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In Re Sanjel (USA), Inc.: Bankruptcy Court Denies Comity to Canadian Court's Injunction Protecting Officers and Directors

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In *In re* Sanjel (USA), Inc., no 16-50778 (Bankr. W.D. Tex Jul. 28, 2016) (docket no. 388),[1] the United States Bankruptcy Court for the Western District of Texas (the "Bankruptcy Court") modified its prior order granting recognition under sections 1517 and 1521 of title 11 of the United States Code (the "Bankruptcy Code") to permit individuals to pursue claims in the United States against a debtor's directors and officers in order to prevent expiration of the statute of limitations. The ruling is significant because the suits against the directors and officers were subject to an injunction entered in the debtors' home court in Canada. The ruling demonstrates the tension between the willingness of U.S. courts to extend comity and protection of U.S. creditor interests.

Background

On April 4, 2016, the Court of the Queen's Bench of Alberta (the "Canadian Court") entered an order (the "Initial Order") under the Companies Creditor Arrangement Act (the "CCAA") granting relief to Sanjel (USA), Inc. ("Sanjel") and certain of its related entities (collectively, with Sanjel, the "Debtors"). In addition to enjoining all acts to collect debts against the Debtors, the Initial Order extended the stay to the Debtors' directors and officers, which is not uncommon for CCAA orders. The stay under the CCAA must be affirmatively extended by the Canadian Court and, in this case, had been extended to July 15, 2016 and a request for an additional extension to August 31, 2016 was pending.

On April 4, 2016, the monitor overseeing the Debtors' CCAA proceedings (the "Monitor") filed a petition for recognition of the foreign proceedings in the Bankruptcy Court. On April 29, 2016, the Bankruptcy Court entered an order granting recognition of the Canadian proceedings and related relief. See *In re* Sanjel (USA), Inc., no 16-50778 (Bankr. W.D. Tex Jul. 28, 2016) (docket no. 185) (the "Recognition Order"). The Recognition Order "gave force" in the United States to, among other things, the Initial Orders' broad grant of injunctive relief in favor of the Debtors' directors and officers. See Opinion at 3 (quoting Recognition Order at ¶ 2 ("the terms of the Initial Order are given full force and effect in the United States.") and ¶¶ 3 & 6).

Prior to the Debtors' commencement of proceedings in Canada or the United States, two individuals (the "Movants") filed separate collective actions in the United States District Court for the District of Colorado (the "Colorado Cases") against Sanjel alleging violations of the Fair Labor Standards Act ("FLSA").[2] More specifically, Movants alleged Sanjel's employees had claims for unpaid minimum wages, unpaid overtime and, if successful on its claims, lawyers' fees. On May 27, 2016, Movants filed a motion for relief from the automatic stay to allow them to join the Debtors' directors and officers to the Colorado Cases and

[1] For citation purposes, docket no. 388 shall be referred to as the "Opinion".
[2] A collective action is not a class action. Similarly situated individuals who want to be part of a lawsuit brought by others must affirmatively "opt in" in writing. Any individual who does not elect to do so won't be part of the lawsuit and won't share in any recovery if the lawsuit is successful. However, employees may bring their own suits against the employer. Class actions cover all employees for a particular claim unless they affirmatively "opt out."

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pursue claims under FLSA, while the Debtors cases were stayed.[3] Although a complaint had been filed against the Debtors, under collective actions, the two year statute of limitations is not tolled until the first additional party "opts-in," in writing, to the suit. Therefore, each day that passed resulted in claims under the FLSA falling outside the statute of limitations and reduced the directors' and officers' liability. The Debtors opposed the request on the following grounds: (1) U.S. courts routinely uphold stays of directors and officers issued by Canadian courts under the CCAA; (2) the Movants will not suffer any prejudice if the relief is not granted because they can bring their request for relief from the Interim Order to the Canadian Court; and (3) the Debtors will suffer prejudice if the relief is granted because they will expend resources responding to the litigation and obstruct their reorganization efforts.

