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In re Sino-Forest Corporation: Enforceability of Non-Debtor Releases in Chapter 15

On November 25, 2013, in the Chapter 15 case of *In re Sino-Forest Corp.*,¹ the United States Bankruptcy Court for the Southern District of New York (the “**Court**”) recognized and enforced a Canadian court order that approved third-party non-debtor releases (the “**Releases**”) that were integral to Sino-Forest Corporation’s (“**SFC**”) plan of compromise and reorganization (the “**Plan**”). This decision is important because it shows the willingness of U.S. courts to approve Releases where (i) the Releases are fully and fairly litigated in the foreign jurisdiction where the main proceeding is pending, (ii) the reorganization plan has near unanimous support, (iii) that support does not rely on votes by insiders, and (iv) in approving the Releases the foreign court has considered factors that are similar to those considered by a U.S. court in a plenary Chapter 11 case.

This case is also significant because it is the first case in the Southern District of New York (where many Chapter 15 cases are filed) to address the enforceability of the Releases since the Fifth Circuit Court of Appeal’s decision in *In re Vitro S.A.B. de C.V.*² In *Vitro*, the U.S. court would not enforce Releases that were approved by the Mexican court under a Mexican concurso. To access a previous client note reviewing the Fifth Circuit’s *Vitro* decision, please click [here](#).

Background

On February 4, 2013, the foreign representative of SFC commenced a Chapter 15 case. The Court recognized SFC’s restructuring proceeding under the Canadian *Companies Creditors Arrangement Act* (the “**Canadian Proceeding**”) pending in the Ontario Superior Court of Justice (the “**Canadian Court**”). In the Canadian Proceeding, SFC sought approval of its proposed Plan, which included a settlement with Ernst & Young LLP (“**E&Y**”), SFC’s external auditor from 2007 through 2012. E&Y, among others, had been named as a defendant in securities class action lawsuits for alleged misrepresentations in SFC’s financial statements issued before 2011.

In settlement of those lawsuits, E&Y agreed to pay CAD\$117 million to a settlement trust fund established under the Plan for the benefit of the securities claimants. It also agreed to release all claims against SFC and its subsidiaries, relinquish its rights to any distribution under the Plan and support approval of the Plan. In exchange, E&Y

¹ *In re Sino-Forest Corp.*, No. 13-10361 (Bankr. S.D.N.Y. Nov. 25, 2013).

² *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031 (5th Cir. 2012).

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would obtain a global release and the benefit of certain injunctions under the Plan. The settlement was supported by substantially all constituents in the Canadian Proceeding, including the lead plaintiffs in the class actions.

The Canadian Court found that the Releases were appropriate because there was “a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan.”³ The Canadian Court also overruled the objections of certain minority investors whose appeals were later dismissed by the Canadian appellate court.

The Court’s Decision

In determining to enforce the Releases approved by the Canadian Court, the Court relied primarily on an earlier decision from the Southern District of New York issued in the Chapter 15 case of *In re Metcalfe & Mansfield Alternative Investments*.⁴ In *Metcalfe*, the bankruptcy court determined that enforcing Releases contemplated by a restructuring plan approved by a Canadian court was appropriate where the issue of Releases had been fully litigated with a full and fair opportunity to be heard consistent with U.S. due process. The Court viewed SFC’s request to enforce the Releases as being on “all fours” with *Metcalfe* insofar as here the Court found that the Canadian Court provided a full and fair opportunity to litigate the Releases, and it reached a reasoned opinion that it had jurisdiction to grant the requested relief and that such relief was appropriate in the circumstances. Also, no party objected to the Court enforcing the Releases. Accordingly, it was appropriate to enforce the Releases as additional assistance to the foreign representatives.

In addition, the Court rejected an argument that the Releases were manifestly contrary to U.S. public policy. Citing to the earlier decision in *Metcalfe*, the Court concluded that its inquiry is limited to determining whether the procedures used in the foreign jurisdiction meet U.S. fundamental standards of fairness. The Court also noted that in the Second Circuit, Releases are not categorically prohibited as they are in other Circuits, including in the Fifth Circuit where *Vitro* was decided.

The Court also observed that the Canadian Court in granting the Releases considered factors that exhibited sensitivities similar to those considered by a U.S. court in evaluating Releases. Specifically, the “reasonable connection” standard and other factors utilized by the Canadian Court are similar to those factors articulated by the Second Circuit in approving Releases under *In re Metromedia Fiber Network, Inc.*⁵ and *In re Johns-Manville Corp.*⁶ For instance, in *Metromedia*, the Second Circuit stated that Releases are appropriate in circumstances where (i) the estate received substantial consideration, (ii) the enjoined claims were “channeled” to a settlement fund rather than extinguished, (iii) the enjoined claims would indirectly impact the debtor’s reorganization “by way of indemnity or contribution,” and (iv) the plan

³ *In re Sino-Forest Corp.*, No. 13-10361 at 8 (citation omitted).

⁴ *In re Metcalfe & Mansfield Alternative Investments*, 421 B.R. 685 (Bankr. S.D.N.Y. 2010).

⁵ *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136 (2d Cir. 2005).

⁶ *In re Johns-Manville Corp.*, 517 F.3d 52 (2d Cir. 2008), *rev’d and remanded sub nom. Travelers Indem. Co. v. Bailey*, 557 U.S. 137 (2009).

otherwise provided for the full payment of the enjoined claims or obtained the affected creditors' consent.

Finally, the Court distinguished *Vitro* from *Metcalfe* and SFC on the basis of the fairness of the process utilized by the Canadian Court in approving the Releases and the support for the Plan shown by creditors of SFC, including the lead plaintiffs who would benefit from the settlement with E&Y.

Lessons Since Vitro

The Court's ruling is important because it reaffirms the *Metcalfe* decision and demonstrates that a foreign representative should be able to obtain an order enforcing Releases if, among other things:

- > The foreign proceeding demonstrates the hallmarks of procedural fairness and due process in that all interested parties are provided with a full and fair opportunity to be heard and an opportunity to appeal.
- > Releases are not obtained with "unclean hands."
- > The factors considered by the foreign court in granting the Releases exhibit similar sensitivities as those factors considered by a U.S. court in granting such relief, including whether (i) there is an identity of interests between the debtor and third party, (ii) the non-debtor has contributed substantial assets to the reorganization, and (iii) the injunction is essential to the reorganization.

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