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The International Scene

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Bankruptcy Court Upholds the Enforcement of the *Ipso Facto* Clause Against a Foreign Debtor

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International comity, a doctrine applied by U.S. courts to determine the effect that foreign law and proceedings will have on domestic proceedings, has been referred to as "an amorphous never-never land whose borders are marked by fuzzy lines of politics, courtesy, and good faith."[1] Courts have recognized that international comity is particularly important in the context of foreign insolvency proceedings.[2] In addition, courts have differentiated between two types of international comity: (1) abstention comity (or comity among courts), under which courts grant deference to a foreign court proceeding and may decline to exercise jurisdiction over a dispute; and (2) choice-of-law comity (or comity among nations), used to determine the substantive law that should apply to a dispute.[3]

In a recent decision, the *SunEdison* court again clarified the distinction between abstention and choice-of-law comity, refusing to apply Korean insolvency law in a contract-termination dispute, and enforcing a contractual New York choice-of-law provision. Applying the New York law, the court upheld the enforcement of an *ipso facto* clause against a foreign debtor, thereby allowing termination of a license that was essential to the debtor's business.

Overview of the Dispute Among SunEdison, GCL and SMP

The SunEdison case involved a dispute among SMP Ltd., a Korean company involved in a rehabilitation proceeding in Korea that subsequently commenced a chapter 15 proceeding in the U.S. Bankruptcy Court for the Southern District of New York; SunEdison Inc., a chapter 11 debtor in the same bankruptcy court; and GCL-Poly Energy Holdings Ltd.,[4] which had purchased certain intellectual property and other assets relating to polysilicon production (the "solar materials business") from SunEdison. SMP, established in 2011 as a joint venture by SunEdison, owned and operated a polysilicon manufacturing plant located in Ulsan, Korea. SunEdison licensed polysilicon manufacturing technology and supplied the necessary equipment to SMP in order to operate the plant pursuant to a supply and license agreement (SLA). The SLA contained a typical *ipso facto* clause, which permitted either party to terminate the SLA if the other party filed for bankruptcy or was unable to pay its debts as they came due.[5]

The SLA also contained a choice-of-law provision stating that the SLA would be governed by New York and U.S. federal law, without regard to their conflict-of-laws principles.[6] According to SMP, without the technology and equipment provided under the SLA, it would be unable to continue operating the plant and would be forced to liquidate.[7] SMP filed its Korean rehabilitation case shortly after

1 *JP Morgan Chase Bank v. Altos Hornos de Mexico S.A. de C.V.*, 412 F.3d 418, 423 (2d Cir. 2005) (citation omitted).

2 *See, e.g., Victrix S.S. Co. S.A. v. Salen Dry Cargo A.B.*, 825 F.2d 709, 713 (2d Cir. 1987) ("American courts have long recognized the particular need to extend comity to foreign bankruptcy proceedings."); *Finanz AG Zurich v. Banco Economico S.A.*, 192 F.3d 240, 246 (2d Cir. 1999) ("We have repeatedly noted the importance of extending comity to foreign bankruptcy proceedings.").

3 *See SMP Ltd. v. SunEdison Inc. (In re SunEdison Inc.)*, __ B.R. __, 2017 WL 4570702 (Bankr. S.D.N.Y. Oct. 13, 2017) ("There are two aspects to the doctrine of comity, abstention and choice of laws, sometimes referred to respectively as 'comity among courts' and 'comity among nations.'") (citing *Maxwell Commc'n Corp. plc v. Societe Generale (In re Maxwell Commc'n Corp. plc)*, 93 F.3d 1036, 1047 (2d Cir. 1996)).

4 Gibson, Dunn & Crutcher LLP represented GCL in its purchase of the solar materials business and in the dispute with SMP.

5 2017 WL 4570702, at *2.

6 *Id.*

7 *SMP v. SunEdison Inc. (In re SunEdison Inc.)*, Case No. 17-11192 (Bankr. S.D.N.Y. May 1, 2017) [Docket No. 1].

