Cross-Border Bankruptcy in 2013: 10 Decisions Shaping Chapter 15

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Chapter 15 of the US Bankruptcy Code, addressing cross-border bankruptcy cases, is fewer than 10 years old, but the cumulative volume of Chapter 15 cases has become substantial. In 2013 alone, 38 Chapter 15 cases (or groups of related cases) were filed, including 17 in Delaware, 14 in the Southern District of New York, and 3 in the Southern District of Florida. Of those cases, 24 were related to Canadian foreign proceedings and most of the balance were related to UK and European foreign proceedings.

The accumulation of Chapter 15 cases brings with it an evolution of the substantive case law defining the contours of cross-border practice in the United States. This alert describes ten reported decisions from the past year, all issued in or relating to Chapter 15 cases, which highlight the evolving nature of cross-border practice and provide some guidance on how cross-border insolvency will be treated in US courts moving forward. These decisions fall roughly into three categories-decisions addressing whether a Chapter 15 case may proceed, decisions addressing what relief may or must be available within a Chapter 15 case, and decisions addressing whether Chapter 15 provides the sole route to recognition of foreign insolvency orders in US federal courts.

Barriers to Entry: What It Takes to Sustain a Chapter 15 Case in the US

Four Chapter 15 decisions in 2013 addressed the question of when a Chapter 15 case may proceed in the US courts.

Generally speaking, Chapter 15 is thought to be an inclusive chapter of the US Bankruptcy Code, being relatively liberal in permitting cross-border ancillary cases to proceed in US courts to address US assets and creditors. But at the end of 2013, the Second Circuit Court of Appeals held that the requirements to qualify as a debtor under the US Bankruptcy Code generally, found in Section 109, also apply to foreign debtors under Chapter 15. *In re Barnet*, 737 F.3d 238 (2d Cir. 2013). As a result, ***a foreign debtor must have a place of business or assets in the United States*** in order to be eligible for Chapter 15 recognition. Even if a foreign debtor has substantial US creditors, a Chapter 15 case may not be employed to enjoin those creditors from enforcing rights against a foreign debtor with no US place of business or assets.[1] The threshold for assets sufficient to satisfy Section 109 is so low under prevailing case law that the requirement for a foreign debtor to have US

assets seems easily satisfied in most instances. Still, this Second Circuit decision aligns with the principle, stated in other Chapter 15 jurisprudence, that the primary role of Chapter 15 is for US courts to further within US borders the foreign debtor's main insolvency proceeding-not for US courts to reach out from the United States and provide purportedly extraterritorial rulings.[2] In this way, the Second Circuit's decision appears to be part of a trend toward circumscribing the geographical scope of Chapter 15.

On the other hand, the Southern District of New York Bankruptcy Court held, a few weeks before the *Barnet* decision, that ***insolvency of a foreign debtor is not a prerequisite to a Chapter 15 case***, notwithstanding the use of the word "insolvency" in the definition of "foreign proceeding" under Section 101(23) of the US Bankruptcy Code. Just as with debtors in plenary Chapter 11 cases in the United States, foreign debtors under Chapter 15 need not be insolvent, so long as insolvency was not a prerequisite to the proceeding under which the foreign debtor's financial affairs are being addressed in its "home" jurisdiction. *In re Millard*, 501 B.R. 644 (Bankr. S.D.N.Y. 2013). In that same case, the court also held that a Cayman liquidation proceeding is not "manifestly contrary" to US public policy, and therefore does not run afoul of Section 1506 of Chapter 15, even though a Cayman liquidation may be carried on for the primary or sole purpose of challenging a judgment obtained by a creditor against the debtor, rather than for the administration of creditor claims generally. Finally, the court found that there is no "good faith" requirement for recognition of a foreign proceeding under Chapter 15, because recognition is nondiscretionary when the basic elements of Section 1517 are satisfied (though the court left open the possibility of later "bad faith" challenges in a Chapter 15 case).

