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Enforcing Ipso Facto Clauses in International Transactions and the Importance of Being Proactive in Dealings with Troubled and Insolvent Entities

By Michael B. Schaedle and Gregory F. Vizza*

The authors of this article examine ipso facto clauses in international transactions using the decision in the SunEdison *bankruptcy case to provide lessons.*

A proactive creditor often ends up in a better legal position, and has more negotiating power, than a reactive one. While that may seem obvious, it is a lesson driven home by the decision in the *SunEdison* bankruptcy case, which involves issues of international comity, choice of law provisions, and ultimately, the tactics employed by a Korean debtor in connection with its contractual relationship with SunEdison. In *SMP Ltd. v. SunEdison, Inc. and GCL-Poly Energy Holdings Limited*,[1] the *SunEdison* bankruptcy court refused to apply Korean insolvency law in a contract termination dispute, and enforced a contractual New York choice-of-law provision. Notwithstanding the Chapter 15 recognition of the Korean debtor's rehabilitation, applying New York law, the court upheld the enforcement of an ipso facto ("by the fact itself") clause against the Korean debtor, thereby allowing termination of a license with SunEdison that was essential to the debtor's business.

OVERVIEW OF THE DISPUTE AMONG SUNEDISON, GCL, AND SMP

The relevant actors in this dispute are SMP Ltd., a Korean company involved in a rehabilitation proceeding in Korea that subsequently commenced a Chapter 15 proceeding in the U.S. Bankruptcy Court for the Southern District of New York; SunEdison Inc., a Chapter 11 debtor in the same bankruptcy court; and GCL-Poly Energy Holdings Ltd., which purchased from SunEdison certain intellectual property and other assets relating to SunEdison's solar materials business in a bankruptcy court-approved sale. SMP, established in

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[1] 577 B.R. 120 (Bankr. S.D.N.Y. 2017).

2011 as a joint venture between SunEdison and Samsung Fine Chemicals Ltd., owned and operated a polysilicon manufacturing plant located in Ulsan, Korea. Under a supply and license agreement ("SLA"), SunEdison licensed polysilicon manufacturing technology and supplied the necessary equipment to SMP in order to operate the plant, the sole purpose of which was to supply SunEdison with product for its solar materials business. The SLA contained a typical ipso facto clause, which permitted either party to terminate the SLA if the other party filed for bankruptcy or was unable to pay its debts as they came due. The SLA also contained a choice-of-law provision stating that the SLA would be governed by New York and U.S. federal law, without regard to their conflict-of-laws principles. According to SMP, the SLA was vital to its continued operation because without the technology and equipment provided by SunEdison under the SLA, it would be unable operate the plant and forced to liquidate. SMP filed its Korean rehabilitation case shortly after SunEdison filed its Chapter 11 case, stating that SunEdison and its affiliates had defaulted on many millions of dollars of payment obligations owed to SMP based on SunEdison's purchase of product from SMP.

On August 26, 2016, SunEdison filed a motion (the "sale motion") requesting bankruptcy court approval of a sale agreement between SunEdison and GCL to sell the solar materials business to GCL. The sale agreement required SunEdison to either reject or terminate the SLA, as reasonably requested by GCL. SMP filed a reservation of rights to the sale motion and, following mediation, the parties reached a settlement that resolved SMP's objection (the "settlement agreement") and allowed the sale to close. The settlement agreement required SunEdison to send a notice to SMP terminating the SLA, but provided that "SMP's rights to contest and challenge [SunEdison's] rights to terminate [the SLA were] fully preserved." The settlement agreement permitted SMP to institute such a challenge in either the bankruptcy court or pursuant to Swiss arbitration under the SLA. Both the U.S. bankruptcy court and the Korean court overseeing SMP's rehabilitation proceeding approved the settlement agreement.

On March 30, 2017, in accordance with the settlement agreement, SunEdison sent a notice to SMP terminating the SLA (the "termination notice"). The termination notice invoked the ipso facto clause and stated that SunEdison was terminating the SLA "as a result of SMP's pending rehabilitation proceedings and its failure to pay debts generally as they [came] due." The sale of the solar materials business to GCL closed the next day. On May 1, 2017, more than one month after receipt of the termination notice and more than a year after SunEdison entered bankruptcy in the United States and SMP sought rehabilitation in Korea, SMP filed a petition in the Southern District of

New York for recognition of the Korean rehabilitation proceeding under Chapter 15 of the U.S. Bankruptcy Code. SMP's Chapter 15 petition was granted on June 15, 2017, recognizing its Korean rehabilitation proceeding as a "foreign main proceeding" under Bankruptcy Code § 1517(b)(1).

