UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

NOT FOR PUBLICATION

In re:

FLAG TELECOM HOLDINGS LIMITED, *et al*.,

Debtors.

Chapter 11

Case No. 02-11732 (ALG)

Jointly Administered

FLAG TELECOM GROUP LIMITED, FLAG ASIA LIMITED, FLAG TELECOM ASIA LIMITED, FLAG TELECOM TAIWAN LIMITED and FLAG TELECOM JAPAN LIMITED,

Plaintiffs,

-against-

Adv. Proc. No. 03-06712 (ALG)

KENSINGTON INTERNATIONAL, LTD. SPRINGFIELD ASSOCIATES, LLC, ELLIOT ASSOCIATES, L.P., ELLIOT INTERNATIONAL, L.P., WILMINGTON TRUST COMPANY, and THE BANK OF NEW YORK,

Defendants.

OPINION ON RENEWED MOTION FOR SUMMARY JUDGMENT

A P P E A R A N C E S:

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ALLAN L. GROPPER
UNITED STATES BANKRUPTCY JUDGE

This adversary proceeding is on remand from the District Court pursuant to an order and opinion dated December 12, 2005, vacating this Court's order dated May 12, 2005, granting summary judgment to plaintiffs FLAG Telecom Holdings Limited, *et al*. (collectively, "FLAG") and against the current holders of certain notes issued by FLAG (collectively called herein the "Defendants"). Familiarity with the District Court's decision, 337 B.R. 15 (S.D.N.Y. 2005), and this Court's decision, 320 B.R. 763 (Bankr. S.D.N.Y. 2005), is assumed.

Prior Proceedings

In its prior decision this Court found that "registration of the FNAL Security Agreement was not permitted under Taiwanese law and could not have resulted in an enforceable security interest under Taiwanese law." 320 B.R. at 769. The District Court accepted this finding, noting that it was "a fact that neither party disputed in oral argument." 337 B.R. at 19. The District Court then found that questions of fact existed on the record as to the second proposition on which this Court's grant of summary judgment was premised. This was that FLAG had satisfied its obligations under Section 5 of the Alcatel Note and had taken "all actions to the maximum extent permitted by applicable law … reasonably necessary to ensure the legality, enforceability, validity and perfection of *such* Security Interest on the Collateral …."[1] This Court held that there was "no need to speculate as to whether the parties could have entered into a separate security agreement governed by Taiwanese law to register a security agreement there" because the operative documents did not require it.

[1] Emphasis supplied; the term "such Security Interest" refers to the interest created under the Security Agreement executed at the same time as the Note and referenced therein.

The District Court reversed on this point. It pointed to evidence in the record that the parties attempted to locate a co-collateral agent in Taiwan who might have been able to enter into a new agreement governed by Taiwanese law, and to the language in the Note requiring FLAG to take "all actions to the maximum extent permitted by applicable law" to perfect "such Security Interest on the Collateral." The District Court said:

> it is entirely unclear whether (1) a willing co-collateral agent could have been located; (2) whether an agreement could have been completed within the time frame provided for in the Alcatel Note, and; (3) whether the Taiwanese courts would have enforced such an agreement. These issues of fact must be evaluated before determining the appropriateness of summary judgment.

337 B.R. at 21. It also pointed to the clause requiring FLAG to take "all actions to the maximum extent …" and the clause requiring the Collateral Agent to make a written request to FLAG to provide further assurances regarding the Security Agreement, such as entry into a new agreement with a co-collateral agent governed by Taiwanese law, and it said that "on remand, the Bankruptcy Court should endeavor to determine how the parties intended for these seemingly contradictory clauses to operate in practice." *Id.* at 21.

The District Court further stated that it was not suggesting that a motion for summary judgment might not eventually prove to be a proper means for the disposition of this case but that "factual findings" were required "both as to FLAG's obligations under the Alcatel Note and Security Agreement and as to the possibility of entering into an enforceable agreement with a co-collateral agent." *Id* at 21. It said:

> In remanding, we are not deciding whether FLAG could have achieved perfection in Taiwan or whether New York or Taiwanese law should apply in determining FLAG's obligations under the Alcatel Note. Instead, we are remanding in order to permit the Bankruptcy Court to answer these questions, at which point the Bankruptcy Court may determine whether an issue of fact remains for trial.