In a sense, the Third Circuit Court of Appeals' decision in *In re ABC Learning Centres Ltd.*, 728 F.3d 301 (3d Cir. 2013), combines and affirms concepts in the *Barnet* and *Millard* decisions. In *ABC Learning Centres*, the Third Circuit held that ***a foreign proceeding can be recognized under Chapter 15, and is not manifestly contrary to US public policy, even if it allows secured creditors to retain all of the debtor's assets (on which they have a lien)*** rather than providing for the administration of all creditor claims, and distributions to all creditors, generally. Relatedly, the Third Circuit found that the fact that the debtor likely has no equity in its assets in the United States, due to undersecured liens on those assets, does not necessarily mean that those assets are not property of the debtor subject to the automatic stay (and, presumably, sufficient to sustain a Chapter 15 case under Section 109 of the US Bankruptcy Code).

Another "gateway" issue in Chapter 15 was decided in 2013 by the Second Circuit Court of Appeals in *In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d Cir. 2013). In that case, the Second Circuit held that ***the foreign debtor's "center of main interests" (COMI)-a primary consideration for determining whether and how a Chapter 15 case may proceed in the United States-should be determined at the time the Chapter 15 petition is filed***, rather than as of an earlier date.[3] This decision narrows and clarifies the relevant point in time at which a foreign debtor must meet the requirements of Section 1517 and thereby may enhance the ability of a foreign debtor to plan its cross-border insolvency strategy. However, the Second Circuit cautioned that a court may also consider whether a debtor has manipulated its COMI in "bad faith" during the period between the commencement of the foreign proceeding and the Chapter 15 filing.

Upon Entry: What Relief May or Must Accompany a Chapter 15 Case

Five other Chapter 15 decisions in 2013 addressed the question of what provisions of the US Bankruptcy Code and other US law, and what provisions of foreign insolvency proceedings, may or must become parts of the foreign debtor's cross-border insolvency.

Chapter 15 expressly prohibits the implementation of certain provisions of other chapters of the US Bankruptcy Code, such as those permitting preferential and fraudulent transfer avoidance actions, in Chapter 15 cases. *See* 11 U.S.C. § 1521(a)(7). The logic of these restrictions is that potentially conflicting avoidance actions in multiple jurisdictions would become a legal quagmire and therefore avoidance actions, if any, should be brought under the law of the primary insolvency proceeding of the foreign debtor-not under US law through Chapter 15.[4] But ***other provisions of the US Bankruptcy Code not expressly carved out from Chapter 15 may be applied by the court overseeing the Chapter 15 case***-such as the ability of the US court to order a turnover of estate property under Section 542 of the Bankruptcy Code, as demonstrated by the decision in *In re AJW Offshore Ltd.*, 488 B.R. 551 (Bankr. E.D.N.Y. 2013). Notably, the court in *AJW Offshore* required that the use of Section 542 to require turnover of assets to the estate (financial records) must be accompanied by the imposition by the court of appropriate conditions to protect creditors and other interested parties under Section 1522, and may only apply to assets within the territorial jurisdiction of the United States.[5]

In contrast to the question of what provisions of the US Bankruptcy Code may be implemented by a bankruptcy court in a Chapter 15 case on a discretionary basis, the Fourth Circuit Court of Appeals, in *Jaffe v. Samsung Elecs. Co., Ltd.*, 737 F.3d 14 (4th Cir. 2013), held that ***the bankruptcy court properly made the protections available to licensees of US intellectual property under Section 365(n) mandatorily applicable in Qimonda's Chapter 15 case***, as part of the protection of creditors and other interested parties under Section 1522.[6] This decision leaves open what other US Bankruptcy Code provisions courts might determine to be mandatory in Chapter 15 cases, and under what circumstances.

A decision in the past year also addressed what provisions of foreign insolvency proceedings will be given effect in the United States through Chapter 15. In *In re Sino-Forest Corp.*, 501 B.R. 655 (Bankr. S.D.N.Y. 2013), the Southern District of New York Bankruptcy Court held that ***third-party releases (of accountants) approved as part of the foreign debtor's Canadian insolvency proceeding may be enforced in the United States through Chapter 15, even if those same releases may not have been approved by a US court as part of a Chapter 11 plan of reorganization***. In rendering this decision, the court compared the facts of the case to the court's prior decision in *Metcalfe*, where third-party releases approved in Canada were also given effect in the United States, and contrasted the facts of the case with the Fifth Circuit's decision in *Vitro*, where nondebtor subsidiary guarantor releases approved in Mexico were not given effect in the US.[7] A major distinction between *Sino-Forest* and *Metcalfe*, on the one hand, and *Vitro*, on the other hand, appears to be the attempt by Vitro to use intercompany claims to obtain requisite creditor approval of its *concurso mercantil* (reorganization) plan in Mexico, contrary to US insider voting principles in the Chapter 11 context. In *Sino-Forest* and *Metcalfe*, the Canadian approvals were not obtained through

a process thought to be in major conflict with US principles, even if, as a matter of substantive US law, the releases in all three cases (*Sino-Forest*, *Metcalfe* and *Vitro*) would not likely have been approved in Chapter 11.