Also on May 1, 2017, SMP commenced an adversary proceeding in the *SunEdison* bankruptcy case challenging the effectiveness of the termination notice. SMP's complaint sought a judgment "declaring the SLA's ipso facto clause unenforceable and SunEdison's Termination Notice invalid." SMP based its argument on underlying, statutory Korean law, which holds ipso facto clauses unenforceable against a Korean debtor in a Korean rehabilitation proceeding. Thus, once the Korean court entered an order commencing the Korean rehabilitation proceeding (the "commencement order"), SMP argued that principles of comity required the bankruptcy court to apply Korean law, thereby preventing SunEdison from using the Korean rehabilitation proceeding as the basis to terminate the SLA under the ipso facto clause. Critical to the outcome of this case, SMP did not include any language in the Korean commencement order that invalidated ipso facto clauses or prevented termination of the SLA. SMP argued, however, that the commencement order "automatically sweeps in every aspect of Korean insolvency law," and that the bankruptcy court "must apply Korean insolvency law, including Korean common law, and invalidate the Termination Notice because [SMP] wants to perform the SLA."

ENFORCEMENT OF CHOICE OF LAW PROVISION

GCL moved for partial summary judgment, arguing that 1) the bankruptcy court was required to apply the choice-of-law rules of New York (the forum in which it sits); 2) New York choice-of-law rules require a court to honor the governing law provision in a contract; and 3) under New York law, the ipso facto clause is enforceable. SMP cross-moved for partial summary judgment, primarily arguing that comity required the application of Korean law, and that Korean law rendered the ipso facto clause unenforceable against a Korean debtor. As a threshold matter, the bankruptcy court noted that "[b]ut for the arguments relating to the effect of the Commencement Order, the resolution . . . would be simple and straightforward." The bankruptcy court then held that as a court sitting in New York, it was required to apply New York's choice-of-law rules, and those rules state that "the Court must abjure a conflicts analysis or consider foreign law or foreign public policy, and must instead apply New York substantive law." Under New York law, ipso facto clauses are enforceable absent fraud, collusion, or overreaching.

Next, the bankruptcy court considered whether granting comity to the

Korean commencement order required the application of Korean law, notwithstanding New York's choice-of-law rules. The bankruptcy court reasoned that despite SMP's assertion that it did "not believe that this was a choice of law issue. . . . In fact, this is precisely what it is. SMP argues that the Court should grant comity to the Commencement Order by which it means [to] give extraterritorial effect to all of the Korean insolvency law." In support of this argument, SMP cited *In re Daebo Int'l Shipping Co.*, which held that an order from a Korean bankruptcy court that "expressly stayed creditors from enforcing or executing on their rehabilitation claims" should be applied extraterritorially to prevent attachments against the Korean debtor's property located in the United States that occurred after the stay order was entered. In *Daebo*, however, the Korean debtor (a Korean shipping company) anticipated potential enforcement actions against its property around the world and included language in its commencement order that specifically "prevented creditors from seizing the debtor's assets, and required them to file claims in the Korean proceeding to effect a payment." Therefore, the *SunEdison* court reasoned that granting comity in that case was "entirely consistent with the principles underpinning abstention comity."

Unlike *Daebo*, upon Korean commencement SMP did nothing to specifically protect against the potential termination of the SLA—arguably its most important asset. The commencement order in its Korean rehabilitation proceeding was silent on whether contract counterparties were stayed from exercising contractual rights to terminate executory contracts. Since SMP was otherwise unable to "provide . . . support for the remarkable proposition that SMP's Korean [rehabilitation proceeding] sweeps in the entirety of Korean insolvency law under principles of international comity, and trumps U.S. bankruptcy and state law," and because "the parties selected New York law to govern their contractual rights, and the application of Korean law ignores that choice and their presumed expectations," the bankruptcy court rejected SMP's request to apply Korean law under the principles of international comity upheld enforcement of the ipso facto clause in the SLA under New York law.

IMPLICATIONS FOR FOREIGN DEBTORS AND CREDITORS

The *SunEdison* decision is a reminder that a foreign debtor must be proactive to protect its contractual rights. Even if SunEdison's termination of the SLA was not anticipated when SMP commenced its Korean rehabilitation case, the sale motion (filed more than seven months prior to SunEdison's termination notice) put SMP on notice that SunEdison might terminate the SLA. At any point prior to SunEdison sending the termination notice, SMP could have sought an order from the Korean court preventing termination of executory contracts,

which would have provided SMP with a much stronger argument that comity required the bankruptcy court to apply Korean law and defer to a specific order of the Korean court. Alternatively, SMP could have commenced a Chapter 11 proceeding in the United States, thereby taking advantage of the automatic stay under § 362(a) and also taking advantage of § 365(e) of the Bankruptcy Code, which generally invalidates post-petition enforcement of ipso facto clauses. Or SMP could have commenced its Chapter 15 proceeding sooner, taking advantage of the automatic stay, and sought an order preventing counterparties from terminating any executory contracts with SMP while enforcing U.S. Bankruptcy Code Section 365(e). This type of relief may have prevented SunEdison from sending the termination notice and would have provided SMP with additional negotiating leverage against SunEdison and GCL.

This case also provides an opportunity to remind foreign creditors to be proactive in enforcing their rights against troubled companies with assets in foreign jurisdictions. Indeed, a creditor or contract counterparty that better anticipates potential pitfalls in its dealings with troubled or insolvent entities will almost always end up with stronger legal positions and more negotiating power than a reactive one. While this principle may be self-evident, the failure of SMP to proactively protect itself in the *SunEdison* case illustrates that you must always practice what you preach.