Id. at 22.

FLAG's New Motion

On remand FLAG has renewed its motion for summary judgment. First, FLAG argues that the phrase "applicable law" in § 5 of the Alcatel Note meant the law of New York, which is the law that governs both the Note and Security Agreement, and that FLAG never had an enforceable contractual obligation to comply with Taiwanese law. Second, FLAG argues that it complied with its obligations under the Alcatel Note. The Defendants dispute each of FLAG's contentions.

1. "Applicable law"

FLAG notes that the Alcatel Note and Security Agreement are both governed by New York law and argues that it can be found, as a matter of law, that it satisfied its obligations in the Alcatel Note to perfect the Collateral under "applicable law" by filing in Washington, D.C. FLAG reaches this conclusion on the basis of § 9-307(c) of the New York Uniform Commercial Code, which provides that a security interest can be perfected by a filing in the District of Columbia if the debtor is located in a jurisdiction outside the United States but is not located "in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral." There is no dispute that the owner of the relevant collateral was located outside the United States. There is a definite dispute as to whether Taiwan provided a filing system that meets the standards of § 9-307(c).

In any event, there is no need to decide any issue under § 9-307(c) because there is no basis in the instant record to find that the phrase "applicable law" meant the law of New York *to the exclusion of* the law of Taiwan. Even FLAG states, "From the outset, the Alcatel Security Agreement evidenced the mutual intent of the Parties to perfect the

'Security Interest' by following the New York Commercial Code and then take further actions in foreign countries if required by a New York choice of law analysis and if possible under foreign law." (Memo. p. 5) There is no question that the parties themselves thought that they had an obligation to perfect "such Security Interest" under Taiwanese law – to the maximum extent possible. As the Defendants argue, the requirement of the Alcatel Note that the security interest be enforceable and perfected, the specific reference in § 5 of the Note to a filing in a foreign jurisdiction (Korea); and the admitted course of conduct of the parties (who went to great effort in an attempt to perfect in Taiwan) all confirm that the parties intended that FLAG would have an obligation to use maximum efforts (or best efforts in the case of Korea) with respect to perfection under the laws of the jurisdictions where the Collateral was located.

On the other hand, there is no basis in the documents or in the record for the Defendants' argument that FLAG guaranteed that it would be able to perfect under the law of Taiwan and assumed the risk that perfection could not be achieved. Section 5 of the Alcatel Note required efforts only to the maximum extent permitted under applicable law. The nature of the commitment is confirmed by § 4(c) of the Security Agreement, which both parties rely on. As FLAG notes, this paragraph constituted a representation and warranty that the Security Agreement would create a valid and continuing Security Interest in the Collateral upon the filing of the appropriate financing statements listed on Schedule I, and the only jurisdiction listed on Schedule I relevant to the instant dispute is the District of Columbia. FLAG overstates the effect of this provision, however, when it contends that this paragraph relieved it of any contractual obligation to perfect in Taiwan if it could. As Defendants point out, the last sentence of § 4(c) provides, "Subject to the penultimate sentence of Section 5 of the [Alcatel] Note, all action by any Grantor necessary or reasonably desirable to protect and perfect such Security Interest on each

item of the Collateral in accordance with the terms hereof will be taken no later than December 31, 2002." This is a cross-reference to the Alcatel Note and its requirement that FLAG take "all actions to the maximum extent permitted by applicable law reasonably necessary to ensure the legality, enforceability, validity and perfection of such Security Interest on the Collateral…"

Nevertheless, although FLAG overstates the import of § 4(c) of the Security Agreement, that section is relevant in demonstrating the intent of the parties. FLAG represented in § 4(c) that filing a financing statement relating to the Security Agreement in the District of Columbia would create a perfected security interest under the Uniform Commercial Code. It did not represent that the Security Agreement would create a perfected Security Interest in Taiwan, and it most assuredly did not guaranty that it would be able to file in Taiwan. It rather agreed to take all actions to the maximum extent permitted by applicable law [including Taiwanese law] reasonably necessary to ensure the legality, enforceability, validity and perfection of such Security Interest…." The question in this case is whether FLAG took all such actions.[2]

