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Fundamental Procedural Fairness

The Sine Qua Non *for the Enforcement of Third-Party Releases Authorized in a Foreign Proceeding*

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Third-party releases have perennially been a hot-button issue in U.S. chapter 11 reorganization cases and have resulted in additional scrutiny in the context of chapter 15 cases, where such releases are included in a foreign restructuring. In *PT Bakrie Telecom Tbk*,[1] a U.S. bankruptcy court, sitting as a chapter 15 court in the Southern District of New York, recently recognized an Indonesian restructuring as a foreign main proceeding, but refused to recognize and enforce third-party releases included in the restructuring plan. In so holding, the court established a test under §§ 1521 and 1507 of the Bankruptcy Code (and the principles of comity) for the enforcement of such releases: Does a "clear and formal record" exist establishing that the foreign court adhered to fundamental standards of procedural fairness in authorizing a third-party release?

BTEL's Indonesian Proceeding and Chapter 15 Case

In 2010 and 2011, Bakrie Telecom Pte. Ltd. (the issuer) issued $380 million in senior notes under indentures governed by New York law. It loaned the proceeds of the notes to PT Bakrie Telecom Tbk (BTEL), an Indonesian company and the parent company of the issuer. In addition, the issuer assigned its rights against BTEL under the loan agreement to the indenture trustee. BTEL and two other subsidiaries guaranteed repayment of the notes to the indenture trustee.

Thereafter, BTEL defaulted, and several noteholders formed an *ad hoc* committee to engage in restructuring discussions. After the parties failed to reach agreement, three members of the *ad hoc* committee filed a complaint against BTEL, the issuer and the subsidiary guarantors in the Supreme Court of the State of New York asserting a breach-of-contract claim based on the parties' defaults under the indenture, including the failure to make timely interest payments. They subsequently accelerated the full outstanding balance due under the notes and demanded immediate payment.

Shortly thereafter, another creditor initiated a "*penundaan kewajiban pembayaran utang*" (PKPU) proceeding against BTEL in the Indonesian Commercial Court. A PKPU proceeding is a court-supervised suspension-of-payments process designed to provide a debtor with a period of time to restructure its debts and reorganize its affairs under a composition plan with its creditors.

Upon the instruction of noteholders, the indenture trustee filed proofs of claim in the PKPU proceeding. The issuer also filed a proof of claim for the entire amount due under the notes. Ultimately, over the noteholders' objection, the Indonesian Commercial Court accepted the claim filed by the issuer and allowed the issuer to vote on behalf of the noteholders regarding the approval of the BTEL composition plan.

During the pendency of the PKPU proceeding, but prior to approval of the composition plan, a broader group of noteholders from the *ad hoc* committee filed a second action in New York state court asserting additional claims concerning the notes. These claims were consolidated with the original New York breach-of-contract action. The state court granted summary judgment in the noteholders' favor as to liability on the notes and guarantees, as well as to related claims for fraud, and the judgment was affirmed on appeal.

Thereafter, the Indonesian Commercial Court approved the composition plan proposed by BTEL on the basis that the required majority of creditors needed to vote for the plan under Indonesian law had done so. The issuer was one of 325 creditors that voted in favor of the composition plan, and its claim represented approximately 56 percent of the total amount of unsecured indebtedness restructured thereby. The composition plan, as approved by the requisite majorities, included third-party nondebtor releases that purported to discharge the issuer and subsidiary guarantors of all liability on the notes.

Three years after the PKPU proceeding formally closed, BTEL appointed Jastiro Abi, a director of both BTEL and the issuer, to serve as its foreign representative. He filed a petition under chapter 15 of the U.S. Bankruptcy Code seeking recognition of BTEL's Indonesian proceeding as a foreign main proceeding, and the enforcement of BTEL's composition plan. Not surprisingly, the noteholders objected to recognition and to the enforcement of the composition plan, including the third-party releases. Following trial in the

1 *In re PT Bakrie Telecom Tbk*, No. 18-10200 (SHL), 2021 WL 1439953 (Bankr. S.D.N.Y. April 15, 2021).

chapter 15 case, the court entered a decision recognizing the Indonesian proceeding as a foreign main proceeding but denying the foreign representative's request to enforce the third-party releases.