SunEdison filed its chapter 11 case, arguing that such filing was necessary because SunEdison and its affiliates had defaulted on many millions of dollars of payment obligations owed to SMP as a result of SunEdison's purchase of product from SMP.[8]

On Aug. 26, 2016, SunEdison filed a motion (the "sale motion") requesting bankruptcy court approval of an agreement (the "stalking-horse agreement") between SunEdison and GCL to sell the solar materials business to GCL. The stalking-horse agreement required SunEdison to either reject or terminate the SLA, as reasonably requested by GCL.[9] SMP filed a reservation of rights to the sale motion; following mediation, the parties reached a settlement that resolved SMP's objection to the sale motion (the "settlement agreement") and allowed the sale to close.

Among other things, the settlement agreement required SunEdison to send a notice terminating the SLA but provided that "SMP's rights to contest and challenge [SunEdison's] rights to terminate [the SLA were] fully preserved."[10] The settlement agreement permitted SMP to institute such a challenge in either the bankruptcy court or pursuant to Swiss arbitration under the SLA.[11] Both the U.S. bankruptcy court and the Korean court overseeing SMP's rehabilitation proceeding approved the settlement agreement.[12]

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In accordance with the settlement agreement, on March 30, 2017, SunEdison sent a notice to SMP terminating the SLA (the "termination notice"). The termination notice invoked the *ipso facto* clause and stated that SunEdison was terminating the SLA "as a result of SMP's pending rehabilitation proceedings and its failure to pay debts generally as they [came] due."[13] The sale of the solar materials business to GCL closed the next day.

More than one month after receipt of the termination notice, on May 1, 2017, SMP filed a petition in the Southern District of New York for recognition of the Korean rehabilitation proceeding under chapter 15 of the U.S. Bankruptcy Code.[14] On June 15, 2017, the court granted recognition of the Korean rehabilitation proceeding as a "foreign main proceeding" pursuant to § 1517(b)(1) of the Bankruptcy Code.[15]

On May 1, 2017, SMP also commenced an adversary proceeding in the *SunEdison* bankruptcy case challenging the effectiveness of the termination notice. In SMP's complaint, it sought a judgment "declaring the SLA's *ipso facto* clause unenforceable and SunEdison's Termination Notice invalid."[16] SMP argued that under Korean law, the SLA's *ipso facto* clause was unenforceable against a Korean debtor in a Korean rehabilitation proceeding.

Accordingly, once the Korean court entered an order commencing the Korean rehabilitation proceeding (the "commencement order"), principles of comity required the bankruptcy court to apply Korean law due, therefore SunEdison could not use such filing as the basis to terminate the SLA pursuant to the *ipso facto* clause.[17] The commencement order did not contain any language that invalidated *ipso facto* clauses or prevented termination of the SLA; however, SMP argued that the commencement order "automatically sweeps in every aspect of Korean insolvency law," and that the bankruptcy court "must apply Korean insolvency law, including Korean common law, and invalidate the Termination Notice because [SMP] wants to perform the SLA."[18]

Enforcement of Choice-of-Law Provision

GCL moved for partial summary judgment, arguing that (1) the bankruptcy court was required to apply the choice-of-law rules of New York (the forum in which it sits); (2) New York choice-of-law rules require a court to honor the governing law provision in a contract; and (3) under New York law, the *ipso facto* clause is enforceable.[19] SMP cross-moved for partial summary judgment, primarily arguing that comity required the application of Korean law, and that Korean law rendered the *ipso facto* clause unenforceable against a Korean debtor.[20]

As a threshold matter, the bankruptcy court noted that "[b]ut for the arguments relating to the effect of the Commencement Order, the resolution ... would be simple and straightforward."[21] The bankruptcy court then held that as a court sitting in New York, it was required to apply New York's choice-of-law rules, and those rules state that "the Court must abjure a conflicts analysis or consider foreign law or foreign public policy, and must instead apply New York substantive law."[22] Under New York law, *ipso facto* clauses are enforceable absent fraud, collusion or overreaching.[23]

