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Enjoining Foreign Actions Against Non-Debtor Entities: *In re Lyondell Chemical Company*

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In the United States, parties are precluded from taking actions against a debtor and the property of its estate during the pendency of the debtor's chapter 11 bankruptcy case. This ensures that the assets are protected while the debtors' case is resolved and that one creditor does not receive favourable treatment over another by simply winning the race to the courthouse. Bankruptcy courts have further extended similar protections to actions against non-debtor third parties because of their potential impact on a debtor and its reorganisation. Last year, the bankruptcy court in *In re Lyondell Chemical Company*, 402 B.R. 571 (Bankr. S.D.N.Y. 2009), took one step further and enjoined all actions against certain foreign non-debtor third parties related to Lyondell, including actions that could be commenced in European courts, due to the impact such actions may have on Lyondell's estate. Although it is not yet clear whether additional courts will follow suit, given our global economy, current economic crisis, and the impact that such injunction can have on all parties involved, it is certainly an issue worth watching.

I. Enjoining actions against third party non-debtors under the United States Bankruptcy Code

In chapter 11 cases, there are two avenues through which bankruptcy courts may enjoin actions against non-debtor third parties because of their potential impact on the debtor and its reorganisation.

The first is found under Section 362(a), which automatically stays actions against the debtor and the property of the estate.[2] By its plain language, this section applies only to actions against the debtor. Courts, however, have extended its protections to non-debtor third parties in 'unusual circumstances', which include instances in which there is such identity between a debtor and non-debtor that a debtor may be said to be the real party defendant or there is a threat that the action will reduce or diminish the property of a debtor.[3]

The second means utilised by bankruptcy courts to enjoin actions against non-debtor third parties is the broad authority afforded in Section 105(a).[4] That section provides courts with the discretion to 'issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title'. Numerous courts have found that this section may be used to stay actions against non-debtors, even when Section 362 would not otherwise provide such relief.[5] As one court explained, 'Section 105 injunctions are granted in these circumstances because one of the overriding purposes of the Bankruptcy Code is to provide debtors with breathing room from their creditors to increase the chances of a successful reorganisation. Because non-debtors do not fall within the protection of the automatic stay, at times section 105 must be invoked on their behalf to prevent creditors from frustrating an otherwise-viable reorganisation effort by pursuing actions against them. In other words, "Congressional intent to provide relief to debtors would be frustrated by permitting indirectly what is expressly prohibited by the Code."'[6]

In determining whether to enjoin an action against a non-debtor under Section 105, bankruptcy courts generally consider: (i) whether there is a likelihood of successful reorganisation; (ii) whether there is an imminent irreparable harm to the estate in the absence of an injunction; (iii) whether the balance of harms tips in favour of the moving party; and (iv) whether

Notes

1 Orrick, Herrington & Sutcliffe LLP represented various creditors in the *Lyondell* bankruptcy.
2 11 U.S.C. § 362(a).
3 See, e.g., *Credit Alliance Corp. v Williams*, 851 F.2d 119, 121 (4th Cir. 1988) (citing *A.H. Robins Co. v Piccinin,* 788 F.2d 994, 999, 1008 (4th Cir. 1986)).
4 11 U.S.C. § 105(a).
5 See *In re Calpine Corp.*, 354 B.R. 45, 48-49 (Bankr. S.D.N.Y. 2006), *aff'd* 365 B.R. 401 (S.D.N.Y. 2007), and cases cited therein.
6 *Calpine Corp.*, 354 B.R. at 49 (quoting *In re United Health Care Organization*, 210 B.R. 228, 233 (S.D.N.Y. 1997)).

the public interest weighs in favour of an injunction.[7] Some courts have further held that 'irreparable injury' need not be shown to issue an injunction under Section 105.[8]

Although there is no hard and fast rule, at least some courts have distinguished between Section 105 and Section 362 for purposes of enjoining an action against a non-debtor based on whether a claim against a non-debtor is economically equivalent to a claim against a debtor and whether a claim involves sureties or guarantors of a debtor.[9] If the former, courts will invoke Section 362's automatic stay to enjoin such action. If the latter, courts will rely upon Section 105 – and the traditional four factor injunction test – to determine whether an action should be enjoined.