Bankruptcy Court Authority to Issue or Enforce Releases Under the Code

In the U.S., courts of appeals are split on the authority of bankruptcy courts to approve third-party releases in a reorganization plan confirmed under chapter 11 of the U.S. Bankruptcy Code.[2] Courts that have found that bankruptcy courts have such authority generally only approve such releases in limited circumstances, such as when the releases are essential to the reorganization, the parties being released made a substantial financial contribution to the reorganization, and/or the affected creditors support the plan.

Notwithstanding chapter 11 jurisprudence regarding third-party releases, the legal standards for the enforcement of third-party releases in a chapter 15 case need not be identical to those that a U.S. court would employ in a chapter 11 case. Indeed, even in the U.S. circuits that do not recognize bankruptcy court authority to approve third-party releases, the enforcement of such releases as approved in a foreign proceeding may be permitted under chapter 15.[3]

Legal Standard for Enforcing Third-Party Releases Under Chapter 15

In the context of a chapter 15 case, the key inquiry is whether the foreign court had the proper authority to grant the releases and whether enforcement of such releases is appropriate as a matter of comity or under §§ 1507 and 1521(a) of the Bankruptcy Code. Section 1521(a) provides that "[u]pon recognition of a foreign proceeding ... where necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief." Such relief may be granted only if the "interests of the creditors and other interested entities, including the debtor, are sufficiently protected." In order to find that creditors are "sufficiently protected," the following must occur: (1) the "just treatment" of all claimants; (2) the protection of domestic claimants against "prejudice and inconvenience" in how claims are processed in the foreign proceeding; and (3) the distribution of proceeds of the foreign estate substantially in the order prescribed by U.S. law. Similarly, § 1507 authorizes a court to provide a foreign representative with additional assistance where such assistance is "consistent with principles of comity" and the court is satisfied that the proceeding provided for the just treatment of all holders of claims and protected U.S. claimants from prejudice and inconvenience.

Thus, the granting of discretionary relief largely turns on subjective factors, many of which also underpin a decision to provide comity to a foreign court. These factors include whether the foreign proceeding (1) abided by fundamental standards of procedural fairness, (2) violated fundamental U.S. public policy, and (3) was affected by fraud. Principally, in determining whether a foreign proceeding abided by fundamental principles of fairness, a U.S. court looks to see whether a "clear and formal record" was made by the foreign tribunal with respect to the relief the foreign representative is seeking to enforce in the U.S.[4] That is particularly true where there is little precedent in the U.S. concerning the foreign tribunal's procedural safeguards for the rights of all parties-in-interest.

In recognizing and enforcing foreign third-party releases, bankruptcy courts have additionally looked to whether a majority of creditors supported the restructuring plan, and whether such creditors were insiders of the debtor. Where a majority of non-insiders voted in favor of the plan, courts in the U.S. have typically recognized such third-party releases.[5] Where, however, a foreign plan is only approved by relying on insiders' votes comity will not be granted.[6]

In *PT Bakrie*, the U.S. bankruptcy court found that the comity analysis overlapped with the requirements of §§ 1521 and 1507 of the Bankruptcy Code. Under either standard, the Indonesian court also did not establish a record sufficient for the chapter 15 court to extend comity and enforce the third-party release. Specifically, there was no evidence in the record that the fundamental standards of procedural fairness necessary to ensure the just treatment and protection of U.S. claimants against prejudice were observed in the PKPU proceeding. In reaching its conclusion, the court noted that there is well-established precedent providing comity to a foreign jurisdiction's decisions, based on the foreign tribunal's sensitivity to procedural safeguards of a party's rights.[7]

On the facts of *PT Bakrie*, the court concluded that there was "no clear and formal record that sets forth whether or how the foreign court considered the rights of creditors when considering this third-party release." In so holding, the court discussed a nonexhaustive list of relevant considerations that could have been included in the record to show fundamental procedural fairness, including (1) how the release was "presented to the Indonesian court for consideration;" (2) whether any creditors were heard, or even had the "ability" to be heard, concerning the release; or (3) the "justification" for the release. The third factor was particularly important, given unrebutted testimony by the noteholders' expert witness that third-party releases were not standard for Indonesian proceedings, "but instead must be justified under Indonesian law." It is possible that if third-party releases were standard in Indonesian debt-composition plans, the court may have found the lackluster record less disqualifying.

