Current issues in Chapter 15 discovery

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Introduction

Unlike Chapter 7 liquidations and Chapter 11 reorganisations, cases filed under Chapter 15 of the US Bankruptcy Code are ancillary – essentially functioning in aid of recognised foreign insolvency proceedings. Once a US bankruptcy court recognises a foreign proceeding under Chapter 15, the court may grant the representative of the foreign proceeding assistance and 'appropriate relief'.(1) Such relief can include authorising the foreign representative to examine witnesses under oath and obtain information regarding the foreign debtor's assets, affairs, rights, obligations or liabilities.(2) In other words, foreign representatives may be empowered to pursue discovery in the United States under Chapter 15.

It is not uncommon for Chapter 15 cases to be filed for the purpose of enabling foreign representatives to obtain discovery and search for assets. This article considers the discovery tools available to foreign representatives under Chapter 15 and then two key issues relating to Chapter 15 discovery:

- seal-and-gag orders; and
- the recent decision in *Platinum Partners*, which, among other things, addressed the extent to which foreign law can limit discovery in Chapter 15.

Discovery tools in Chapter 15

To understand the discovery tools available under Chapter 15, it is worth considering the types of discovery available in Chapter 11 reorganisations. There are three principal avenues for pursuing discovery in Chapter 11 cases. First, normal discovery tools are provided under the Federal Rules of Civil Procedure, such as interrogatories, document requests, requests for admission and depositions. The Federal Rules of Civil Procedure ordinarily govern discovery in non-bankruptcy civil litigation pending in the federal courts. Yet, the Federal Rules of Bankruptcy Procedure import many of the Rules of Civil Procedure and apply them to contested matters and adversary proceedings occurring under the umbrella of the overall Chapter 11 case.(3)

Second, there is the turnover remedy available under Section 542(e) of the Bankruptcy Code. Section 542(e) allows a court to order an attorney, accountant or other person holding information regarding the debtor's property or financial affairs to turn over that information to the debtor in possession or, if one is appointed, a Chapter 11 trustee.(4)

Third, there are depositions and document discovery authorised under Rule 2004 of the Federal Rules of Bankruptcy Procedure. Rule 2004 allows any party in interest to obtain leave of court to examine any entity as to a broad range of subject matter that some courts have described as tantamount to fishing expeditions.(5) Rule 2004 exams are often employed as a means of:

- searching for transferred assets;
- scrutinising suspect transactions;
- determining whether the bankruptcy estate has claims against other parties; and
- evaluating potential litigation.

Because Rule 2004 provides a broad discovery tool, the courts have developed the pending proceeding rule, meaning that once litigation has commenced, Rule 2004 cannot be used to circumvent scope limitations and other restrictions that apply under non-bankruptcy discovery rules in civil litigation.(6)

Chapter 15 includes a provision specific to discovery – Section 1521(a)(4). This section authorises the court, on recognition of a foreign proceeding, to grant relief "providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations, or liabilities".(7) The plain language of Section 1521(a)(4) does not limit the subjects of inquiry to only the debtor's assets, affairs and other matters that are connected with the United States.(8) Moreover, because Chapter 15 "is not an independent *in rem* proceeding but an ancillary proceeding designed to assist a foreign representative in administering the foreign estate", Chapter 15 discovery "need not concern assets in the U.S. to be permissible under § 1521(a)(4)".(9) Section 1521(a)(4) and the relief provided thereunder can serve as a basis for conducting Rule 2004 examinations in Chapter 15,(10) although this use is not entirely without controversy (discussed further below).