Next, the bankruptcy court considered whether granting comity to the commencement order required the application of Korean law, notwithstanding New York's choice-of-law rules. First, it noted that comity "is neither a matter of absolute obligation ... nor of mere courtesy and goodwill.... But it is the recognition [that] 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 or of other persons who are under the protection of its laws."[24]

8 *Id.*
9 2017 WL 4570702, at *3.
10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*
14 *Id.* at *4.
15 *Id.*
16 *Id.*
17 *Id.* at *10.
18 *Id.*
19 *Id.* at *4.
20 *Id.* Because the bankruptcy court ultimately held that New York law applied, it did not decide whether the *ipso facto* clause was enforceable under Korean law. *Id.* at *5.
21 *Id.* at *4.
22 *Id.*; *see also IRB-Brasil Resseguros S.A. v. Inepar Invs. S.A.*, 20 N.Y.3d 310, 982 N.E.2d 609, 612 (2012) ("[The] plain language of General Obligations Law § 5-1401 dictates that New York substantive law applies when parties include an ordinary New York choice-of-law provision," and "[e]xpress contract language excluding New York's conflict-of-law principles is not necessary."), *cert. denied*, __ U.S. __, 133 S. Ct. 2396 (2013).
23 2017 WL 4570702, at *6 (citing *W.F.M. Rest. Inc. v. Austern*, 35 N.Y.2d 610, 324 N.E.2d 149, 150, 153 (1974)).
24 *Id.* at *8 (citation omitted).

The bankruptcy court then distinguished abstention comity from choice-of-law comity, stating that abstention comity "is concerned with which court should decide the parties' rights, and relatedly, whether a U.S. court should enforce a foreign bankruptcy court's order relating to the debtor's assets or the adjudication of a creditors claim."[25] Thus, it "aims to prevent an 'end-run' around the foreign bankruptcy proceeding, by a creditor seeking to collect a claim against a foreign debtor through a U.S. court proceeding instead of through the foreign bankruptcy case."[26] In contrast, choice-of-law comity "can limit the reach of a domestic law to conduct occurring abroad."[27] Choice-of-law comity involves an "analysis to determine whether the application of U.S. law would be reasonable under the circumstances."[28]

Because (1) SMP was not asking the bankruptcy court to abstain, (2) both the bankruptcy and Korean courts approved the settlement agreement under which SMP agreed to bring its challenge to the termination notice outside of the Korean court, and (3) SMP elected to commence the adversary proceeding in the bankruptcy court in New York, the bankruptcy court determined that there was "no effort to make an 'end-run' around the Korean" rehabilitation proceeding, and abstention comity was therefore inapplicable.[29]

The bankruptcy court further reasoned that despite SMP's assertion that it did "not believe that this was a choice of law issue.... In fact, this is precisely what it is. SMP argues that the Court should grant comity to the Commencement Order by which it means [to] give extraterritorial effect to all of the Korean insolvency law."[30] In support of this argument, SMP had cited *In re Daebo Int'l Shipping Co*.,[31] which held that an order from a Korean bankruptcy court that "expressly stayed creditors from enforcing or executing on their rehabilitation claims" should be applied extraterritorially to prevent attachments against the Korean debtor's property located in the U.S. that occurred after the stay order was entered.[32] Because the order in *Daebo* specifically "prevented creditors from seizing the debtor's assets, and required them to file claims in the Korean proceeding to effect a payment," the bankruptcy court agreed that granting comity in that case was "entirely consistent with the principles underpinning abstention comity."[33]