2 *See In re PT Bakrie Telecom Tbk*, No. 18-10200 (SHL), 2021 WL 1439953, at *15 (Bankr. S.D.N.Y. April 15, 2021) (comparing standards between Second, Third and Sixth Circuits with Fifth, Ninth and Tenth Circuits). *Compare SEC v. Drexel Burnham Lambert Grp. Inc. (In re Drexel Burnham Lambert Grp. Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992); *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 212-13 (3d Cir. 2000), *with Bank of N.Y. Tr. Co. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009); *Resorts Int'l Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401-02 (9th Cir. 1995); *Landsing Diversified Props.-II v. First Nat'l Bank & Tr. Co. of Tulsa (In re W. Real Estate Fund Inc.)*, 922 F.2d 592, 600 (10th Cir. 1990).

3 *See In re Vitro S.A.B. de CV*, 701 F.3d 1031, 1061, 1064 (5th Cir. 2012).

4 *See Hilton v. Guyot*, 159 U.S. 113, 205-06 (1895).

5 *See, e.g., In re Agrokor d.d.*, 591 B.R. 163, 173 (Bankr. S.D.N.Y. 2018); *In re Avanti Commc'ns. Grp. PLC*, 582 B.R. 603, 618 (Bankr. S.D.N.Y. 2018); *In re Sino-Forest Corp.*, 501 B.R. 655, 665-66 (Bankr. S.D.N.Y. 2013).

6 *In re Vitro S.A.B. de CV*, 701 F.3d at 1067-69.

7 *See In re PT Bakrie Telecom Tbk*, 2021 WL 1439953, at *19 n.16 (comparing Canadian foreign proceedings to Indonesian proceedings).

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Ultimately, the court held that there must be at least a "rudimentary record" in the foreign proceeding as to the "basis" for the release and "procedural fairness of the underlying process," and parties cannot rely on mere post-hoc rationalizations. As no such record was presented in *PT Bakrie*, the U.S. bankruptcy court would not enforce the release granted by the Indonesian court. In so holding, the court specifically emphasized that it was not ruling on the permissible scope of third-party releases under Indonesian law or whether such releases could, as a general matter, be recognized in the U.S. Notably, while the U.S. bankruptcy court left open the possibility for the parties to return after the Indonesian court better developed the record and explained its decision, the question remains as to whether a U.S. court would still recognize these nonconsensual releases. Similar to *Vitro*, it appears that the plan was approved based only on an insider having majority control over a consenting class of creditors.[8]

Conclusion

PT Bakrie is a decision about fundamental fairness, process and procedure. While the *PT Bakrie* court refused to enforce third-party releases under chapter 15, the court's decision and analysis does not appear to be a departure from the line of cases considering and enforcing foreign third-party releases in the U.S. The court specifically emphasized that the issue in *PT Bakrie* was the lack of a record regarding the Indonesian approval process and not the form and substance of the releases, as releases approved by a foreign court need not be identical to the releases a chapter 11 court may authorize, and U.S. bankruptcy courts have properly recognized foreign third-party releases emanating from a number of different countries. The court's reasoning for refusing to enforce *PT Bakrie*'s third-party releases, however, established an important analytical framework that bankruptcy courts can employ when they consider providing additional assistance to a foreign representative.

Where there are significant creditor objections to a foreign restructuring, or there is little precedent as to the fairness and procedural safeguards employed by a foreign court, the parties benefiting from an order of such foreign court would be well served by being mindful of Hon. **Sean H. Lane**'s views regarding process and comity. Specifically, such parties should urge the presiding court to make detailed findings and conclusions regarding the foreign court's jurisdiction to enter an order providing for a third-party release or injunctive relief, the notice provided to creditors and other stakeholders of the relief being requested, the court's reason for approving such relief, and whether creditors and other stakeholders had a full and fair opportunity to vote and object. abi

8 *See In re Vitro S.A.B. de CV*, 701 F.3d at 1067.