2. "All actions to the maximum extent … reasonably necessary …"

In its moving papers, FLAG identifies five reasons why this Court should find, as a matter of law, that it satisfied its obligations to take "all actions to the maximum extent permitted by applicable law reasonably necessary to ensure the legality, enforceability,

[2] The foregoing is not intended to underestimate the importance of a filing in the District of Columbia. A filing there would give Alcatel a perfected security interest under the laws of the United States and, from the perspective of U.S. law, would likely be considered to be effective world-wide. This is because the U.S. Uniform Commercial Code requires a filing outside of the United States only where the foreign jurisdiction has a filing system reasonably comparable that that used in this country, and (as FLAG argues) the only country that is commonly considered to have such a system is Canada. *See, e.g.*, Kuhn, *Multi-State and International Secured Transactions Under Revised Article 9*, 40 Va. J. Int'l L. 1009, 1049-51 (2000). It should not be forgotten that the Alcatel Note was issued in connection with FLAG's exit from a U.S. bankruptcy proceeding, and that a filing in the District of Columbia would almost certainly be effective for all purposes in the event there was a second Chapter 11 filing by the reorganized FLAG entities. Nevertheless, the Alcatel Note required FLAG to perfect under "applicable law," and it cannot be found on this record that FLAG was excused from taking all actions, to the maximum extent permitted, to file under Taiwanese law.

validity and perfection of such Security Interest on the Collateral…" The Defendants dispute each of these and argue either that the facts are conclusive in their favor or that questions of fact persist, precluding a grant of summary judgment. It is necessary to examine each of FLAG's arguments within the context of the District Court's direction that this Court consider, on remand, the issues identified above and that a "rule of reasonableness" be applied to determine the extent of FLAG's obligations under the clause of the Note at issue.

(i) FLAG first contends that this Court should find that in 2003 Taiwanese law did not permit the registration of the Alcatel Security Interest, even through a Taiwanese trustee. This basic premise is not contested. Any security agreement filed in Taiwan would have had to be a new agreement, written in Mandarin, governed by Taiwanese law and with a Taiwanese co-collateral agent, and the agreement would have had to be limited to the Collateral within the territorial jurisdiction of Taiwan. But the point does not entitle FLAG to summary judgment, based on the District Court's opinion. The District Court required this Court to consider additional facts and circumstances in construing FLAG's obligations under the documents, not just the fact that FLAG would not have been able to perfect the original Security Agreement in Taiwan.

FLAG further argues, based on the history of the Fubon Registration, that "registration was impossible in 2003." The Fubon Registration is, of course, the registration of another security interest through a Taiwanese agent in 2004 on which Defendants rely for the proposition that registration by FLAG would have been possible in 2003 if only FLAG had gone to the same lengths Fubon did a year later. It is not contested that the Fubon Registration was submitted to the Taiwanese Ministry of Economic Affairs in December, 2003 and that it was accepted for filing on or about April

2, 2004, when the Taiwan Ministry of Finance released, for the first time, "guidelines" for utilizing a local trustee in place of a foreign secured party.

The history of the Fubon Registration demonstrates the difficulty that FLAG would have faced had it attempted this type of registration in Taiwan. However, it cannot be said, on this record and for purposes of a motion for summary judgment, that FLAG could not have accomplished what Fubon was able to do later. As the Defendants argue, "At a minimum there is an issue of fact whether the procedures that Fubon Bank followed in 2003-2004 could have been followed by FLAG in 2002-2003." (Defendants' Memo at 33.) Nevertheless, for the reasons discussed below, the possibility that a filing might have been recognized in Taiwan does not preclude judgment from being entered in FLAG's favor. FLAG could not have perfected the existing Security Agreement, and as discussed in Point (iii), FLAG could not have taken any action unilaterally and without the instructions of the Secured Party.