In addition, Section 1521(a)(7) authorises the court, on recognition of the foreign proceeding, to grant "any additional relief that may be available to a [bankruptcy] trustee", except for certain avoidance powers.(11) This provision can be used as a basis for invoking the Section 542(e) turnover remedy in Chapter 15 cases.(12)

Finally, Section 1507(a) authorises the court, on recognition, to "provide additional assistance to a foreign representative". This too can serve as grounds for allowing the foreign representative to take broad discovery under Rule 2004.(13)

Limitations on Chapter 15 discovery

Chapter 15 imposes limits on the ability of foreign representatives to obtain discovery. Section 1522 (a) provides that a court may grant appropriate relief, including discovery-related relief, under Section 1521 only if the interests of creditors and other interested entities are sufficiently protected. (14) In other words, Section 1522(a) requires that there be a balance between the relief that may be granted to a foreign representative and the interests of other persons who may be affected by that relief. Thus, parties can seek to curtail or bar discovery by arguing that their interests would not be sufficiently protected if broad discovery were allowed to go forward.

In addition, Section 1507(b) sets out various fairness considerations that courts must weigh in deciding whether to grant additional assistance to foreign representatives under Section 1507(a). One of these considerations is whether the requested assistance will reasonably assure just treatment to creditors and interest holders.(15)

There is also the public policy exception set out in Section 1506. In a nutshell, Section 1506 provides that a court may refuse to take action – including recognition of a foreign proceeding – if that action would be manifestly contrary to the public policy of the United States.(16) The words 'manifestly contrary' set a high threshold and have led courts to conclude that this exception should be invoked only under the narrowest of circumstances.(17) Nevertheless, the public policy exception has been invoked in at least one case involving discovery: *In re Toft*.(18) In *Toft*, the foreign representative asked the US bankruptcy court to grant *ex parte* recognition of a German mail interception order in order to capture the foreign debtor's emails from two US-based internet service providers. However, the court determined that the proposed action to capture emails would, if granted, violate US wiretap and privacy laws and was therefore manifestly contrary to US public policy.(19) The court in *Toft* thus rejected the proposed relief.

Finally, the terms of Chapter 15's discovery-specific provision – Section 1521(a)(4) – could be

interpreted to preclude broad discovery in Chapter 15. There is a slight disagreement among the courts as to whether the language of Section 1521(a)(4) curtails the scope of Rule 2004 discovery. One court posits that the language of Section 1521(a)(4) specifically addresses discovery in Chapter 15 and does not suggest that a Rule 2004-type fishing expedition can occur there.(20) Another court disagreed, noting that the additional assistance that a court can provide to a foreign representative under Section 1507(a) can serve as grounds for authorising broad Rule 2004 discovery.(21)

Seal-and-gag orders

Since cash and other assets can move quickly across international boundaries, foreign insolvency fiduciaries searching for assets often wish to conduct discovery in secret so as not to tip off the targets of an investigation that inquiries are underway and thereby prompt the targets to remove or hide the assets. Other considerations may also call for secret discovery, such as the risk that records will be destroyed or witnesses tampered with if the targets catch wind of the discovery.

To achieve stealth in their investigations or asset tracing, a few foreign representatives have asked US bankruptcy courts to issue seal-and-gag orders. Under these types of order, the court typically places discovery-related motions, discovery demands and third-party subpoenas under seal and thus outside the public record. In addition, these orders bar the recipients of the discovery demands or subpoenas from disclosing to anyone the contents of these demands and subpoenas, which is the so-called 'gag' aspect of these orders.

While courts or tribunals in other countries may be more amenable to seal-and-gag orders and secret discovery in general (eg, the German email interception order in *Toft)*, seal-and-gag orders face a number of legal hurdles in the United States, including:

- the presumption in favour of open court records;
- procedural rules requiring debtors or litigants to receive notice of ongoing discovery;
- the freedom of speech rights of the targets of the gag; and
- the due-process rights of the investigation's ultimate targets.

These legal hurdles were addressed in *Petroforte Brasileiro*.(22) In this case, on a motion for relief from a previously entered seal-and-gag order, the bankruptcy court decided to unseal documents and lift the gag because the seal-and-gag provisions were:

- neither limited in duration nor narrowly tailored; and
- based on non-specific and speculative assertions that documents would be disposed of and assets fraudulently transferred if the seal-and-gag protections were not in place.

