaries because they carried out nontransitory operational, managerial, and financial activities in Canada).

[20] *See In re Angiotech Pharmaceuticals, Inc., et al.*, Case No. 11-10269 (Bankr. D. Del. Feb. 22, 2011). Although certain noteholders had initially objected to recognition (albeit not challenging COMI), they withdrew their objection prior to the recognition hearing.

[21] *See also In re Fraser Papers Inc., et al.*, Case No. 09-12123 (KJC) (Bankr. D. Del. July 13, 2009) (granting foreign main status to CCAA proceeding involving Canadian parent company and its Canadian and U.S. subsidiaries; COMI was not contested); *In re MAAX Corp., et al.*, Case No. 08-11443 (CCS) (Bankr. D. Del. July 14, 2008) (granting foreign main status to CCAA proceeding involving Canadian parent company as its Canadian and U.S. subsidiaries; COMI was not contested).

[22] The Debtors' restructuring proposal in *Catalyst Paper* would leave trade creditors unimpaired.

[23] *See, e.g.*, *Fairfield Sentry Ltd.*, 440 B.R. at 66.

[24] *See In re Ran*, 607 F.3d 1017, 1026 (5th Cir. 2010); *In re Betcorp Ltd.*, 400 B.R. 266, 291 (Bankr. D. Nev. 2009).

[25] *In Re Eurofood IFSC Ltd*, (Case C-341/04) [2006] Ch 508.

[26] *Re Stanford International Bank Ltd*, [2010] EWCA Civ 137.

[27] *In re Matter of Hellas Telecommunications (Luxembourg) II SCA*, [2009] EWHC 3199 (Ch).

[28] Recently, the administrators for Hellas Telecommunications (Luxembourg) II SCA commenced a chapter 15 proceeding in the Southern District of New York, seeking recognition of the UK proceeding as a foreign main proceeding. *See In re Hellas Telecommunications (Luxembourg) II SCA*, Case No. 12-10631 (MG) (Bankr. S.D.N.Y. Feb. 16, 2012). On March 14, 2012, the bankruptcy court granted foreign main status. The request was unopposed.

[29] *SAS Heart of La Defense,* Paris Commercial Court 3 November 2008, RG n° 2008077996, Dame Luxembourg and RG n° 2008077997.

[30] *Eurotunnel Plc*, RG 07/05764, jurista No. 2007/346870 and RG 07/05752, jurista No.2007/354294, Tribunal de commerce de Paris, January 15, 2007; Court of Appeal of Paris, 3rd Court, Section B, November 29, 2007.