(ii) FLAG's second argument is that even if Taiwanese law permitted registration through a co-collateral agent, it was impossible for the parties to obtain a willing, licensed agent. The record certainly demonstrates the difficulty that Wilmington Trust Company ("WTC" or "Wilmington"), Collateral Trustee for the Secured Party under the Security Agreement, had in attempting to find a co-collateral agent doing business in Taiwan. For example, one potential collateral agent concluded that Taiwanese law did not recognize the concept of a security or collateral agent and that the agent would also have to be a creditor on the underlying debt. (Letter dated 2/13/03 from Ophelia Fung of JP Morgan Chase Bank.) Nevertheless, there is some evidence on this record that after the Ministry of Finance had acted, Fubon Bank was able to register a security interest while acting essentially in the guise of a co-collateral agent. It is a matter of speculation whether a filing would have been possible or enforceable; nevertheless, on a motion for

summary judgment, all inferences must be drawn in favor of the non-moving party. *See Heyman v. Commerce & Indus. Ins. Co.*, 524 F.2d 1317, 1318 (2d Cir. 1975); *see also Ames Dep't Stores, Inc.*, 161 B.R. 87, 89 (Bankr. S.D.N.Y. 1993). Questions of fact on this issue preclude summary judgment, as FLAG has not established as a matter of law that it would not have been possible to locate a co-collateral agent in Taiwan.

Mention must be made, however, of the Defendants' further argument that even if it had been impossible to locate a co-collateral agent, or to comply with Taiwanese law, FLAG bore the contractual risk of this impossibility. That was not the parties' agreement. FLAG agreed to "take all actions to the maximum extent *permitted by applicable law* … reasonably necessary to ensure the legality, enforceability, validity and perfection of such Security Interest …" (emphasis added.) As discussed above, FLAG did not covenant or represent that perfection was feasible in Taiwan. It did so represent with respect to perfection in the District of Columbia under the Uniform Commercial Code, and it complied with its obligations to perfect there. Its obligations to perfect in Taiwan were only as quoted above, not to guaranty that perfection could be achieved.

(iii) FLAG's motion finally rests on three separately argued but related contentions -- that it is entitled to summary judgment because this Court should find that its obligations could arise only under a "further assurance" clause and no such obligations arose; because FLAG and Alcatel reached an agreement as to further actions in Taiwan and Defendants, as Alcatel's successors, are bound by it; and because even if it is assumed that a Taiwanese collateral agent could have been found, new Taiwanese agreements could not have been completed in time to meet the deadlines agreed to by the parties. Although FLAG overstates the import of these propositions, for the reasons stated below, the admitted facts of the existing record collectively entitle FLAG to summary judgment in its favor.

FLAG's contentions implicate what the District Court termed the "rule of reasonableness" at the conclusion of its opinion, as follows:

> On remand, the Bankruptcy Court must weigh the expectations of the parties at the time the relevant agreements were made against the reality of the Taiwanese legal landscape at the time FLAG sought perfection of the Collateral. Appellants' counsel conceded in oral argument that a 'rule of reasonableness' must apply to the 'maximum extent permitted by applicable law' language in the Alcatel Note. Tr. at 17. We agree that a rule of reasonableness must apply here, and urge the Bankruptcy Court to evaluate the parties' obligations under that standard.

337 B.R. at 22. It will also be recalled, as quoted above, that the District Court directed this Court to determine how the parties intended two "seemingly contradictory clauses to operate in practice" -- the two clauses being the clause requiring FLAG to take all actions to the maximum extent permitted by applicable law and the clause requiring the Collateral Agent to make written request to FLAG to provide further assurances regarding the Security Agreement.

Complying with the direction of the District Court, and applying at all times a "rule of reasonableness," it is respectfully suggested that there is no contradiction between the clause requiring FLAG to take all actions to the maximum extent permitted by applicable law to perfect the Security Agreement in Taiwan and the "further assurances" clause. The parties to such highly sophisticated and carefully negotiated documents as the ones at bar draft the documents with precision. FLAG's obligation under § 5 of the Alcatel Note was to take all actions permitted by local law to perfect the security interest in the Collateral provided for in the Security Agreement ("such Security Interest"). These were actions that it could agree to take as they were effectively within its control. However, if FLAG had to take actions beyond filing the Security Agreement, such as entering into a new security agreement under Taiwanese law or appointing a co-collateral agent, it would need the cooperation and participation of the Secured Party and

the existing Collateral Agent for the Secured Party. Indeed, under the existing Security Agreement, only WTC as Collateral Agent had the power to appoint a co-collateral agent to act in another jurisdiction. (Security Agreement § 27(a).) FLAG agreed, in the "further assurances" clause, to cooperate with the Secured Party and its Collateral Agent and "take such further actions as Collateral Agent may reasonably deem desirable to obtain the full benefits of this Security Agreement and of the rights and powers herein granted…." Security Agreement, § 5(a)(i). However, action was only required upon written request of the Collateral Agent and action could only be taken if the Collateral Agent agreed to it.