Although the court in *Petroforte* mostly sustained the challenge to the seal-and-gag order, it suggested that future orders might withstand challenge if they are limited in duration – that is, a few hours or days rather than months – and supported with specific evidence of wrongdoing, not speculation of what could happen without the order.(23)

In *Transbrasil*, which involved a similar order,(24) the bankruptcy court lifted the seal-and-gag restrictions going forward after a subpoenaed party disclosed some of the sealed information in violation of those restrictions.(25) Nevertheless, one interesting aspect of *Transbrasil* is that the bankruptcy court originally issued the seal order as an extension of comity to the foreign court's authorisation for discovery to be conducted confidentially and under seal.(26) This raised the issue of the extent to which foreign law can shape Chapter 15 discovery in the United States – an issue more recently addressed in *Platinum Partners*.(27)

***Platinum Partners* – comity and arbitration clauses**

In 2016 Platinum Partners Value Arbitrage Fund LP, a multi-strategy hedge fund, and an affiliated feeder fund were placed into liquidation in the Cayman Islands.(28) The funds' demise occurred in the wake of conduct alleged by the US government to have been a multi-pronged fraudulent scheme.(29) The Cayman liquidators, acting as foreign representatives, obtained Chapter 15 recognition of the Cayman proceedings in the US Bankruptcy Court for the Southern District of New York. Later in the Chapter 15 case, the liquidators served subpoenas on the debtors' former auditors, demanding

production of their work papers. When the auditors refused, the liquidators filed a motion with the bankruptcy court to enforce the subpoena and compel the production of the work papers.(30)

The dispute in *Platinum Partners* presented two principal issues for the bankruptcy court to decide. First, can the discovery limitations of the foreign or home jurisdiction control the scope of discovery in Chapter 15? The auditors asserted that their work papers were not discoverable under Cayman law and therefore should not be discoverable in the Chapter 15 case. In other words, they argued, international comity prevented the Cayman liquidators from using the discovery tools under Chapter 15 to circumvent limitations under Cayman law. The second issue pertained to arbitration clauses that appeared in the engagement letters between the auditors and the debtors. The former auditors claimed that the arbitration clauses prohibited discovery in the bankruptcy case and made the discovery dispute with the liquidators subject to arbitration.

On 17 April 2018 the bankruptcy court rendered its decision overruling the objections of the former auditors and granting the liquidators' motion. As to whether Cayman law could limit or bar discovery in Chapter 15, the court determined that there was insufficient evidence to support a conclusion that Cayman law put auditor work papers outside the reach of discovery.(31) Even if the work papers were not discoverable under Cayman law, the court indicated that it could still require the auditors to produce them because:

> *comity does not require that the relief available in the United States be identical to the relief sought in the foreign bankruptcy proceeding; it is sufficient if the result is comparable and that the foreign laws are not repugnant to our laws and policies.*(32)

The court went on to observe that Cayman law is not hostile to US discovery procedures, noting the liquidators' unrebutted evidence that "Cayman courts are in fact receptive to evidence obtained through U.S. discovery procedures, even if such evidence may not be discoverable under Cayman law".(33)

As to the arbitration issue, the court agreed with the liquidators that the discovery dispute between them and the auditors was not a pending proceeding or a dispute, claim or controversy that would trigger the arbitration clauses in the engagement letters.(34) The court also agreed that ruling in the auditors' favour on the arbitration issue would, among other things, undermine the fundamental purposes of Section 1521 and Rule 2004. According to the court:

> *One of the significant objectives of chapter 15 is to provide judicial assistance to foreign representatives in gathering information which will enable them to comply with their duties. It would be at cross purposes with this objective... to interpret an arbitration clause so broadly that it eliminates this right.*(35)

The court emphasised that the discovery sought by the liquidators "clearly [fell] within the scope of relief set forth in sections 542(e), 1521(a)(4), and 1521(a)(7) of the Bankruptcy Code and Bankruptcy Rule 2004".(36) Further, the liquidators' need for discovery was "particularly acute given the anticipated lack of cooperation by the Funds' executives and the alleged criminal fraud with respect to the Funds".(37) On these grounds, the court concluded that the arbitration clauses did not limit the discovery relief sought by the liquidators.