Two decisions in 2013 addressed the application of US law outside the US Bankruptcy Code to Chapter 15 cases. In *In re Worldwide Education Services, Inc.*, 494 B.R. 494 (Bankr. C.D. Cal. 2013), the court held that ***the same standard for evaluating whether a preliminary injunction should be granted by a federal court generally should be applied when a bankruptcy court is considering an injunction (in the form of the temporary application of the automatic stay) at the outset of a Chapter 15 case*** under Section 1519, prior to the court's determination of whether the foreign debtor's insolvency proceeding should be recognized and whether the Chapter 15 case may therefore proceed (at which point the automatic stay would apply under Section 1520). The court departed from a prior ruling in the same California bankruptcy court, where a lower standard was applied. In *In re British American Insurance Company Ltd.*, 488 B.R. 205 (Bankr. S.D. Fla. 2013), the Southern District of Florida Bankruptcy Court, in a detailed decision addressing central issues of US bankruptcy jurisdiction, held that ***bankruptcy courts presiding over Chapter 15 cases may also exercise jurisdiction over disputes "related to" those Chapter 15 cases, pursuant to the jurisdictional authority granted in 28 U.S.C. § 1334***.[8] The court reached this conclusion despite contrary arguments that "related to" jurisdiction means that the dispute must be "related to" a bankruptcy estate, and, technically speaking, there is no "estate" in a Chapter 15 case in the way that there is in a Chapter 7 or 11 case. The court in *British American* also adopted a plain reading of the "permissive abstention" language in 28 U.S.C. § 1334(c)(1), holding that the doctrine of permissive abstention is inapplicable in the Chapter 15 context-even to disputes only "related to" the Chapter 15 case. Thus, under *British American*, the only type of abstention applicable in Chapter 15 is mandatory abstention under 28 U.S.C. § 1334(c)(2), which on its express terms requires abstention for certain matters "related to" Chapter 15 cases that do not also "arise under" or "arise in" those Chapter 15 cases. The court reasoned that its interpretation was consistent with Chapter 15's overall goals and focus on comity.

Absent Entry: Alternatives to Chapter 15 in US Courts?

One decision in 2013, outside the context of Chapter 15 itself, demonstrates that Chapter 15 may not be simply an option for enforcing foreign insolvency orders in the United States. In *Oak Point Partners, Inc. v. Lessing*, No. 11-CV-03328, 2013 WL 1703382 (N.D. Cal. Apr. 19, 2013), a defendant in a US debt-collection lawsuit (who was the German foreign representative for the defendant/debtor) sought to have the action dismissed on the grounds of international comity because of the pending German insolvency proceeding. The Northern District of California held that ***Chapter 15 is the sole avenue for recognition of foreign insolvency proceedings, absent a "true conflict" of US and foreign laws***. Thus, the court refused to dismiss the US suit. The court rejected the defendant's argument that doing so would be an extension of comity to the foreign insolvency proceeding-because such a dismissal for comity in the insolvency context should occur only through the Chapter 15 context.

While the foreign representative in *Oak Point* sought to use the existence of a foreign insolvency

proceeding defensively, foreign representatives commonly seek to commence actions in US courts to use their status under foreign insolvency proceedings offensively to enforce the rights of foreign debtors. There too, the commencement of a Chapter 15 case can be an essential (or at least preferred) step in pursuing those rights. The court in *Millard* characterized recognition of a foreign proceeding as a "*sine qua non* for access to the U.S. Courts." 501 B.R. at 653 ("Section 1509 of the Code . . . effectively establishes the bankruptcy court as a gatekeeper for a foreign representative's access to the U.S. Courts, with recognition as the means to open the gate."). While the court in *Millard* may have overstated the point somewhat-Section 1509 allows for certain exceptions-the court in *British American* recognized that establishing standing and jurisdiction may prove difficult without resort to the right of direct access to US courts afforded by Section 1509 (and thus without the filing and recognition of a Chapter 15 case). *See* 488 B.R. at 227-228.

