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Bankruptcy and Financial Restructuring Alert

Coming to America?—Applying Bankruptcy Code Section 109(a) to Vet Foreign Companies Filing US Bankruptcy Cases Under Chapter 15

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I. Introduction

Chapter 15 of the US Bankruptcy Code provides a doorway for non-US companies to obtain creditor protection and other benefits of a US bankruptcy in support of insolvency proceedings for those companies in their "home" jurisdictions. But how wide open is that doorway? Recent decisions interpreting section 109(a) of the US Bankruptcy Code in the chapter 15 context provide answers—but not necessarily consistent ones—to this question.

Under chapter 15, a representative of a non-US debtor company may obtain recognition in the United States for an insolvency proceeding pending for the company outside the United States. Recognition of a foreign insolvency proceeding allows a foreign debtor company to take advantage of significant benefits available under the US Bankruptcy Code, such as the application of the automatic stay within US borders, even though the company's primary insolvency proceeding is pending in a different country.[1]

Over the past few years, there has been an increase in chapter 15 petitions for recognition due in part to financial globalization, which refers to the integration of domestic financial systems with international financial systems.[2] As a result of the globalization of national and regional economies, businesses are now more likely to take advantage of foreign capital markets where the domestic market is unable to meet their capital needs. Such businesses are also more inclined to hold assets abroad.[3] When these businesses fail, what ultimately results is a single debtor company spread across multiple countries—with assets and creditors in different countries than the company's organizational jurisdiction or headquarters.[4] This unique cross-border scenario is precisely the type of insolvency that chapter 15 of the US Bankruptcy Code

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[1] *See In re Creative Fin. Ltd.*, 543 B.R. 498, 503 (Bankr. S.D.N.Y. 2016) (stating if recognition order was granted, foreign debtor would reap the "benefits of the US automatic stay, and preclude execution …on [its] assets … in the United States."); *In re Chiang*, 437 B.R. 397, 402 (Bankr. C. D. Cal. 2010) ("The recognition of a foreign proceeding as a main proceeding brings certain statutory benefits to the debtor. Section 1520(a) specifies that, upon recognition: (a) the automatic stay provisions of §§ 361 and 362 apply with respect to a debtor's US property within the territorial jurisdiction of the United States; (b) §§ 363, 549 and 552 apply to a transfer of interest of the debtor in US property; (c) the foreign representative may operate the debtor's business in the United States and may exercise the powers of a trustee pursuant to §§ 363 (use, sale or lease of property) and 552 (postpetition effect of security interests); and (d) § 5[4]2 applies to US property of the debtor.").

[2] Paul J. Keenan, Chapter 15: A NEW CHAPTER TO MEET THE GROWING NEED TO REGULATE CROSS-BORDER INSOLVENCIES, 15 J. Bankr. L. & Prac. 2 Art. 4 (April 2006).

[3] *Id.*

[4] *Id.*

was designed to address.[5]

This increase in chapter 15 petitions has resulted in a correlating increase in case law interpreting chapter 15's provisions. One fundamental issue that a handful of decisions from the Second Circuit and the New York and Delaware bankruptcy courts have addressed in recent years is the applicability of Bankruptcy Code section 109(a) in the context of chapter 15. Section 109(a), titled "Who may be a debtor," governs precisely that—who may be a debtor under the Bankruptcy Code—by requiring a debtor to have a domicile or assets in the United States to be eligible for relief under the Bankruptcy Code.[6]

Currently, as discussed below, there is a division of authority with respect to the application of section 109(a) in chapter 15. While some courts have argued that this section applies and therefore presents a hurdle that foreign representatives seeking recognition of foreign insolvency proceedings under chapter 15 must clear, other courts have disagreed, stating section 109(a) is irrelevant in chapter 15 and that recognition should be granted unless doing so would be contrary to US public policy.

II. US Bankruptcy Code Section 109(a)

Section 109(a) governs who may be a debtor under the Bankruptcy Code by requiring a person or entity petitioning for bankruptcy to reside or have a domicile, a place of business, or property in the United States.[7] Despite the seemingly straightforward nature of the statute's language, a question has emerged over the past few years—notwithstanding the fact that chapter 15 became part of the Bankruptcy Code in 2005—as to whether the requirements of section 109(a) apply in the chapter 15 context.

A split of authority currently exists between the Second Circuit and a Delaware bankruptcy court regarding whether the eligibility requirements under section 109(a) apply in chapter 15. Courts within the Second Circuit have ruled that section 109(a) does apply, and that property such as a bank account or an indenture governed by US state law satisfies the "property" requirement under section 109(a). One Delaware bankruptcy court, however, has said section 109(a) is irrelevant to the determination of whether a foreign debtor's proceedings should be granted recognition under the US Bankruptcy Code, and that granting recognition is mandatory unless doing so is contrary to US public policy.