The *Platinum Partners* decision was recently affirmed on appeal by the federal district court in an unpublished order.(38) The auditors have taken a subsequent appeal to the US Court of Appeals for the Second Circuit, which is currently pending.

Comment

Chapter 15 can provide foreign representatives with broad tools for pursuing discovery in the United States, and the decision in *Platinum Partners* signals a judicial willingness to accommodate and assist foreign representatives in their discovery endeavours once the foreign insolvency proceeding has been granted recognition. However, as *Toft* and *Petroforte* demonstrate, there are limits as to how far the courts can accommodate and assist a foreign representative's discovery efforts, particularly when constitutional or privacy rights are at stake.

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Endnotes

(1) See 11 USC §§ 1507, 1521.

(2) *Id* § 1521(a)(4).

(3) Fed R Bankr P pt VII, 9014(c).

(4) 11 USC § 542(e).

(5) Fed R Bankr P 2004(a),(b); see, for example, *In re Dinubilo*, 177 BR 932, 939 (ED Cal 1993) (describing the range of discoverable information in a Rule 2004 examination as "unfettered and broad" and tantamount to a "fishing expedition").

(6) See, for example, *In re Enron Corp*, 281 BR 836, 840 (Bankr SDNY 2002), which states that, under the pending proceeding rule, "once an adversary proceeding or contested matter is commenced, discovery should be pursued under the Federal Rules of Civil Procedure and not by Rule 2004".

(7) 11 USC § 1521(a)(4).

(8) Compare Section 1521(a)(4), which does not require a US connection, to 11 USC 1520(a)(2), which specifically refers to transfers "of an interest of the debtor in property that is within the territorial jurisdiction of the United States".

(9) *In re Millennium Glob Emerging Credit Master Fund Ltd*, 471 BR 342, 347 (Bankr SDNY 2012) (citations omitted).

(10) *See In re Pro-Fit Int'l Ltd*, 391 BR 850, 860 (Bankr CD Cal 2008).

(11) 11 USC § 1521(a)(7).

(12) See *In re AJW Offshore Ltd*, 488 BR 551, 564 (Bankr EDNY 2013).

(13) See *Millennium Glob Emerging Credit Master Fund Ltd*, 471 BR at 346-47.

(14) 11 USC § 1522(a) (providing that the court may grant relief to a foreign representative under Section 1521 "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected").

(15) *Id* § 1507(b)(1).

(16) *Id* § 1506. The public policy exception is not unique to Chapter 15; it originates from the Model Law on Cross-Border Insolvency, promulgated by the United Nations Commission on International Trade Law (UNCITRAL). See HR Rep 109-31, at 109 (2005) (stating that Section 1506 "follows the Model Law article 5 exactly, is standard in UNCITRAL texts, and has been narrowly interpreted on a consistent basis in courts around the world"), as reprinted in 2005 USCCAN 88, 172.

(17) See, for example, *In re Vitro SAB de CV*, 701 F3d 1031, 1069 (5th Cir 2012) ("The narrow public policy exception contained in § 1506 is intended to be invoked only under exceptional circumstances concerning matters of fundamental importance for the United States".) (citation and internal quotation marks omitted.)

(18) 453 BR 186 (Bankr SDNY 2011).

(19) *Id* at 197-98.

(20) See *In re Glitnir Banki HF*, 08-14757, 2011 WL 3652764, at *6 n15 (Bankr SDNY 19 August 2011) (observing that "§ 1521(a)(4) may not authorize the 'fishing expeditions' associated with Rule 2004").

