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Client Alert

A report for clients and friends of the firm

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New Decisions Changing International Commercial Litigation

Three recent decisions—from the Second Circuit, the U.S. District Court for the Southern District of New York, and the Southern District's Bankruptcy Court—enhance the growing body of law addressing the relationship between U.S. and foreign legal regimes. More significant than the fact that Proskauer represented the winning party in each of the cases is the fact that two of the three decisions address significant issues of first impression of particular importance to our domestic and foreign clients with international aspects to their business.

Compañia Embotelladora del Pacifico, S.A. ("CEPSA") v. Pepsi Cola Company, No. 03-7979 (2d Cir. 9/24/04) (Sack, Raggi, and Hall, JJ). This case involves Peruvian liquidation and bankruptcy proceedings and civil and criminal actions, on the one hand, and a $300+ million lawsuit brought by CEPSA against PepsiCo in the U.S. District Court for the Southern District of New York on the other. On Proskauer's motion for PepsiCo and after considering extensive affidavits of Peruvian law and rulings of administrative bankruptcy tribunals in Peru and holding a hearing to determine Peruvian law, the District Court dismissed CEPSA's case based on the Court's determinations of Peruvian law. The District Court also accepted our practical argument that CEPSA was not authorized to bring the action since a Special Creditors Committee in Peru had disapproved of the lawsuit's continuation. By invoking 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), we avoided the conventional strictures of a motion to dismiss under Fed. R. Civ. P. 12(b)(6). We were therefore able to obtain a determination of the foreign law issues on a pre-discovery motion to dismiss, rather than having to go through extensive and costly discovery before a motion for summary judgment was ripe.

On appeal, the Second Circuit disagreed with the District Court's legal determination, but fully supported the practical approach we had urged. Following *Finanz A.G. Zurich v. Banco Economico S.A.*, 192 F.3d 240, 246 (2d Cir. 1999), the Second Circuit gave comity to the proceedings in Peru, requiring CEPSA first to obtain a determination whether in fact the lawsuit was authorized, staying all U.S. proceedings in the interim, and directing dismissal of the U.S. action if the authorization is not obtained. On a tangential issue—whether a partial assignment of CEPSA's claims was valid—the Court of Appeals similarly expressed its willingness to defer to Peruvian courts on the subject of validity.

What is interesting about the case is not merely that the Court of Appeals accepted extensive affidavits filed for the first time on appeal or that it accorded deference to administrative tribunals in Peru. The Second Circuit also granted comity to the Peruvian proceedings notwithstanding the fact that it was PepsiCo that had insisted on the litigation being in New York under New York substantive law.

In re Multicanal, Dkt. No. 04-10280 (Bankr. S.D.N.Y. 8/27/04) (Gropper, J.). Proskauer represented objecting creditors in this proceeding brought by a debtor under Section 304 of the Bankruptcy Code. Section 304 is a statutory mechanism increasingly used by foreign debt issuers who, having sold debt in the U.S., restructure the debt under foreign regimes and then return to the U.S. for "recognition." Section 304 recognition has been read to cut off claims and litigation by U.S. creditors in U.S. courts, avoid U.S. judgments for collection, and hence enable the foreign company's return to the U.S. to raise money in the future. In a significant post-trial ruling, the United States Bankruptcy Court for the Southern District of New York addressed several issues of general applicability in the area of international debt restructurings and the deference U.S. courts should give to foreign restructuring regimes.

To raise more than $500 million in debt, Multicanal (an Argentine cable company) came to the U.S. in the late 1990s. Using U.S. agents, bankers and lawyers, and expressly invoking the protections of the U.S. securities laws to facilitate its access to the U.S. capital market, Multicanal sold five series of bonds, more than 80% to U.S. investors. The bonds are governed by New York law and provide for New York jurisdiction. Multicanal also took advantage of the lower cost of funds available for borrowings made under "New York Indentures" and broadened investor appeal by qualifying the issues under the Federal Trust Indenture Act, registering some of them with the SEC under the Securities Exchange Act.