III. Statutory Construction Issues

To a degree, the split of authority in respect of section 109(a) may arise from language in chapter 15 that could be characterized as imprecise, or mismatched with other chapters of the US Bankruptcy Code. For example, section 1502(1) defines "debtor" as "an entity that is the subject of a foreign proceeding … for the purposes of this chapter."[8] Section 101(13), by contrast, has another definition of "debtor"—a "person or municipality concerning which a case under this title has commenced."[9] So when section 109(a) sets forth the requirements for a "debtor"—that a debtor must have assets or a domicile, etc., in the United States—it is not clear which of the "debtor" definitions is implicated. Some may argue that section 1502's definition of "debtor" supplants the definition provided under section 101 and thereby bypasses the requirements under section 109(a), while others may argue that section 109(a) is a part of

[5] *In re Fairfield Sentry Ltd.*, 484 B.R. 615, 626 (Bankr. S.D.N.Y. 2013) (stating the "origins of Chapter 15 rest in section 304 of the Code … and the Model Law on Cross-Border Insolvency … each of which were specifically designed to formalize cross-border coordination and cooperation").
[6] 11 U.S.C. § 109(a).
[7] *Id.*
[8] *Id. at* § 1502(1).
[9] *Id. at* § 101(13).

chapter 1, which applies to all debtors under title 11, and therefore the requirements of section 109(a) apply to both section 101(13) "debtors" and section 1502(1) "debtors."

A similar interpretive issue arguably exists with respect to section 1501(c), which describes entities and persons to which "chapter [15] does not apply."[10] For example, section 1501(c)(1) states that chapter 15 does not apply to "a proceeding concerning an entity, other than a foreign insurance company, identified by exclusion in section 109(b)."[11] As noted in more detail below, the Second Circuit has argued that this provision's reference to section 109(b), yet silence regarding section 109(a) indicate Congress' intent to apply section 109(a), but not (b), in chapter 15.[12] However, one could also argue the opposite conclusion: given that section 1501(c) addresses the same subject matter as section 109 (who may be a debtor), section 1501(c) arguably *replaces* section 109 for purposes of chapter 15, leading to the conclusion that section 109(a) does not apply in chapter 15, and section 109(b) applies in chapter 15 only to the limited extent specified in section 1501(c).

With these considerations of statutory construction in mind, we next turn to the decisions that have addressed the applicability of section 109(a) in the chapter 15 context.

IV. Ruling That Bankruptcy Code Section 109(a) Applies in Chapter 15

i. *Drawbridge Special Opp. Fund LLP v. Katherine Elizabeth Barnet* (*In re Barnet*), 737 F.3d 238 (2d Cir. 2013)—claims or causes of action governed by US law, or a US attorney retainer, satisfy section 109(a)

In *Barnet*, foreign representatives of Octaviar Administration Pty Ltd., (OA), a company incorporated in Queensland, Australia, sought recognition of its Australian insolvency proceedings under chapter 15 of the Bankruptcy Code to facilitate the pursuit of avoidance actions. Creditor Drawbridge Special Opportunities Fund LP (Drawbridge) objected to the chapter 15 petition, arguing that OA had no domicile, place of business or property in the United States as required by section 109(a), and therefore the court could not grant recognition. The SDNY bankruptcy court, however, overruled Drawbridge's objection and granted recognition, finding there was no requirement that an entity satisfy section 109(a) to qualify as a debtor under chapter 15 the Bankruptcy Code.[13]

Shortly thereafter, Drawbridge directly appealed the recognition order to the Second Circuit, arguing the bankruptcy court had erred in holding that a petitioner is not required to satisfy section 109(a) to obtain recognition of a foreign main proceeding. Focusing on the "plain terms of the statute," the Second Circuit reversed the bankruptcy court's decision and ultimately held that the requirements of section 109(a) *do* apply in chapter 15 proceedings because section 109 is within chapter 1 of the Code, which chapter applies in a case under chapter 15.[14] Accordingly, the court reasoned that section 109 applies in a case under chapter 15.[15]

The court also focused on section 1502's definition of a "debtor" as "an entity that is the subject of a foreign proceeding … for the purposes of this chapter."[16] While the court acknowledged that section 1502's definition supplants section 101's definition of "debtor" in the context of chapter 15 because of section 1502's limiting language, the court concluded that "it does not supplant

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[10] *Id. at* § 1501(c).
[11] *Id.* at § 1501(c)(1).
[12] *Drawbridge Special Opp. Fund LLP v. Katherine Elizabeth Barnet* (*In re Barnet*), 737 F.3d 238, 249 (2d Cir. 2013).
[13] *In re Octaviar Admin. Pty Ltd.*, 511 B.R. 361, 366 (Bankr. S.D.N.Y. 2014).
[14] *Barnet*, 737 F.3d at 247.
[15] *Id.*
[16] *Id.* at 248.

