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Will Chapter 15 Be the "Exclusive Destination" for Foreign Debtors?

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The U.S. Bankruptcy Court for the District of Delaware's recent decision in *Northshore Mainland Services Inc., et al.*[1] — regarding the Baha Mar resort in The Bahamas — appears to take an additional step toward a regime in which, for at least some foreign debtors, chapter 15 cases may be not just an option, but the exclusive type of U.S. bankruptcy protection available.

History of Availability of Chapter 11 Cases for Foreign Debtors

Even before 2005, when chapter 15 was added to the U.S. Bankruptcy Code, there was a tension between provisions of the U.S. Bankruptcy Code that extended a broad invitation to foreign companies to become chapter 11 debtors in the U.S., such as § 109, and Code provisions that were used to prevent U.S. bankruptcy courts from encroaching on foreign insolvency proceedings, such as the former § 304 and the emphasis given to its codified principle of international comity among courts. Historically, courts were willing to permit a "plenary" U.S. chapter 11 case when no foreign insolvency proceeding was pending, as long as the bare-bones requirements for a chapter 11 debtor under § 109 were satisfied.[2]

Even where a foreign insolvency proceeding was pending, U.S. courts were open to allowing the foreign debtor to pursue a chapter 11 case in the U.S. concurrently. While there were exceptions — generally where a foreign debtor's connections to the U.S. were exceedingly slim, or where the U.S. case would serve no reorganizational purpose — the U.S. appeared to extend the welcome mat for foreign companies to use U.S. laws to implement their financial restructurings.

This welcoming approach of U.S. bankruptcy courts did not apply in the same way when involuntary chapter 11 filings were considered. Generally speaking, attempts of creditors to force a foreign debtor into chapter 11 faced strong headwinds, especially when a foreign insolvency proceeding was already pending.[3] In decisions from the early days of chapter 15, there seemed to be a high degree of consistency with the pre-2005 regime. Voluntary chapter 11 filings by foreign debtors were still rather liberally permitted, while involuntary chapter 11 filings against foreign debtors seemed to be discouraged.

However, the chapter 15 era seemed to bring with it a renewed focus on the "universalist" approach to international insolvency. Under this approach, a country's courts should take an especially light approach when dealing with insolvency issues of a company organized in, and with its center of interests in, another country. This is especially true when a company has an insolvency proceeding pending elsewhere.

This "universalist" focus was seen in cases such as *In re Compañía de Alimentos Fargo SA*.[4] In *Fargo*, while a proceeding was pending under Argentine insolvency law, a group of bondholders filed an involuntary chapter 11 case in the U.S. Bankruptcy Court for the Southern District of New York. The debtor, Fargo, moved to dismiss the involuntary chapter 11 case on the basis that the New York Bankruptcy Court should abstain from hearing the case under § 305(a)(1) of the Bankruptcy Code.[5]

1 2015 WL 5444707 (Bankr. D. Del. Sept. 15, 2015) ("*Baha Mar*").
2 *See Aerovias Nacionales de Colombia SA Avianca*, 303 B.R. 1 (Bankr. S.D.N.Y. 2003); *In re Global Ocean Carriers Ltd.*, 251 B.R. 31 (Bankr. D. Del. 2000).
3 *See In re Satelites Mexicanos SA de CV*, Case No. 05-13862 (Bankr. S.D.N.Y.); *but see In re Globo Comunicacoes e Participacoes SA*, 317 B.R. 235 (S.D.N.Y. 2004) (recognizing that while efforts to cause foreign debtor's "adjudication as an involuntary debtor-in-possession status may be novel, involuntary debtor-in-possession status is clearly authorized under the Bankruptcy Code").
4 376 B.R. 427 (Bankr. S.D.N.Y. 2007).
5 Section 305(a)(1) provides that "[t]he court ... may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time, if ... the interests of creditors and the debtor would be better served by such dismissal or suspension."

The *Fargo* court noted that while "abstention under § 305 is considered an extraordinary remedy, the pendency of a foreign insolvency proceeding alters the balance by introducing considerations of comity into the mix."[6] The court observed that U.S. courts traditionally defer to foreign proceedings as long as the foreign proceedings are fair and equitable. The court must also weigh the benefits and burdens of exercising jurisdiction, and evaluate the reason for filing the involuntary petition.

In *Fargo*, the New York Bankruptcy Court concluded that the Argentine insolvency system, while different from the U.S. Bankruptcy Code, was procedurally and substantively fair and able to adjudicate the rights of the parties. The unavailability under Argentine law of particular remedies that were available in a U.S. bankruptcy proceeding was insufficient to dissuade the court that the foreign proceedings were fair.

