USING CHAPTER 15 TO PROTECT FOREIGN DEBTORS' ESTATES IN CROSS BORDER CASES

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Chapter 15 incorporates the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency adopted by UNCITRAL into the United States Code. Enacted in 2005, a central goal of the law is to develop a uniform approach by U.S. courts to address foreign insolvencies with a cross border component.

This article provides an introduction into the basic concepts governing Chapter 15 of the U.S. Bankruptcy Code, describes how Chapter 15 may be used defensively or offensively, and provides a summary of some important recent decisions.

Chapter 15 is designed to provide a mechanism for debtors in foreign insolvency proceedings to protect their assets in the U.S. from local creditors' collection actions or to stay any litigation commenced in the U.S. The ultimate goal in a Chapter 15 proceeding is to preserve the value of the assets of a foreign debtor for the benefit of all of its creditors.

First, it prevents piecemeal (and potentially contrary) adjudication relating to the same insolvent estate. Second, it prevents inequitable distributions to creditors of the same estate located in different countries, which may otherwise receive different distributions based on local law. Finally, it encourages better cooperation between courts in different countries, with an eye toward a globally efficient administration of all of a foreign debtor's assets.

At its core, Chapter 15 is a mechanism for recognition by a U.S. Bankruptcy Court of an insolvency proceeding being administered outside the U.S. Of course, not just any foreign proceeding will be recognized, and foreign proceedings must meet certain criteria for recognition. The foreign proceeding may take the form of a liquidation or reorganization, but it must be governed by law relating to insolvency or adjustment of debt and must be supervised by a foreign court. Notably, a receivership for the benefit of one party does not qualify as a foreign proceeding.

A case under Chapter 15 is commenced with a foreign representative filing a petition for recognition of a foreign proceeding. After the filing of the petition but prior to a formal recognition of the foreign proceeding, the Bankruptcy Court may provide certain interim relief, such as staying litigation or execution against the debtor's assets or entrusting the administration of the debtor's assets to the foreign representative. Interim relief is granted only to the extent that it is urgently required and upon proof that the legal standard applicable to preliminary injunctions is met.

Once it has determined that the petition contains all required information and that the proceeding in question qualifies as a foreign proceeding as defined in the Bankruptcy Code, the Bankruptcy Court enters an order formally recognizing the foreign proceeding. The Bankruptcy Code identifies two types of foreign proceedings: main and nonmain. Since the relief available hinges on the type of proceeding, the court must make that determination at the inception of the case.

A foreign main proceeding is one administered in the jurisdiction in which the debtor has its center of main interests (COMI). This term is not defined in the Bankruptcy Code, but has been defined by courts

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through analyses of several factors, including the location of the debtor's headquarters, managers, primary assets, and affected creditors, as well as the jurisdiction whose law would apply to most disputes. A foreign nonmain proceeding is one taking place in a country in which the debtor has an "establishment," defined as "any place of operations where the debtor carries out a nontransitory economic activity."

Upon recognition of a foreign main proceeding, certain relief is imposed by operation of law—the automatic stay takes effect, certain sections of the Bankruptcy Code are made applicable, and the foreign representative is entitled to operate the debtor's business. In contrast, no relief is automatically imposed upon recognition of a foreign nonmain proceeding. Rather, the Bankruptcy Court must authorize appropriate relief upon request of the foreign representative.

Regardless of whether a foreign proceeding is recognized as main or nonmain, however, one important power is not conferred on the foreign representative—the avoidance power generally available to a Chapter 11 debtor or trustee. A foreign representative does not have standing to avoid certain transfers under U.S. law, although it may have such power under foreign law under certain circumstances.

Chapter 15 operates based on the principle of comity, which is reciprocal respect between courts in different jurisdictions for the decisions of the other. One exception, which is invoked on rare occasions, occurs when the court believes that the application of comity in a Chapter 15 case would be "manifestly contrary to the public policy of the United States." This could include violation of U.S. laws or the rights of U.S. citizens.

Offensive, Defensive Options

Chapter 15 offers debtors in cross border cases both offensive and defensive options. Companies can use the law defensively to protect against certain adverse actions against the debtor and its assets. For example, Chapter 15 can be used to stay litigation in the U.S. against the debtor. It is important to note, however, that the automatic stay imposed in a Chapter 15 proceeding does not have extraterritorial reach and only applies to assets in the U.S. Other examples of the defensive use of Chapter 15 include using it to stay execution on the debtor's assets located in the U.S. or to protect the assets from creditors' attacks.

Chapter 15 may also be used offensively. For example, a debtor that has obtained a foreign court's approval of a plan of reorganization may use Chapter 15 to bind U.S. creditors to the plan's terms in certain circumstances. Chapter 15 may also be used to implement the sale of a debtor's assets located in the U.S. and abroad if the court is satisfied that the standard for the sale of assets under the business judgment rule has been met. Due to jurisdictional and other limitations, it may be difficult for a debtor in the U.S. to use the cash collateral of a foreign secured lender. Through a Chapter 15 proceeding, however, its use may be authorized.