Until recently, Section 105 has been utilised to enjoin domestic actions against a non-debtor, that is, actions falling within the U.S. judicial system. The 2009 decision in *Lyondell*, however, took Section 105 even one step further and, for what appears to be the first time, applied Section 105 to enjoin foreign actions against a non-debtor.

II. *Lyondell* – enjoining foreign actions against non-debtors via Section 105

Lyondell Chemical Company and its affiliates are part of a cross-border chemical manufacturing enterprise, which is organised under a European parent company, LyondellBasell Industries AF S.C.A. ('LBIAF'). In January 2009, Lyondell and other U.S. based affiliates (the 'Debtors') filed for chapter 11 protection in the United States Bankruptcy Court for the Southern District of New York. At that time, LBIAF did not institute its own bankruptcy proceedings.

Just weeks later, however, the bankruptcy court issued a temporary restraining order precluding certain creditors and noteholders from taking any action against LBIAF and other non-debtor affiliates, including foreign actions. Shortly thereafter, in *In re Lyondell Chemical Company*, 402 B.R. 571 (Bankr. S.D.N.Y. 2009), the bankruptcy court issued a 60-day preliminary injunction pursuant to Section 105 enjoining similar actions. As stated, that decision appears to be the first time a bankruptcy court has utilised Section 105 to enjoin foreign actions against a non-debtor.

The bankruptcy court's issuance of the preliminary injunction was hotly contested and included extensive briefing, discovery and two days of hearings. At issue was LBIAF's role as guarantor of various of the Debtors' unpaid obligations to contractual counterparties, whose claims totalled at least USD 131,000,000. In addition, LBIAF was the principal obligor on notes held by other creditors in the amount of USD 615,000,000, which were due in 2015 and guaranteed by certain LBIAF subsidiaries, including a number of the Debtors (referred to as the '2015 Notes'). Significantly, the Debtors' chapter 11 filing triggered an event of default under the 2015 Notes. As a result, the indenture trustee for the 2015 Notes or the holders of 25% of the principal amount of the outstanding 2015 Notes could declare such notes due. Insofar as LBIAF would be unable to make principal and interest payments under acceleration of the 2015 Notes, the indenture trustee or the noteholders could then seek to commence involuntary insolvency proceedings against LBIAF in a foreign venue.

Given these facts, the Debtors maintained that the preliminary injunction was critical to protect them from the risks associated with foreign involuntary insolvency proceedings against LBIAF, which they believed could wreak havoc on the financial and operational well-being of all of the entities owed by LBIAF, including debtors and non-debtors. Ultimately, the bankruptcy court agreed with the Debtors but limited the injunction to just 60 days and, as a condition to granting the injunction, further precluded LBIAF from taking certain actions that would dissipate its assets.

In so doing, the bankruptcy court first addressed whether it had the jurisdiction to enter the injunctive relief, which some of the defendants had questioned. It quickly concluded that it did and that it could work to protect the Debtors' reorganisation, even abroad. According to the bankruptcy court, to the extent anyone took steps abroad to cause injury to the Debtors' reorganisation, it would be the same as someone 'shooting a bullet across a state line'.[10] Similar to other courts, the bankruptcy court also rejected the Debtors' request that it extend the automatic stay under Section 362 to grant the relief requested. Instead, the bankruptcy court proceeded under Section 105 and the traditional four-factor test for issuance of an injunction.

With regard to the first factor in that test – the likelihood of successful reorganisation – the bankruptcy court found it sufficient that the Debtors were proceeding on track towards a reorganisation and had met the challenges they faced to date. With regard to the second – whether irreparable injury would result to the Debtors in the absence of an injunction – the bankruptcy

Notes

7 See *In re Calpine Corp.*, 365 B.R. 401, 409 (S.D.N.Y. 2007).

8 See *Calpine Corp.*, 354 B.R. at 48; *In re Alert Holdings, Inc.*, 148 B.R 194, 200 (Bankr. S.D.N.Y. 1992)

9 *In re Calpine Corp.*, 365 B.R. 401, 408-09 (S.D.N.Y. 2007) (citing *A.H. Robins,* 788 F.2d at 999; *Queenie Ltd. v Nygard Int'l*, 321 F.3d 282, 287 (2d Cir. 2003); *Credit Alliance*, 851 F.2d at 121-122).