(21) See *Millennium Glob Emerging Credit Master Fund Ltd*, 471 BR at 347 (stating that "one of the main purposes of chapter 15 is to assist a foreign representative in the administration of the foreign estate, which would militate in favor of granting a foreign representative broad discovery rights using the full scope of Rule 2004.") (citations omitted.)

(22) *In re Petroforte Brasileiro de Petroleo Ltda*, 530 BR 503 (Bankr SD Fla 2015).

(23) *Id* at 516.

(24) *In re Transbrasil SA Linhas Aereas*, Case 11-19484, 2014 WL 1655990, at *3 (Bankr SD Fla 25 April 2014), *aff'd*, 644 Fed App'x 959 (11th Cir 2016) (*per curiam*).

(25) See *id* at *3. In addition, the bankruptcy court eventually unsealed many of the documents at issue. See *Transbrasil SA Linhas Aereas*, 644 Fed App'x at 961 n1.

(26) See *Transbrasil SA Linhas Aereas*, 2014 WL 1655990, at *2.

(27) *In re Platinum Partners Value Arbitrage Fund LP*, 583 BR 803 (Bankr SDNY 2018), *aff'd* by unpublished order, 18-cv-5176 (SDNY 29 June 2018), appeal docketed, 18-1958 (2d Cir 2 July 2018).

(28) In addition, an affiliated intermediate fund was placed into liquidation in the Cayman Islands in 2017. See *id* at 806 n2.

(29) *Id* at 806 (citing *SEC v Platinum Mgmt (NY) LLC*, Civ 16-06848, 2016 WL 10731734, ¶ 1 (EDNY 19 December 2016).

(30) More precisely, the liquidators of the feeder fund filed the motion to compel, and the liquidators of the master fund filed a joinder to the motion. For simplicity purposes, this article refers to all of them as the 'liquidators' and does not distinguish between them.

(31) *Platinum Partners*, 583 BR at 815. The federal rules provide that, in "determining foreign law, the court may consider any relevant source material or source, including testimony, whether or not submitted by a party or admissible under the Federal Rules of Evidence". Fed R Civ P 44.1; see also Fed R Bankr P 9017 (making Civil Rule 44.1 applicable in bankruptcy proceedings). In examining whether auditor work papers were discoverable under Cayman law, the court in *Platinum* considered the witness declarations submitted by the liquidators and the former auditors and the foreign legal sources accompanying those declarations. See *Platinum Partners*, 583 BR at 812-13.

(32) *Id* at 815 (footnote omitted).

(33) *Id* at 816. A subsidiary issue in *Platinum* concerned the interplay of Section 1521 of the Bankruptcy Code with Section 1782 of the US Judicial Code. Section 1782 empowers federal district courts to order persons to give testimony or produce documents for use in a proceeding before a foreign or international tribunal (28 USC § 1782). There is case law from the US Supreme Court – namely, the *Intel* case – suggesting that, in determining whether to grant discovery under Section 1782, the courts should consider, among other factors, whether the discovery would be unavailable in a foreign proceeding. Although the auditors in *Platinum* argued that this same consideration is relevant in Chapter 15, the point was unavailing. The bankruptcy court acknowledged that courts routinely read Section 1521 in concert with Section 1782 but pointed out that *Intel* expressly states that apart from safeguarding privileged material, nothing in Section 1782 "limits a district court's production-order authority to materials that could be discovered in the foreign jurisdiction if the materials were located there". *Platinum Partners*, 583 BR at 816 n38 (quoting *Intel Corp v Advanced Micro Devices, Inc*, 542 US 241, 261 (2004)).

(34) *Id* at 821.

(35) *Id.*

(36) *Id.*

(37) *Id.*

(38) *See supra* note 27; *see also In re Platinum Partners Value Arbitrage Fund LP*, 2018 WL 3207119 (SDNY 29 June 2018) (denying auditors' motion for stay pending appeal).