The Defendants concede all this in their Memorandum of Law, stating:

> In reality, it is not at all difficult to reconcile the various provisions of the Alcatel Note and the Security Agreement. Section 5 of the Alcatel Note imposed on FLAG the 'heavy burden,' as this Court described it, to 'take all actions … reasonably necessary to ensure the legality, enforceability, validity and perfection of [the][3] Security Interest in the Collateral.' Sections 27(a) and 5(a)(i) of the Security Agreement empowered Wilmington, respectively, to appoint a co-collateral agent and to instruct FLAG to take additional actions to effectuate the purposes of the Security Agreement and required FLAG to comply with Wilmington's instructions.

(Def. Memorandum, p. 23) The Defendants have it exactly right. Only WTC ("Wilmington") could appoint a co-collateral agent, and WTC had to instruct FLAG to "take additional actions to effectuate the purposes of the Security Agreement…." There is no question that WTC (which acted at all times at the instructions of the Secured Party) did not appoint a co-collateral agent and did not provide FLAG with a demand for any further assurances.

As noted above, in considering a motion for summary judgment, a court must resolve all ambiguities and resolve all inferences in favor of the party against whom

[3] At this point Defendants change the wording of § 5 from "such" Security Interest, meaning the Security Interest under the Security Agreement, to "the" Security Interest, implying that FLAG agreed to perfect a security interest under an agreement other than the Security Agreement, which it never did.

judgment is sought. Nevertheless, based upon the documentary record, and accepting Defendants' own construction of the applicable documents, as well as their acknowledgement that "it is not at all difficult to reconcile the various provisions of the Alcatel Note and the Security Agreement," the situation regarding perfection has been established for purposes of summary judgment. The situation was summarized in an email documenting a telephone conference on March 6, 2003, among the principals and attorneys for FLAG, Alcatel, and WTC. FLAG's counsel memorialized the conversation in a document which is important enough to be quoted at length:

> Wilmington [WTC] cannot find a party in Taiwan to serve as pledgee because perfected security interests in physical collateral are rare in Taiwan and the idea of constructive possession by the pledgee is even more uncommon. Wilmington has approached at least five top tier international banks and all save Bank of New York have declined the job. Bank of New York is still pondering the idea. Without a pledgee having a physical presence in Taiwan, no Taiwanese security agreement can be executed. Without a Taiwanese security agreement, there is no means under Taiwanese law for perfecting a security interest in personal (or movable) property and contract rights. William Edwards, FLAG's Taiwanese counsel, has, for some time, had a security agreement (in Mandarin, as required by law) ready for execution as soon as the name of the pledgee is provided.
>
> Taiwanese courts will recognize and enforce New York law security agreements. However, the existence of such an agreement in no way translates into perfection and thus is of little effect with regard to rights against third parties. FLAG's Taiwanese counsel has reviewed the existing New York law security agreement and determined that his firm can issue an enforceability opinion with certain carve outs.
>
> The only difference of opinion that Mike [counsel for Alcatel, then the Secured Party] and I had was that I understand FLAG's position to be that FLAG will EITHER wait until a co-collateral agent is found in Taiwan OR provide a legal opinion of Taiwanese counsel as to enforcement. *Mike indicated that the arrangement struck today was that FLAG would deliver an opinion of counsel AND continue to await the identification of a co-collateral agent.*
>
> While this certainly needs to be clarified, I have in the meantime instructed, on behalf of FLAG, Taiwanese counsel to draft the enforceability opinion. I should know tomorrow when it will be ready.

> William [Edwards, FLAG's local counsel in Taiwan], could you please "reply to all" as to any inaccuracies in my summary and provide us with an idea of when the opinion might be ready to present to Alcatel?
>
> Mike, Sandra (of Wilmington Trust) and Jeff (US counsel to Wilmington) please also feel free to correct or clarify anything I have written about your experience with the potential co-collateral agents.