Unlike *Daebo*, the commencement order was silent as to whether contract counterparties were stayed from exercising contractual rights to terminate executory contracts.[34] SMP was otherwise unable to "provide ... support for the remarkable proposition that SMP's Korean [rehabilitation proceeding] sweeps in the entirety of Korean insolvency law under principles of international comity, and trumps U.S. bankruptcy and state law."[35] In addition, "the parties selected New York law to govern their contractual rights, and the application of Korean law ignores that choice and their presumed expectations."[36] Accordingly, the bankruptcy court rejected SMP's request to apply Korean law under the principles of international comity, and the court upheld enforcement of the *ipso facto* clause in the SLA under New York law.[37]

The Implications of *SunEdison* for Foreign Debtors

The *SunEdison* decision is a reminder that a foreign debtor must be proactive to protect its contractual rights. The sale motion, which was filed more than seven months prior to sending the termination notice, put SMP on notice that SunEdison might terminate the SLA. At any point prior to SunEdison sending the termination notice, SMP could have sought an order from the Korean court preventing termination of executory contracts, which would have provided SMP with a much stronger argument that comity required the bankruptcy court to apply Korean law and defer to a specific order of the Korean court.

Alternatively, SMP could have commenced a chapter 11 proceeding in the U.S., thereby taking advantage of the automatic stay under § 362(a) and also taking advantage of § 365(e) of the Bankruptcy Code, which generally invalidates post-petition enforcement of *ipso facto* clauses. Or SMP could have commenced its chapter 15 proceeding sooner, taking advantage of the automatic stay, and sought an order preventing counterparties from terminating any executory contracts with SMP.[38] This type of relief would have prevented SunEdison from sending the termination notice and would have provided SMP with additional negotiating leverage against SunEdison and GCL.

SunEdison also serves as an important lesson that a foreign debtor must be careful in choosing a forum to adjudicate a dispute if substantive foreign law might be relevant. If a foreign debtor believes that the law of another country will be more favorable in resolving a particular issue, the foreign debtor should attempt to have such dispute adjudicated in that country. The foreign debtor might then have a stronger argument under the principles of international comity that a U.S. court should defer to and enforce the judgment entered in the other country. On the other hand, if a foreign debtor consents to adjudication in a U.S. court, then the foreign debtor may find the U.S. court unwilling to consider substantive foreign law in the absence of a foreign governing law provision or another compelling reason why foreign law should apply. abi

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25 *Id.*
26 *Id.*
27 *Id.* at *9.
28 *Secs. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Secs. LLC*, 2016 WL 6900689, at *12 (Bankr. S.D.N.Y. Nov. 22, 2016).
29 2017 WL 4570702, at *8.
30 *Id.* at *9.
31 543 B.R. 47 (Bankr. S.D.N.Y. 2015).
32 2017 WL 4570702, at *9.
33 *Id.* at *9-10.
34 *Id.* at *10.
35 *Id.*
36 *Id.*

37 *Id.* The bankruptcy court also noted that its decision was consistent with a 2014 decision from the English High Court, which addressed a case with similar facts and upheld enforcement of an *ipso facto* clause under English law notwithstanding the debtor's pending rehabilitation proceeding in Korea. *See id.* (citing *In re Pan Ocean Co. Ltd.* [2014] EWHC 2114 (Ch), 2014 WL 2807873 (2014)).

38 Section 365(e) of the Bankruptcy Code does not automatically apply in chapter 15 cases. *See* 11 U.S.C. § 1520; *In re Bluberi Gaming Techs. Inc.*, 554 B.R. 841, 848 (Bankr. N.D. Ill. 2016) ("[S]ection 365 does not automatically apply in chapter 15 cases upon their recognition."). However, bankruptcy courts have granted relief in chapter 15 cases preventing a counterparty from terminating executory contracts. *See, e.g., In re W.C. Wood Corp. Ltd.*, Case No. 09-11893 (Bankr. D. Del. June 1, 2009) (interim order preventing termination of contracts immediately following chapter 15 filing); *In re Gandi Innovations Holdings LLC*, Case No. 09-51782 (Bankr. W.D. Tex. June 5, 2009) (chapter 15 recognition preventing termination of executory contracts).