CHAPTER 15 WATCH / MULTI-JURISDICTION

Azeri Restructuring Could Test Limits of Chapter 15 Foreign Plan Enforcement

By **ELENA D. LOBO** *and* **DANIEL J. SOLTMAN**

On December 12, 2017, the International Bank of Azerbaijan (the "**IBA**"), the national development bank and largest commercial and retail bank in the Republic of Azerbaijan, filed a motion in the United States Bankruptcy Court for the Southern District of New York, seeking permanent enforcement in the United States of its plan of reorganization that has been confirmed and substantially consummated in its Azeri proceeding (the "**Azeri Plan**"). The relief sought by the IBA in December 2017 follows the relief granted by the Bankruptcy Court in June 2017, when it recognized the IBA's Azeri proceeding as a foreign main proceeding under Chapter 15 of the Bankruptcy Code,[1] overruling the objections of an ad hoc group of noteholders (the "**Ad Hoc Group**"), who argued that doing so would be manifestly contrary to United States' public policy.[2] Written objections to permanent enforcement of the Azeri Plan are due on January 9, 2018, and a hearing is scheduled for January 18, 2018.[3]

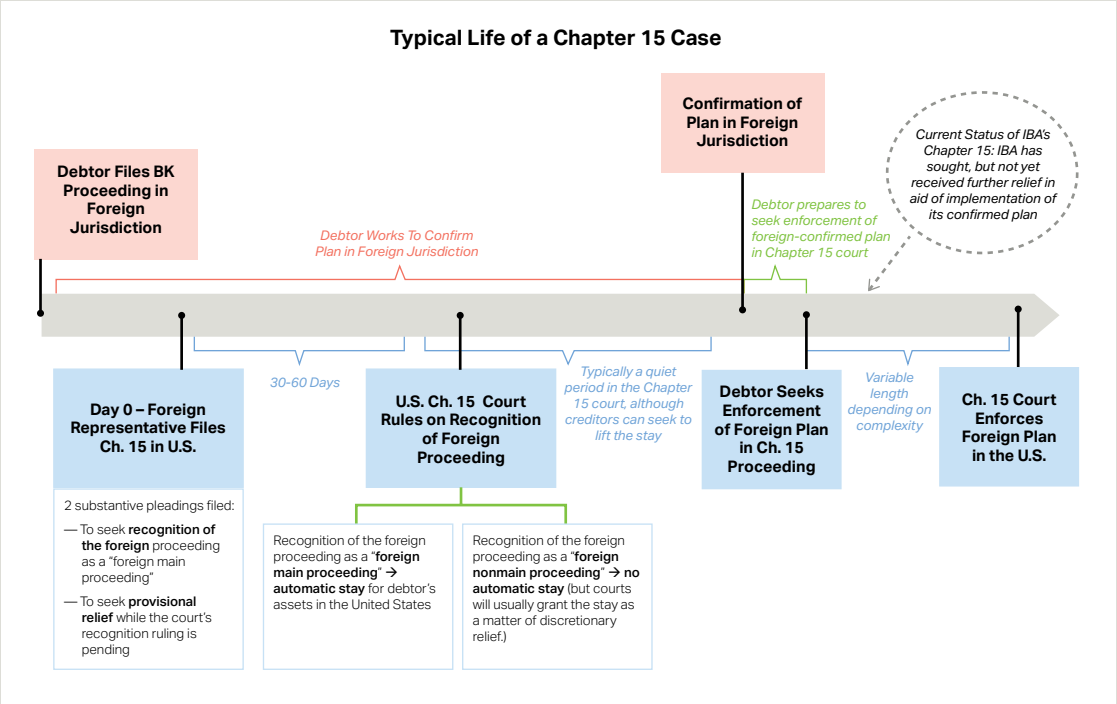
Chapter 15 Background

Unlike Chapter 11 of the Bankruptcy Code, through which a debtor (or debtors) can effectuate plenary restructurings, Chapter 15 proceedings are ancillary to proceedings in foreign jurisdictions, with the stated goal of "provid[ing] effective mechanisms for dealing with cases of cross-border insolvency".[4] Accordingly, unlike a Chapter 11 proceeding, a Chapter 15 proceeding can only exist where a proceeding already exists in a foreign jurisdiction.