With respect to the "benefits and burdens" of exercising jurisdiction, the court examined the physical locations of the parties (including the magnitude of the debtor's U.S. assets), the existence of parallel proceedings, and the nature of the dispute. The court concluded that since Fargo had few U.S. assets that could be reorganized through a U.S. bankruptcy proceeding, a U.S. chapter 11 would not be of significant benefit. In addition, the court considered that the dispute between the petitioning creditors and the debtor related to actions taken in the foreign proceeding, which counseled in favor of abstention. Finally, the court questioned whether the purpose of the U.S. filing was potentially to "hijack" the foreign proceeding or possibly gain leverage in negotiations with the debtor and other creditors. For these reasons, the New York Bankruptcy Court decided to abstain from hearing, and to dismiss, the petitioning creditors' chapter 11 case against Fargo.

In at least some cases, the indirect result of creditor efforts to commence plenary involuntary U.S. bankruptcy proceedings for foreign debtors has been the filing by the foreign debtors of voluntary U.S. chapter 15 cases.[7] For example, in *Suntech*, a minority group of bondholders commenced an involuntary chapter 7 case against Suntech Power Holdings Co. Ltd., a Cayman Islands holding company for a Chinese operating company in the solar energy sector. Suntech opposed the involuntary petition, but ultimately commenced an insolvency proceeding in the Cayman Islands, and the bondholders and Suntech entered into a restructuring support agreement pursuant to which Suntech commenced a chapter 15 filing in the U.S.[8] In other words, the resistance of U.S. courts to allow an involuntary chapter 11 case ultimately resulted in the foreign debtor commencing a chapter 15 case (which can only be commenced on a voluntary basis).

Baha Mar: "Shifting Sands" of Voluntary Chapter 11 Relief for Foreign Debtors

In the recent *Baha Mar* decision, the Delaware Bankruptcy Court seems to be extending a similar rationale for abstaining from *involuntary* chapter 11 cases to efforts by foreign debtors to sustain a voluntary chapter 11 case in the U.S., at least when a foreign insolvency proceeding is pending elsewhere. If that is the case, *Baha Mar* would seem to mark at least a partial departure from pre-chapter 15 case law in that "universalism" would be reigning ascendant in respect of both involuntary and voluntary efforts to bring foreign debtors into chapter 11.

> **[A] number of recent chapter 15 decisions have shaped ... the types of relief that can be obtained in (and the geographic reach of) chapter 15.**

The debtors in *Baha Mar*, predominantly Bahamian entities, were developing a resort complex in The Bahamas that would be one of the largest destination resorts in the Caribbean. Due to construction setbacks and disputes with its construction company and lender, the debtors faced a liquidity crisis. As a result, they filed chapter 11 cases in Delaware within weeks of opening U.S. bank accounts for the purpose of establishing eligibility as debtors under the U.S. Bankruptcy Code.

Simultaneously, the debtors sought recognition by the Supreme Court of the Commonwealth of The Bahamas of their chapter 11 cases and a stay of all proceedings involving the debtors. The Bahamian Attorney General filed a petition seeking orders for the winding up of the debtors' business and requesting the appointment of provisional liquidators for the debtors. The Bahamian Supreme Court denied the debtors' request for a stay because it said that it would offend public policy where the locus of the debtors' business and disputes with creditors was in The Bahamas, and because the debtors' connections to the U.S. were limited.[9] The Bahamian Supreme Court appointed joint provisional liquidators with limited powers, with the goal that they would promote a plan among all stakeholders that could reverse the debtors' insolvency.

The debtors' construction company and secured lender moved to dismiss the U.S. cases, arguing that the core issues in the cases lacked any meaningful connection to the U.S. The debtors countered that there were significant benefits to proceeding under chapter 11 rather than under the Winding Up Act in The Bahamas, which the debtors contended would end in liquidation.

As a threshold issue, the U.S. court, in line with longstanding precedent and recent decisions like *Suntech*,[10] held

6 *Fargo*, 376 B.R. at 434.

7 This same result also occurred under the predecessor to chapter 15, § 304 of the Bankruptcy Code, which authorized the commencement of cases ancillary to a foreign proceeding. *In In re Satelites Mexicanos SA de CV*, Case No. 05-13862 (Bankr. S.D.N.Y.), a group of secured bondholders commenced an involuntary chapter 11 filing against the SatMex, which opposed the petition. Ultimately, a settlement between the parties resulted in the filing of a § 304 ancillary proceeding. *See also* George W. Shuster, Jr. and Benjamin W. Loveland, "Can Chapter 15 Be an Ally to Bondholders in Foreign Insolvency Cases?," XXXIII *ABI Journal* 8, 50-51, 91-92, August 2014, *available at* abi.org/abi-journal (discussing concept of "involuntary" chapter 15 cases).