Bankruptcy Court Analysis

The Bankruptcy Court relied upon section 1522(a) of the Bankruptcy Code for the standard to modify the Recognition Order. That section provides, in relevant part, that "[t]he court may . . . modify or terminate relief under [section 1522(c)], only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected." 11 U.S.C. § 1522(a).[4] Critical to its decision, the Bankruptcy Court reasoned it was free to fix relief that is appropriate. First, Congress gave the courts great flexibility to fashion appropriate relief in Chapter 15 cases. See Opinion at 8 ("Congress intended to give bankruptcy courts 'broad latitude to mold relief to meet specific circumstances.'") (citing H.R. Rep. No. 109-31, at 16; *Jaffe v. Samsung Elecs. Co.* (*In re* Quimonda), 737 F.3d 14, 29 (4th Cir. 2013)). Second, bankruptcy courts may "give effect to certain orders of a foreign court and not give effect to other orders." Opinion at 8 (citing *In re* Cozumel Caribe, 482 B.R. 330, 337-38 (Bankr. S.D.N.Y. 2014)("Granting comity to orders of a foreign court is not an all or nothing exercise – some orders or judgments in the same case or proceeding merit comity while others may not."). After concluding that it was consistent with the intent of Chapter 15 to modify the Recognition Order if appropriate, the Bankruptcy Court engaged in a "balance of the hardships" analysis to determine whether, in this case, the Recognition Order should be modified. See Opinion at 8.

Important to this analysis, the Bankruptcy Court stated that "[i]n balancing the hardships under § 1522, a court may refuse to recognize specific orders in a foreign proceeding when those orders unjustifiably harm an interested party." Opinion at 8 (citing *In re* Quimonda AG, 462 B.R. 165, 182-83 (Bankr. E.D. Va. 2011), aff'd, *Jaffe v. Samsung Elecs. Co.*, 737 F.d 14, 29 (4th Cir. 2013)). Cf. In re Nortel Networks Corp., 2013 WL 6053845 (D. Del. Nov. 15, 2013). In *In re* Quimonda AG, after initially granting recognition to a German insolvency proceeding, the bankruptcy court refused to recognize that part of German insolvency law which did not give patent licensees the same protections upon rejection that is afforded under section 365(n) of the Bankruptcy Code. See *In re* Quimonda AG, 462 B.R. at 185. In *In re* Nortel, the district court affirmed the bankruptcy court's decision not to modify the recognition order to permit plaintiffs to pursue securities litigation against the debtors' directors and officers, which were stayed under a Canadian court's CCAA order. In that case, the bankruptcy court engaged in its own "balance of the hardships" analysis and concluded that the plaintiffs should have first sought relief from the Canadian court and that exposing directors and officers to litigation would strain the debtors' resources. See *In re* Nortel Networks Corp., 2013 WL 6053845 at *3.

In Sanjel, the Bankruptcy Court determined that the balance of hardships tipped decidedly in favor of the Movants. As a result of the Initial Order, individuals were enjoined from "opting in" to the Colorado Cases and pursue claims against the Debtors' directors and officers. In addition, the Initial Order's injunction could conceivably extend long enough such that the statute of limitations for all such claims could lapse.[5] The

[3] Although the Movants styled their request as relief from the "automatic stay" under section 362, the Bankruptcy Court observed that since the automatic stay does not extend to any party other than the Debtors, the proper request was to modify the Recognition Order. The Bankruptcy Court's procedural analysis is not relevant to the analysis herein.
[4] Section 1522(c) provides, "[t]he court may, at the request of the foreign representative or an entity affected by relief granted under section 1519 or 1521, or at its own motion, modify or terminate such relief." 11 U.S.C. § 1522(c).
[5] There was no tolling agreement in place and section 108(c) of the Bankruptcy Code, which tolls statutes of limitations, is inapplicable to non-debtors.

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Bankruptcy Court stated that “modifying the [stay against the directors and officers] would appear to be the only way to ensure protection of Movants’ interests so that consents may be filed within the applicable statute of limitations period.” Opinion at 11. The Bankruptcy Court recognized that the Debtors would be burdened by the additional litigation but it did not outweigh the harm to the Movants. See Opinion at 11.

The Bankruptcy Court also rejected the Debtors’ argument that denying the request would not prejudice the Movants because they could seek relief from the Initial Order directly from the Canadian Court. The Bankruptcy Court believed it would be “unreasonably and exceedingly burdensome to require Movants to go to Canada and request that the Canadian Court lift the [stay against directors and officers] to allow Movants to pursue claims in Colorado based wholly on a statutory right created by United States law to protect employees within the United States.”[6] Opinion at 11.