10 *Lyondell*, 402 B.R. at 587.

court agreed with other courts that irreparable injury need not be shown in connection with a request for an injunction under Section 105. Nonetheless, the bankruptcy court went on to find that irreparable injury to the Debtors and their ability to reorganise would plainly result if an involuntary insolvency proceeding were commenced against LBIAF or its subsidiaries.

Among other things, the bankruptcy court noted that involuntary insolvency proceedings against LBIAF in a foreign venue (namely, Luxembourg or the Netherlands) would likely not involve a process of reorganisation, could cause LBIAF to liquidate, and could ultimately force all of the European affiliates into their own liquidation proceedings. In turn, such liquidation could trigger fiduciary or other legal obligations of directors of LBIAF and other non-debtor affiliates of the Debtors located in Europe, which could force all of the European entities into their own liquidation proceedings. Moreover, an involuntary proceeding against LBIAF would constitute an event of default under the Debtors' DIP and, if the DIP lenders exercised their default rights, the Debtors themselves would be forced to liquidate their business. Although none of these results were certain to occur, it was sufficient for the bankruptcy court's purposes that the Debtors needed to be protected from such threats.

With regard to the third factor in the injunction test – the balance of the harms – the bankruptcy court concluded that the potential harm to the Debtors if creditors were permitted to commence involuntary insolvency proceedings against LBIAF 'dramatically' tipped in favour of granting the Debtors some sort of relief. Further, the bankruptcy court noted that guaranty creditors and noteholders were unlikely to have their claims satisfied if were they allowed to proceed because of their positions in the recovery process. To be sure, the bankruptcy court acknowledged some harms that the guaranty creditors and noteholders might suffer as a result of an injunction (for instance, if LBIAF dissipated its assets during the injunction) but the bankruptcy court limited the injunction to 60 days and imposed extra conditions, which it believed would prevent such harms from occurring (namely, it precluded LBIAF from transferring or encumbering certain stock; transferring, releasing or compromising its receivables; and making payments out of the ordinary course of business).

As to the fourth factor – whether the public interest weighed in favour of an injunction – the bankruptcy court acknowledged the importance of respecting and honouring guaranties wherever possible, and of avoiding the unequal treatment of similarly situated creditors. Although it did not find that the public interest factor warranted denial of the injunction *in toto*, it did find that a 60-day limit on the injunction was critical, in the court's mind, to give LBIAF time to file for bankruptcy protection voluntarily.

Sure enough, as the bankruptcy court anticipated, just three days before the conclusion of the 60-day injunction, LBIAF filed for chapter 11 protection in the same court as the Debtors.

III. Looking ahead

Despite the fact that the bankruptcy court in *Lyondell* enjoined foreign actions against a non-debtor entity, for what appears to be the first time, there has been limited analysis to date of the decision's implications nor does it appear that any other court has followed suit. This is not wholly surprising. Indeed, upon review of the decision in *Lyondell*, one can surmise that the bankruptcy court was motivated by the particular facts in the case. There is no doubt that the Debtors, LBIAF, and other non-debtor affiliates and subsidiaries might have suffered disastrous consequences had involuntary insolvency proceedings been brought in Europe. At the same time, there is equally little doubt that the guaranty creditors and noteholders had legitimate and monetarily significant claims. The bankruptcy court addressed both aspects by its limited injunction.

With that said, the decision in *Lyondell* is subject to criticism for failing to address issues of international comity and choice of law. To be sure, the bankruptcy court concluded that it had the jurisdiction to order the relief requested and that foreign involuntary insolvency proceedings could be disastrous. But it did not consider or otherwise recognise the legislative or judicial imperatives of any of the European nations whose insolvency proceedings it was potentially usurping nor did it analyse the merits of it so doing. Should *Lyondell* be seized upon in the future by a party seeking similar relief as the Debtors, one can anticipate such issues to be raised.

At a minimum, today, in the absence of further legal discourse on the subject, those involved in insolvencies with cross-border connections should be aware of the reach of *Lyondell*. From a debtor's or foreign non-debtor's perspective, *Lyondell* may be a useful tool for preventing a foreign involuntary insolvency proceeding for at least enough time for a non-debtor to determine the best course of action to take. From the perspective of a creditor with obligations guaranteed or otherwise secured by a foreign non-debtor, *Lyondell* should serve as a reminder that its rights against such a non-debtor may not be without limits and, where equity so demands, may be subordinated to the interests of a debtor's successful reorganisation.

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