8 Chapter 15 expressly preserves a debtor's (or foreign representative's) right to commence a plenary proceeding even when a foreign case is pending. *See* 11 U.S.C. § 1511; *In re Sphinx Ltd.*, 351 B.R. 103, 113 (Bankr. S.D.N.Y. 2006).

9 In essence, the Bahamian court concluded that Baha Mar had gotten it backwards — that the ancillary Bahamian case could not be treated as such, because the locus of the debtor was in The Bahamas. This is a similar result (in the inverse) to the *Bear Stearns* case in the U.S., where a chapter 15 case was not recognized because the debtor was considered to be a New York business, not a Cayman business, and therefore no U.S. bankruptcy case could properly be an ancillary case. *See In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd.*, 374 B.R. 122 (Bankr. S.D.N.Y. 2007), *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008).

10 *In re Suntech Power Holdings Co. Ltd.*, 520 B.R. 399 (Bankr. S.D.N.Y. 2014); *see also Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013).

that the debtors were eligible to file in the U.S. based on even a minimal amount of property in the U.S., and that the relevant date for making a determination of eligibility is the petition date.[11] To determine whether to exercise its discretion to abstain under § 305, the court gauged the overall best interest of the debtor and creditors. The movants argued that a majority of the parties were located in The Bahamas, the parties had "legitimate expectations" that Bahamian law would apply, and the Bahamian Supreme Court's refusal to recognize the chapter 11 cases meant that those cases would be essentially futile. The debtors argued primarily that the chapter 11 cases were necessary for the reorganization rather than liquidation of the project, because chapter 11 provides significant protections that are not available in The Bahamas, including flexibility in developing a plan, continuity of management, debtor-in-possession financing, and the ability to assume or reject executory contracts. The movants disagreed, saying that the joint provisional liquidators could restructure rather than liquidate under Bahamian law.

The U.S. court acknowledged that the central focus of the proceedings was the unfinished project in The Bahamas, and it discounted the debtors' argument that Bahamian law limited their options to a liquidation proceeding. The court concluded that stakeholders should have expected Bahamian insolvency law to apply, and that these expectations should be respected. In evaluating comity, the court determined that the Bahamian proceedings were fair and impartial. Although differences between the Bahamian insolvency proceedings and the U.S. chapter 11 process existed, the court had not seen evidence that the Bahamian laws contravened the public policy of the U.S. in a manner sufficient to warrant disregard for comity.

The U.S. court did recognize that the debtors' right to have recourse to relief in the U.S. bankruptcy court was a fundamentally important right, and it noted that chapter 11 would be an ideal vehicle for restructuring the debtors and allowing for completion of the project on sound financial footing. Indeed, the court stated that it would have considered denying the motions to dismiss if it had been convinced that the chapter 11 process would bring stakeholders to the table in a productive way. But ultimately, the court concluded that allowing the chapter 11 cases to proceed would invite further litigation in multiple forums. On balance, the court abstained from asserting its jurisdiction over the debtors' chapter 11 cases.

Conclusion

In deciding to abstain as to Baha Mar's voluntary chapter 11 case in Delaware, in deference to the debtors' Bahamian proceeding, the court embraced principles of comity with particular vigor and suggested that only a subset of foreign debtors will successfully have their plenary cases survive in a U.S. court. This fact may push more foreign debtors away from chapter 11 and into chapter 15.

However, it should also be recognized that a number of recent chapter 15 decisions have shaped, and to some extent narrowed, the types of relief that can be obtained in (and the geographic reach of) chapter 15. Combined with the fact that chapter 15 itself limits the relief that debtors can obtain, the trend appears to be one in which, absent unique circumstances, a foreign insolvency proceeding will be respected, and any U.S. proceeding will serve as truly ancillary to such foreign proceeding. *Baha Mar* seems to be part of that trend, with courts moving further away from a "territorial" approach to foreign insolvency and toward the "universalist" approach to foreign insolvency that chapter 15 was designed to embrace. **abi**

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11 The court also declined to dismiss the case as a "bad faith" filing under § 1112(b)(1) because it served a valid reorganizational purpose. Although the debtors filed the case to maintain control of the project, the court concluded that was not the type of "tactical advantage" that constitutes bad faith.