Chapter 15 may also prove to be an effective mechanism when dealing with other parties in interest. For example, a foreign representative may use Chapter 15 to conduct broad discovery in the U.S. Chapter 15 may also be used to offset claims or to implement claims resolution procedures for U.S. creditors. The foreign representative may also

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use Chapter 15 to toll avoidance actions for a two-year period under Section 108 of the Bankruptcy Code.

Of course, Chapter 15 does have its limits. As mentioned previously, avoidance powers under U.S. law are unavailable in Chapter 15. Chapter 15 also affords fewer creditors' protections and generally cannot be used for a debt restructuring, and it does not address issues relating to a group of companies or enterprises.

Recent Developments in Case Law

Several recent decisions rendered in Chapter 15 cases provide significant guidance on the application of the law going forward. These cases touch on two general concepts: the debtor's qualification to file Chapter 15 and the relief available in Chapter 15.

Debtor's Qualification to File. The 2nd U.S. Circuit Court of Appeals, in *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013), recently determined that the eligibility requirements to become a debtor under Title 11 of the Bankruptcy Code contained in Section 109 of the code apply in Chapter 15. Therefore, foreign debtors must have assets or a place of business in the U.S. to file a Chapter 15 case. However, current case law sets a low standard in this regard—a debtor may meet the asset requirement with as little as an unearned retainer paid to professionals or a bank account in the U.S. Practitioners, however, should still be aware of this requirement to ensure that the threshold for eligibility under Section 109 is met.

The 3rd U.S. Circuit Court of Appeals analyzed the debtor's property interest in assets for purposes of Chapter 15 in *In re ABC Learning Centres, Ltd.*, 728 F.3d 301 (3d Cir. 2013). There, the debtor had only fully encumbered assets in the U.S. The debtor's lack of equity in the assets did not, however, remove them as property of the debtor or from the protection of the automatic stay. Seemingly, the assets would enter into Chapter 15 eligibility analysis. The court also determined that the public policy exception did not bar recognition of a foreign proceeding, even when the debtor's secured creditors in that proceeding would retain all debtor assets.

The court in *In re Millard,* 501 B.R. 644 (Bankr. S.D.N.Y. 2013), determined that there was no good faith requirement for foreign proceeding recognition. Further, the debtor did not need to be insolvent to commence a Chapter 15 case, at least when insolvency was not a requirement under the foreign proceeding, despite the fact that the word "insolvency" is included in the definition of "foreign proceeding" in the Bankruptcy Code.

In another recent decision touching on the debtor's qualifications to file a Chapter 15, the 2nd Circuit determined that the Chapter 15 petition date should be the relevant date to determine the location of the debtor's COMI. The case of *In re Fairfield Sentry Ltd.,* 714 F.3d 127 (2d Cir. 2013) shows that the debtor's COMI may shift, even strategically, prior to commencement of a Chapter 15 filing. Although debtors may now engage to some extent in prebankruptcy planning, the court warned that it would closely scrutinize debtors who attempt to manipulate their COMI before commencing a Chapter 15 case.

Available Relief. As stated earlier, Chapter 15 excludes application of certain code provisions, most notably the avoidance powers of a debtor or trustee. In the absence of express exclusions, however, Bankruptcy Courts have discretion to use other

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code sections to provide appropriate relief. In *In re AJW Offshore Ltd.*, 488 B.R. 551 (Bankr. E.D.N.Y. 2013). The Bankruptcy Court found it had authority in a Chapter 15 case to order the turnover of debtor property under Section 542 of the Bankruptcy Code. The court required that the turnover order apply only to assets located in the U.S. and include appropriate conditions to protect creditors and other parties in interest.

Application of other code sections may be mandatory. For example, in *Jaffe v. Samsung Electronics Co. Ltd.*, 737 F.3d 14 (4th Cir. 2013), the 4th Circuit upheld the Bankruptcy Court's mandatory application of the protections in Section 365(n) of the Bankruptcy Code to licensees of U.S. intellectual property as part of the protection offered under Chapter 15.

The enforceability in Chapter 15 of certain third-party release provisions in a foreign plan of reorganization, which remains an open question in most jurisdictions, was at issue in *In re Sino-Forest Corp.*, 501 B.R. 655 (Bankr. S.D.N.Y. 2013). In that case, certain third-party releases of the debtor's accountants had been approved as part of the debtor's Canadian insolvency proceeding. The Bankruptcy Court determined that through a Chapter 15 case, such releases were enforceable in the U.S.

The court distinguished the case of *In re Vitro S.A.B. de CV*, 701 F.3d 1031 (5th Cir. 2012), where certain third-party releases approved in Mexico were not honored in the U.S. because the result of such releases, among other things, would have resulted in violation of the absolute priority rule.

Extensive Discretion

From a foreign representative's point of view, Chapter 15 provides a very flexible and efficient way of obtaining relief from the U.S. Bankruptcy Courts to preserve the integrity of a debtor' estate that spans borders. Once a Bankruptcy Court recognizes a foreign proceeding as a main proceeding, or even a non-main proceeding, the bankruptcy judge has extensive discretion under Chapter 15 to provide appropriate relief and assist the foreign representative in managing a debtor's estate, subject to the proviso that there is no violation of U.S. laws or the rights of U.S. citizens. J

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