Instead of restructuring the U.S. securities in the obvious forum (*i.e.*, the U.S.), Multicanal proposed a restructuring under newly enacted Argentine rules called an APE. Using the APE rules, Multicanal sought to replace $527 million in debt with $220 million in debt, eradicating up to 70% of the value of the U.S. bondholders' investment. Yet the equity available to bondholders would be capped at 35%; Multicanal's parent retains 65% of the equity in return for a mere $15 million contribution. There was no market test or other fairness valuation of the $15 million. Worse, none of the equity is available to Multicanal's U.S. retail investors, nor are the replacement debt securities being offered to the retail sector.

Multicanal turned to the U.S. Bankruptcy Court for "recognition" of its foreign APE. The Court read § 304 and the prior case law as entailing a narrower scope of review than that urged by the objecting creditors. The Court stated that its primary function was to determine the most "economical and expeditious administration of the estate" – not whether U.S. 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 § 304 factors, certain aspects of the APE were, in the Court's view, similar to U.S. pre-packaged bankruptcies. The Court found it important that many creditors voted in favor of the APE, although the Court acknowledged that there were voting irregularities in the APE (irregularities that would not have been tolerated in a U.S. proceeding). Even the Court's finding that there was indeed disparity in the procedures for obtaining "yes" and "no" votes was insufficient to withhold recognition. Said the Court, "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."

Despite the foregoing, the Bankruptcy Court nonetheless agreed with our arguments and withheld § 304 "recognition" on two grounds:

First, it agreed with our proof that Multicanal discriminated against U.S. retail creditors, who were not able to exercise the vote that other creditors were and were being forced to accept a type of consideration (cash) that the Court found was worth substantially less than the other consideration (new notes and equity). The Court rejected Mulitcanal's many excuses for the discrimination and has required Multicanal to remedy the discrimination before according the restructuring any U.S. recognition.

Second, the Court reacted to the fact that, in Argentina, Multicanal had caused criminal accusations to be initiated against individual employees of our client – which we showed to be rank efforts to intimidate 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 has required Multicanal to prove the "substantial justification" for its conduct and is withholding § 304 recognition absent such a showing.

<u>*SHL v. Cablevision*, 04-CV-6720 (S.D.N.Y. 10/6/04)(Kram, J.)</u>. In this hotly contested tender offer litigation, our client SHL, a large creditor of Cablevision (another large Argentine cable company), sued in federal District Court for violations of both the federal tender offer rules and the Trust Indenture Act ("TIA"). Just after our motion for summary judgment and injunctive relief was set for briefing and a timely determination before Cablevision went forward with a "vote" on the illegal offer, Cablevision went before the Southern District Bankruptcy Court and procured a TRO under § 304 of the Bankruptcy Code stopping the District Court proceedings without notice to the District Court and on only a two-hour notice to us. We then obtained emergency relief from the TRO so that we could make a motion under 28 U.S.C. § 157(d) to "withdraw the reference of the § 304 case," moving the case from the Bankruptcy Court back to the District Court. Although a § 304 case had never been withdrawn before, we showed that withdrawal was both mandatory and permissive under the statute because, among other things, significant issues of non-bankruptcy federal law would have to be considered in order to decide what sort of deference the Bankruptcy Court should give to the foreign out-of-court restructuring being pursued by Cablevision.

Judge Kram heard the motion to withdraw on an emergency basis, directed expedited briefing, heard argument, and rendered a decision, the first of its kind, withdrawing the § 304 case to the District Court. The Court agreed with us and, granting both mandatory and permissive withdrawal, held that creditors are entitled to an Article III Court, rather than a bankruptcy court, to decide the issues of the prioritization or interplay between both the Federal tender offer rules and the TIA on the one hand and § 304 (granting "comity" to foreign restructuring proceedings) on the other.

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