(emphasis added).

FLAG contends on its motion for summary judgment that this message memorializes an "agreement" between FLAG and Alcatel that "(1) FLAG would wait to see if a co-collateral trustee could be located, and (2) in the meantime, deliver an opinion of counsel as the enforceability of the Security Interest in Taiwan." As the Defendants contend in opposition to FLAG's motion, FLAG overstates the import of this email. It cannot and need not be found for purposes of the instant summary judgment record that Alcatel agreed that it would be satisfied if FLAG would wait to see if a co-collateral trustee could be located and in the meantime would accept an opinion of counsel, and it also cannot be determined on this record that the opinion of counsel that was circulated later was acceptable to Alcatel or that it even satisfied the Alcatel conditions memorialized in the March 6th email.

Nevertheless, even if it is assumed for purposes of summary judgment that there was no new agreement as of March 6, 2003 or that the opinion of counsel provided was inadequate, FLAG did not subsequently breach its obligations under § 5 of the Alcatel Note.

This conclusion is based on the unambiguous Alcatel Note and Security Agreement that clearly allocated the parties' respective responsibilities, and the manner in which the parties construed them in practice. The following facts as to the status of the matter subsequent to March 6, 2003, and prior to July 30, 2003, when the deadline (as extended) expired, have been conclusively established for purposes of the instant motion.

It had been determined that the existing Security Agreement could not be filed in Taiwan, and as the March 6 email states, FLAG's counsel in Taiwan had drafted a security agreement in Mandarin that was ready to be filed if a co-collateral agent could be found.

WTC had continued its efforts to locate a co-collateral agent in Taiwan. The last remaining prospect, apparently, was Bank of New York. On April 24, 2003 a representative of Bank of New York, as possible co-collateral agent, sent an email to Sandra R. Ortiz of WTC, requesting a retainer for legal fees before proceeding to study the matter further.

Then, subsequent to the Bank of New York request, all activity stopped. There were no instructions to WTC, and the record does not even show that Alcatel rejected the legal opinion that FLAG's counsel had provided. For purposes of the instant motion it is irrelevant why this happened. Nevertheless, it was later revealed that Defendants had purchased the Alcatel Note as of April 25, 2003, one day after the email from Bank of New York to WTC. Moreover, there is no dispute that despite a request for instructions from WTC, Defendants as the new holders of the Alcatel Note and Security Agreement took no action with respect to the issue of perfection in Taiwan or the pending search for a co-collateral agent, until they declared the Alcatel Note in default and attempted to cross default other bonds that FLAG had issued and that they or their affiliates had purchased.

Defendant's position is that they simply could let the clock run out and collect millions of dollars on a declaration of default. Yet they have never specified exactly what FLAG should have done in the absence of any cooperation from the new holders of the Note and Security Agreement, except to assert (incorrectly) that FLAG had an absolute obligation to perfect in Taiwan. That is not what the unambiguous documents

required. Section 5 of the Note required FLAG to perfect a filing in Taiwan only if permitted by Taiwanese law. The Security Interest created under the Security Agreement could not be perfected in Taiwan, and FLAG could not take any action in Taiwan unilaterally, without a co-collateral agent and a new security agreement.

While Alcatel held the Note, the parties worked cooperatively for months toward the goal of entering into a new security agreement with a co-collateral agent, with WTC taking the lead at all times in locating such an agent. As Defendants concede, however, only WTC had the right to appoint a co-collateral agent and to instruct FLAG to take additional actions to effectuate the purposes of the Security Agreement. After the Defendants purchased the Note, all activity ceased, notwithstanding that the documents clearly and unambiguously placed the burden on the Secured Party or its agent to appoint a co-collateral agent and demand further assurances. Under the unambiguous documents, FLAG had fulfilled its reasonable responsibilities under § 5 of the Note even though it took no further action, because perfection in Taiwan of the security interest created under the Security Agreement was not within its capabilities, and it failed to receive any further instructions or cooperation from the Secured Party

Conclusion

Summary judgment should be entered in favor of FLAG, which is directed to settle an appropriate order on five days' notice.

Dated: New York, New York
October 23, 2006

/s/ Allan L. Gropper
UNITED STATES BANKRUPTCY JUDGE