Although all cases are unique, there are typically two flash points of activity over the life of a Chapter 15 proceeding: *first*, when the Chapter 15 proceeding is first filed and the debtor's foreign representative seeks "recognition" of the foreign proceeding; and *second*, after a plan has been approved in the foreign jurisdiction, when the debtor's foreign representative will seek relief in aid of implementation of the confirmed plan.[5] As of this publication, relief is pending in the second stage.[6]

The IBA's Chapter 15 Petition for Foreign Main Proceeding Recognition

On April 16, 2017, the Azerbaijan legislature enacted new restructuring provisions (the "**Azeri Restructuring Law**") that allow for the voluntary



restructuring of financial institutions in Azerbaijan, and which appear tailor-made for the IBA.[7] The day after the new Azeri Restructuring Law was enacted, the IBA's supervisory board proposed the commencement of a judicial reorganization proceeding under the new law, and the following week the IBA had submitted a draft of its Azeri Plan and applied for a proceeding with the Nasimi District Court. On May 4, 2017, the Nasimi District Court granted the application and the Azeri proceeding commenced.

Shortly after the commencement of the Azeri proceeding, the IBA defaulted on a substantial portion of its debt and became increasingly vulnerable to creditor action, particularly regarding its U.S. Dollar-denominated debt and U.S. accounts. According to its Chapter 15 petition, the IBA sought Chapter 15 relief in order to safeguard its U.S. accounts from attachment or set-off, to guard itself against parallel U.S. lawsuits brought by non-Azeri creditors and to obtain U.S. judicial recognition of the Azeri proceeding, and eventually enforcement of the Azeri Plan, to be able to restructure its U.S. Dollar-denominated debt. The IBA asserted in its Chapter 15 petition that a loss of access to its U.S. accounts and ability to carry out U.S. Dollar-denominated transactions, would cause severe harm to the IBA and, due to the IBA's involvement and influence in Azerbaijan's business and infrastructure projects, the Azerbaijan economy as a result.

The Ad Hoc Group's Objection to Recognition

The Ad Hoc Group responded to the IBA's Chapter 15 petition by filing an objection[8] that sets forth its arguments against recognition by the Chapter 15 court and focuses on its objections to the new Azeri Restructuring Law.

The Ad Hoc Group's chief argument was that the Azeri Restructuring Law fundamentally violates U.S. laws and policies and that, as such, the Bankruptcy Court should deny recognition of the Azeri proceeding because it does not meet the "minimal level of procedural and substantive fairness" required by Chapter 15.[9] The Ad Hoc Group's objection asserts that the Azeri Restructuring Law does not provide any meaningful protections

for creditors, particularly for non-Azeri creditors, evidenced in part by the fact that creditors with disparate treatment are permitted to vote together in the same class, there are no restrictions on counting insider votes, there are no provisions for avoiding fraudulent transfers and there is no requirement that the debtor's assets be used to satisfy outstanding claims. Another feature that the Ad Hoc Group highlights in its objection is that, under the Azeri Plan, all of the IBA's foreign (non-AZN) denominated debt is impaired, while equity and AZN-denominated debt would be left unimpaired.[10] As a result, unsecured creditors (who are owed U.S.$2.38 billion) would take significant haircuts. These features, the Ad Hoc Group argued, substantiate the Ad Hoc Group's argument that the Azeri Restructuring Law and the Azeri proceeding, are "designed to enhance the value of the Republic's equity in the IBA, at the expense of foreign creditors", in direct conflict with the legal and political foundation of Chapter 15 and thus manifestly contrary to U.S. public policy.[11]

The Bankruptcy Court's Recognition Decision

In the June 28, 2017 ruling from the bench, in which it overruled the Ad Hoc Group's objections and recognized the Azeri proceeding as a foreign main proceeding, the Bankruptcy Court was careful to make clear that it was *not* deciding on the substantive objections raised by the Ad Hoc Group at that time. Specifically, the Bankruptcy Court explained that "[a]ll that is before the Court is the authorized representative's request pursuant to Section 1517 of the Bankruptcy Code that the Court recognize the authorized representative as IBA's foreign representative, recognize the Azeri proceeding as a foreign main proceeding, and grant the automatic effects attendant with recognition under Section 1520 of the Bankruptcy Code, including the application of the automatic stay under Section 362 to IBA and IBA's property within the territorial jurisdiction of the United States."[12] As such, Judge Garrity went on to explain that "[i]n reality, the bondholders' objection is a preemptive strike against the IBA plan"[13], that the objection would be better formulated if and when the IBA returns to the Bankruptcy Court to seek enforcement of a confirmed plan, and that the standalone act of recognizing the Azeri proceeding "will not undermine in any way any U.S. policy and granting stay relief that the authorized representative is presently seeking is hardly inconsistent with U.S. policy."[14]