The Bankruptcy Court then modified the Recognition Order to permit: (a) the Movants to conduct limited discovery to determine the identity of the Debtors’ past and present directors and officers; and (b) potential plaintiffs to “opt in” to the Colorado Cases. Opinion at 12.

Cross-Border Implications

This case presents a recent example of the tension faced by U.S. courts when asked to decide between principles of comity and potential harm to U.S. creditors. As a general matter, comity has been routinely granted to orders of Canadian courts enjoining actions against a debtor’s directors and officers. Indeed, as noted by the United States District Court for the Southern District of New York:

> The stay of proceedings for officers and directors is a standard feature of proceedings under the CCAA and has routinely been enforced in the United States upon recognition of a foreign proceeding under Chapter 15. See, *e.g.*, *In re* Muscletech Research and Development Inc. *et al.*, 06 Civ. 538, Dkts. 45, 46. The stay against individual directors is a fixture of Canadian bankruptcy proceedings in part because Canadian bankruptcy proceedings typically involve a claims process where claims against the company, officers, and directors are filed and handled together. Although this is not always true in the United States, “[w]e are not so provincial as to say that every solution of a problem is wrong because we deal with it otherwise at home.” *Ackermann v. Levine*, 788 F.2d 830 (2d Cir.1986) (quoting *Loucks v. Standard Oil Co.*, 224 N.Y. 99, 111, 120 N.E. 198 (N.Y.1918)). . . . The Court cannot conclude that the enforcement of the Canadian Court’s temporary stay of proceedings would be contrary to the most fundamental policies of the United States. It is true that the protection of United States investors and the regulation of United States capital markets are matters of national public interest, and private securities class actions are an important component of that protection. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007). But, extending a temporary stay of proceedings will not be manifestly contrary to those interests.

Collins v. Oilsands Quest, Inc., 484 B.R. 593, 597 (S.D.N.Y. 2012).

What sets the Sanjel case apart from others was the interplay of the two-year statute of limitations which provided a windfall to the Debtors’ directors and officers (*i.e.* So long as the injunctions contained in the initial order and Recognition order were in place, they received the functional equivalent of a discharge relating to claims against them under the FLSA). The ultimate result appears correct: the stay in favor of the

[6] The Bankruptcy Court distinguished its case from In re Nortel because: (1) there was little reasoning in Nortel why the claimants in that case should have gone to the Canadian Court; and (2) Nortel did not address a case where litigants risked losing claims on the basis of a statute of limitations. See Opinion at 11.

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Debtors' officers and directors was modified to permit individuals to preserve potential claims against them under the FLSA. The interesting aspect of the decision was that the Bankruptcy Court did not defer to (or consult with) the Canadian Court to modify the Initial Order. It is not unreasonable to predict that the Canadian Court would have granted the same or similar relief in favor of the Movants if the question was put before it. And Canadian courts are also known to be flexible and can schedule hearings on short notice, if necessary.

Moreover, the Bankruptcy Court's decision resulted in additional claims against the Debtors' estates in Canada. While the Bankruptcy Court did not believe the Canadian Court had a sufficient interest in the outcome of its decision, see Opinion at 11 ("claims in Colorado based wholly on a statutory right created by United States law to protect employees in the United States."), modification of the Recognition Order in fact had a direct impact on the Debtors' cases in Canada. Permitting individuals to opt-in to the Colorado Cases and crystalize claims against the directors and officers, triggered the directors and officers claims against the Debtors for indemnification.

Given the Canadian Court's direct interest in the outcome of the Bankruptcy Court's decision, an alternative approach would have been for either the parties or the Bankruptcy Court to request a court-to-court communication with the Canadian Court under sections 1525, 1526 and 1527 in fulfillment of Chapter 15's universalist objectives noted in Section 1501 (a)(1) and (a)(3) of the Bankruptcy Code (cooperation between courts in the United States and in foreign countries and the fair and efficient administration of cross border insolvencies that protects the interests of creditors and the debtor). The Bankruptcy Court and Canadian Court could have jointly determined the most efficient way to administer the two cases. While use of these sections is rare, this case presents an excellent example of where it could have been useful. Had the Canadian Court and the Bankruptcy Court discussed the matter directly a jurisdictional tug of war could have been avoided.

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