requirements for 'a debtor under this title' not included in the definition."[17] In further support of its reasoning, the court stated that "if Congress wished to exclude Chapter 15 from the reach of Section 109(a), it did not say as much. Congress' silence is particularly inexplicable in light of the fact that Congress did expressly restrict the application of Section 109(b) to Chapter 15 by removing a prohibition on application to foreign insurance companies."[18]

The Second Circuit therefore vacated the bankruptcy court's recognition order and remanded the case back to the bankruptcy court to determine whether section 109(a) was satisfied.[19]

Back before the bankruptcy court, the foreign representatives argued that OA satisfied the requirements of section 109(a) because the debtor had property in the United States in the form of (i) claims and causes of action against Drawbridge and other US entities, and (ii) a $10,000 retainer in the possession of the foreign representatives' US counsel. The bankruptcy court, finding the foreign debtor did indeed possess "property" in the United States, agreed that section 109(a) had been satisfied, and emphasized that granting recognition would further the goals of chapter 15 and foster the fair, efficient and timely administration of the debtor's case and maximize value for the estate and its creditors.[20]

ii. *In re Suntech Power Holdings, Co.*, 520 B.R. 399 (Bankr. S.D.N.Y. 2014)—a US bank account will satisfy section 109(a)

Debtor Suntech Power Holdings, a Cayman Islands exempted company that manufactured solar power cells, was the subject of liquidation proceedings pending in the Cayman Islands in late 2014. Pursuant to a prepetition restructuring support agreement, the debtor's liquidators were required to petition for recognition under chapter 15, despite the debtor's lack of property, residence or domicile in the United States.[21] In light of the Second Circuit's *Barnet* decision, the liquidators established a New York bank account hoping to satisfy section 109(a).[22] Following the filing of the petition for recognition, however, an objection was lodged to entry of the recognition order, contending the liquidators failed to establish that Suntech satisfied section 109(a).[23]

In response to this objection, the SDNY bankruptcy court acknowledged that the debtor lacked a residence or domicile in the United States, but found that the debtor's bank account located in New York constituted sufficient "property" to satisfy the requirements of section 109(a).[24] The court also noted that the foreign representative's preemptive opening of the bank account was not "improper," and emphasized that section 109(a) rejects investigations into how and why the bank account was established or the amount of money in the account.[25] The court stated that such an exacting inquiry would "contravene the purposes of the statute to provide legal certainty, maximize value, protect creditors … and rescue financially troubled businesses."[26]

iii. *In re Berau Capital Resources Pte*, 540 B.R. 80 (Bankr. S.D.N.Y. 2015)—an indenture governed by US law satisfies section 109(a)

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[17] *Id.* at 249.
[18] *Id.* (citing 11 U.S.C. § 1501(c) ("This chapter does not apply to—(1) a proceeding concerning an entity, other than a foreign insurance company, identified by exclusion in section 109(b)")).
[19] *Id.* at 251.
[20] *Octaviar*, 511 B.R. at 375.
[21] *In re Suntech Power Holdings, Co.*, 520 B.R. 399, 409 (Bankr. S.D.N.Y. 2014).
[22] *Id.* at 409–10.
[23] *Id.* at 410.
[24] *Id.* at 412.
[25] *Id.* at 413.
[26] *Id.*

In *Berau*, a foreign representative petitioned for chapter 15 recognition of proceedings pending in Singapore. No objections to the petition were filed. At the outset of its opinion, the SDNY bankruptcy court acknowledged the body of case law—specifically the *Barnet* case—that had developed addressing whether a foreign debtor must satisfy section 109(a) to obtain recognition under chapter 15.[27] Although the court noted that the *Barnet* decision and its progeny "continue[] to be a frequent subject of discussion and criticism," the court acknowledged the decision was binding on the court.[28] The court first found that the retainer held by the debtor's New York counsel was a valid basis for eligibility under section 109(a).[29] "However," the court continued, "it is apparent that another substantial (and frequently recurring) basis for chapter 15 eligibility exists here."[30] The court held that an indenture under which the debtor was an obligor *also* satisfied the requirements of section 109(a) because it was governed by New York law and contained a New York forum selection clause. In support of its analysis, the court explained that "[c]ontracts create property rights for the parties to the contract" and the indenture represented property in New York because the "situs" of the property—the indenture—was clearly New York.[31] The court noted it would be "ironic if a foreign debtor's creditors could sue to enforce debt in New York, but in the event of a foreign insolvency proceeding, the foreign representative could not file and obtain protection under chapter 15 from a New York bankruptcy court."[32]

Notably, the *Berau* court stated that its decision "addresses only whether the debt indenture satisfies the section 109(a) requirement of 'property in the United States,' an issue likely to recur in other cases."[33] Moreover, the court observed in a footnote that its decision "does not decide whether [] contracts [such as patent, trademark or intellectual property licensing agreements]—entered into by a foreign debtor that include New York choice of law and forum selection clauses may satisfy the section 109(a) 'property in the United States' eligibility requirement."[34] Accordingly, the *Berau* court expressly left open the issue of what other types of contracts constitute "property" sufficient to satisfy section 109(a).