The Bottom Line

It is difficult to make broad inferences from these 10 decisions, but many of them seemed aligned in their general views on Chapter 15. Overall, they seem to support the view that Chapter 15 has relatively low barriers to entry, is a relatively powerful tool to resolve a wide array of insolvency-related issues with US connections, and may be the only method for recognizing foreign insolvency orders (and the best method for a foreign representative to assert its rights) in the US federal courts system. These 10 Chapter 15 decisions of 2013 have brought a higher degree of clarity on a number of meaningful issues within Chapter 15, and have materially added to the still young, but ever-expanding, Chapter 15 jurisprudence.

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[1] The foreign representatives in *Barnet* sought recognition for the purposes of enjoining actions against them in the United States, seeking discovery to determine whether to pursue actions in the United States and obtaining access to the US courts to pursue any such actions.

[2] This principle was recently affirmed by the Southern District of New York Bankruptcy Court in the Fairfield Funds Chapter 15 case, where the US court declined to revisit a British Virgin Islands court's approval of an asset sale because the asset sold was not located in the United States. *See In re Fairfield Sentry Ltd.*, 484 B.R. 615 (Bankr. S.D.N.Y. 2013). We discussed the *Fairfield* decision in our prior alert, Jurisdictional Mix-and-Match: *Vitro*, *Elpida* and *Fairfield* Demonstrate the Uncertainties of Cross-Border Bankruptcy for US Bondholders and Buyers (Feb. 13, 2013), available here.

[3] In *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), the court in performing its COMI analysis declined to consider foreign connections arising after the commencement of the Chapter 15 case. In contrast to *Bear Stearns*, where the court held that the debtor's connections were insufficient for recognition, Fairfield's connections were deemed sufficient for recognition even when consideration was limited to the time of the filing of the Chapter 15 case. For additional discussion of *Bear Stearns*, see our prior alert, Recent Decisions in *Saad*, *Metcalfe*, and *Condor*: Chapter 15 Re-Energized (Mar. 25, 2010), available here.

[4] Prior to the enactment of Chapter 15, some early authority had suggested that avoidance powers under US law could be used in an ancillary proceeding under former Section 304 of the Bankruptcy Code (Chapter 15's predecessor). Later cases, however, concluded they could not be. *See In re Axona Int'l Credit & Comm. Ltd.*, 88 B.R. 597, 607 n. 17 (Bankr. S.D.N.Y. 1988).

[5] The *AJW Offshore* decision cites a prior decision of the Fifth Circuit Court of Appeals in *In re Condor*, 601 F.3d 319 (5th Cir. 2010), which was discussed in our prior alert, Recent Decisions in *Saad*, *Metcalfe*, and *Condor*: Chapter 15 Re-Energized (Mar. 25, 2010), available here.

[6] We discussed the bankruptcy court's and Fourth Circuit's decisions in the *Qimonda* case in more detail in our prior alerts, *In re Qimonda AG*: Protections for Intellectual Property Licensees in Cross-Border Insolvencies (Nov. 4, 2011), available here, and *In re Qimonda AG*: Fourth Circuit Upholds US Patent Licensee Protections in Chapter 15 Cross-Border Bankruptcy Case (Dec. 19, 2013), available here.

[7] *See In re Metcalfe & Mansfield Alt. Invs.*, 421 B.R. 685 (Bankr. S.D.N.Y. 2010); In *re Vitro S.A.B. de CV*, 701 F.3d 1031 (5th Cir. 2012). For additional discussion of *Metcalfe* and *Vitro*, see our prior alerts, Recent Decisions in *Saad*, *Metcalfe*, and *Condor*: Chapter 15 Re-Energized (Mar. 25, 2010), available here, and Jurisdictional Mix-and-Match: *Vitro*, *Elpida* and *Fairfield* Demonstrate the Uncertainties of Cross-Border Bankruptcy for US Bondholders and Buyers (Feb. 13, 2013), available here.

[8] The court in *British American* framed the "related to" inquiry as looking at the impact on the debtor or the impact on the handling and administration of the Chapter 15 estate. In the alternative, the court stated that it could "define the extent of related to jurisdiction in Chapter 15 cases by the potential effect of the action on the estate administered in the foreign proceeding." 488 B.R. at 224.

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