Financial Restructuring

New York Bankruptcy Court Sanctions Hundreds of Avianca's Foreign Creditors

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In early 2020, Avianca Holdings S.A., a major Colombian airline, filed for chapter 11 in New York. This case raised important issues in cross-border restructuring, including legal and practical questions concerning the resolution of claims arising in foreign jurisdictions.

Under U.S. law, the filing of a bankruptcy petition operates as an "automatic stay" of all litigation and debt collection efforts against the debtor worldwide. In addition, the confirmation of a plan of reorganization under chapter 11 "discharges" or releases the debtor from all debts that arose prior to the date of confirmation, with creditors to be compensated under the terms of the plan itself. A recurring issue in cross-border restructuring, however, is how practically to bind creditors outside the United States who seek relief in their home countries' courts despite the worldwide automatic stay and the global discharge under U.S. bankruptcy law.

In November 2022, Avianca requested that the Bankruptcy Court sanction approximately 150 Colombian and Brazilian creditors who had filed claims in Avianca's bankruptcy but had continued to litigate against Avianca in their home countries. Under the Bankruptcy Code, Avianca's liability to those creditors was discharged upon its plan becoming effective, with those creditors entitled to recover only under the terms of the plan. In addition, the plan itself prohibited creditors from continuing proceedings against Avianca regarding the discharged debt.

Avianca was forced to admit two facts, however. First, Avianca had made a strategic decision not to seek court orders in Brazil and Colombia themselves to recognize and enforce the U.S. automatic stay, discharge, and plan, which Avianca could have done under the UNCITRAL Model Law on Cross-Border Insolvency, which both countries had adopted. Second, Avianca could not point to any prior cases granting sanctions under similar circumstances.

The Court nevertheless determined that the sanctions were appropriate. The Court reasoned that (i) the creditors had violated the plan's discharge and injunction provisions; (ii) evidence of such violations met a "clear and convincing" standard; and (iii) the creditors had not made "diligent efforts" to comply with the confirmation order. In addition, the Court followed established law in holding that, by filing claims in the U.S. bankruptcy case, the creditors had submitted to the jurisdiction of the Bankruptcy Court. The Court also agreed with Avianca that the appropriate sanction was to disallow the creditors' claims if they failed to discontinue their litigations abroad within 30 days.

Central to the Court's reasoning was that it would be unfair for creditors to recover for the same claims both in the U.S. and in foreign proceedings. Such double-recovery would be at the expense of other creditors, including creditors who had complied with the automatic stay and discharge provisions of the Bankruptcy Code and with the order confirming Avianca's plan.

Notably, Avianca stated at the hearing on its motion that it would continue to defend the claims abroad on the merits, even though they had been barred as a matter of U.S. law. Avianca and the Court recognized the practical limitations of the Court's ability to enforce compliance with its orders and the Bankruptcy Code abroad. From creditors' standpoint, however, the ruling is a reminder that continuing to pursue litigation abroad in violation of U.S. bankruptcy law may affect their ability to recover in U.S. bankruptcy proceedings, even in situations where the U.S. bankruptcy has not been recognized by the courts of their home countries.

Practice Area News

In re Pazzo Pazzo 2022 WL 17690158 (U.S. 3rd Circuit Court of Appeals, Dec. 15, 2022): Before filing for bankruptcy, the debtor failed to exercise an allegedly valuable option to purchase property from a third party, thereby leaving the third party as the owner of the property. The Third Circuit ruled that the debtor's failure to exercise the option did not constitute a "transfer" of the property under the Bankruptcy Code. Accordingly, the debtor could not seek to recover the value of the option as a "fraudulent transfer."

In re COMAIR Limited, Case No. 21-10298(JLG) (Bankr. S.D.N.Y., Feb. 12, 2023): When a foreign reorganization proceeding has been recognized in the United States under chapter 15 by order of the Bankruptcy Court, but the foreign proceeding is then converted to a liquidation, that conversion does not require a new chapter 15 filing. Rather, the reorganization and the subsequent liquidation constitute the same "foreign proceeding" under chapter 15, and the new foreign representatives appointed in the liquidation can take the place of the former foreign representatives by modifying the existing U.S. recognition order.

In re LTL Mgmt., LLC, 58 F.4th 738 (U.S. 3rd Circuit Court of Appeals, Jan. 30, 2023): A corporation created a new subsidiary to hold certain tort liabilities, and the subsidiary filed for chapter 11. The Third Circuit dismissed the bankruptcy case, reasoning that the subsidiary debtor was not in "financial distress" because it had a funding agreement from its corporate parent that was sufficient to satisfy its liabilities. The Court concluded that, without such "financial distress," the case did not serve a valid bankruptcy purpose.

Bartenwerfer v. Buckley 2023 WL 2144417 (U.S. Supreme Court, Feb. 22, 2023): The U.S. Supreme Court unanimously held that section 523(a)(2)(A) of the Bankruptcy Code prohibits a debtor from discharging any debt the debtor has for money "obtained by . . . fraud," even when the fraud at issue was not committed by the debtor itself. Accordingly, if the debtor is liable for someone else's fraud, like that of a partner or an agent, that liability cannot be discharged in bankruptcy.

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