V. Ruling That Bankruptcy Code Section 109(a) Does Not Apply in Chapter 15

iv. *In re Bemarmara Consulting, A.S.*, No. 13-13037 (Bankr. D. Del. Dec. 17, 2013)—section 109(a) does not apply in chapter 15, and recognition thereunder is mandatory unless manifestly contrary to public policy

Bemarmara Consulting, a company with pending insolvency proceedings in the Czech Republic, petitioned for recognition under chapter 15 of the Bankruptcy Code. One party contested recognition based on, among other issues, the debtor's lack of property in the United States. In a ruling from the bench, the Delaware bankruptcy court rejected this argument, stating it "does not agree with the decision of the Second Circuit" and that section 109(a) does not apply in the chapter 15 context.[35] In support of its decision, the court first turned to the language of section 109(a), which the court emphasized describes who may be a "debtor" under the Bankruptcy Code, and not who may be a "foreign representative."[36] The court concluded that section 109(a) did not apply because the debtor's *foreign representative* was petitioning for recognition, not the debtor.[37] The court also noted that "[c]ommentors have reflected on the possibility that it was a

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[27] *In re Berau Capital Res. Pte*, 540 B.R. 80, 81 (Bankr. S.D.N.Y. 2015).
[28] *Id.* at 81–82.
[29] *Id.* at 82.
[30] *Id.*
[31] *Id.* at 83–84.
[32] *Id.* at 83.
[33] *Id.* at 84.
[34] *Id.* at 84 n. 5.
[35] *In re Bemarmara Consulting, A.S.* (No. 13-13037) (Bankr. D. Del.) Hrg. Tr. at 8:24–25 (Dec. 17, 2013).
[36] *Id.* at 9:1–8.
[37] *Id.*

scrivener's error and that the intent was that 109(a) not apply [in chapter 15]."[38]

In further support of its conclusion, the court looked to the definition of a "debtor" under section 1502, which defines a "debtor" simply as an entity that is the subject of a foreign proceeding.[39] The court noted that nowhere in the definition of "debtor" under chapter 15 was there any indication of a property requirement.[40] Moreover, the court emphasized that "[i]n the absence of a finding that the motion for recognition is manifestly contrary to public policy, recognition is mandatory in aid of the main proceeding …").[41]

Accordingly, the court found that an entity subject to a foreign insolvency proceeding may be a debtor under chapter 15 even if it does not possess property in the United States.[42]

VI. The Bottom Line

As of the date of this writing, very few courts have addressed whether section 109(a) applies in chapter 15. As a result, open issues regarding its application remain. These issues include, among others, the threshold question of whether the drafters of chapter 15 intended foreign representatives to be required to demonstrate the debtor's possession of US property before receiving recognition of a foreign proceeding under chapter 15. Some commentators have argued that the policy goals furthered by chapter 15 conflict with a reading of section 109(a) that creates an obstacle for foreign debtors seeking relief under the US Bankruptcy Code.

Unfortunately, Congress has yet to provide any guidance with respect to who may be a debtor under chapter 15, and the relevancy, if any, of section 109(a) in such a determination.

Another open issue yet to be explicitly addressed by case law is the type of property that will satisfy section 109(a)'s requirements. To date, courts have found that a bank account, an indenture governed by US law, a retainer held by a US attorney, and claims or causes of action governed by US law are "property" under section 109(a). However, as noted by the *Berau* court, an issue likely to be revisited, and in the process likely to stir up litigation, is determining what type of contracts—in addition to an indenture—will be considered property of a foreign debtor located in the United States.

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[38] *Id.* at 9:8–10.
[39] *Id.* at 9:11–15.
[40] *Id.* at 9:15–17.
[41] *Id.* at 6:23–25; *see also* 11 U.S.C. § 1506 ("Nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to public policy of the United States."). The public policy exception "requires a narrow reading." *In re Fairfield Sentry*, 714 F.3d 127, 139 (2d Cir. 2013); *accord* H.R. Rep. No. 109-31, pt. 1, at 109 (2005) ("[Section 1506] follows the Model Law article 5 [sic] exactly, is standard in UNCITRAL texts, and has been narrowly interpreted on a consistent basis in courts around the world. The word 'manifestly' in international usage restricts the public policy exception to the most fundamental policies of the United States.").
[42] *Id.* at 9:17–18.

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