Recognizing the Azeri proceeding as a foreign main proceeding "wil not undermine in any way any U.S. policy and granting stay relief that the authorized representative is presently seeking is hardly inconsistent with U.S. policy"

United States Bankruptcy Court for the Southern District of New York, June 28, 2017

What to Watch For

Ultimately, the recognition of the Azeri proceeding as a foreign main proceeding is unsurprising. The Bankruptcy Court's ruling is simply the latest in a long line of decisions that narrowly construe the public policy exception to grant relief under Chapter 15 of the Bankruptcy Code, particularly at the initial stage when all that is sought is recognition of the foreign proceeding and stay relief.[15] The real test for the Azeri Restructuring Law in the Chapter 15 context will come if and when any creditor files an objection to the IBA's motion for plan enforcement, at which time the Bankruptcy Court may have to grapple with the substantive objections it was able to avoid, given the relatively limited stay relief that results automatically from recognition of a foreign main proceeding.[16]

1. An order was formally entered on July 7, 2017. *See In re Int'l Bank of Azerbaijan*, Case No. 17-11311 (JLG) (Dkt. 38). All further pleading references herein are to the same docket.
2. *See* 11 U.S.C. § 1506.
3. This Issue No. 5 of the Cleary Gottlieb Emerging Markets Restructuring Journal went into production before the January 9, 2018 objection deadline.
4. 11 U.S.C. § 1501(a).
5. Where appropriate, motions for recognition and plan enforcement may be combined.
6. For a more detailed overview of the Chapter 15 recognition and enforcement process, *see* James L. Bromley and Daniel J. Soltman, "U.S. Chapter 15 Overview", *The Restructuring Review of the Americas 2018, Global Restructuring Review*, August 16, 2017, *available at* http://globalrestructuringreview.com/benchmarking/the-restructuring-review-of-the-americas-2018/1145713/us-chapter-15-overview.
7. These provisions were enacted in the form of an amendment to the Law of the Republic of Azerbaijan on Banks.
8. Dkt. 22.
9. *Id.*, ¶ 23.
10. In its response to the Ad Hoc Group's objection, the IBA responded to the allegations of discrimination against foreign denominated debt by noting that "[w]hen claiming prejudice against foreign creditors, the Ad Hoc Group ignores the most important fact: that IBA has no Azeri-denominated debts other than its customer deposits and certain low-cost loans that allow the [IBA] to provide important business services to its customers at competitive rates." Dkt. 23, ¶ 27.
11. Dkt. 22, ¶ 15.
12. Dkt. 39 at 17-18.
13. *See id.* at 19.
14. *See id.* at 19-20.
15. Only a few Chapter 15 courts have ever relied on the public policy exception in refusing to grant relief, and reliance on the public policy exception at the proceeding recognition stage (as opposed to the plan enforcement stage) is even more rare.
16. As noted above, written objections are due on January 9, 2018 and a hearing is scheduled for January 18, 2018. In its motion for permanent enforcement of its Azeri Plan, the IBA noted that the Azeri Plan was approved in Azerbaijan with 93.9% in amount of total claims subject to the restructuring voting in favor of the plan, and to the best of its knowledge, only one member of the Ad Hoc Group that objected to recognition had voted against the Azeri Plan in the Azeri proceeding. *See* Dkt. 22, ¶¶ 41, 44. Accordingly, it is not clear at this time whether the Ad Hoc Group will revive the substantive objections it raised in its objection to recognition.

Elena D. Lobo is an associate in the New York office of Cleary Gottlieb Steen & Hamilton LLP. Elena's practice focuses on a broad range of corporate and financial transactions including financings, restructuring and capital markets transactions. Her practice is primarily cross-border, focusing on Latin America. Elena joined the firm in 2013.

Daniel J. Soltman is an associate based in Cleary Gottlieb's New York office. Dan's practice focuses on bankruptcy and restructuring. Dan joined the firm in 2013.

Dan has published articles on bankruptcy and restructuring in various legal journals, including *The Emerging Markets Restructuring Journal*, *Pratt's Journal of Bankruptcy Law*, *Banking Law Journal*, *Global Restructuring Review* and *Law360*.