Chapter 15 at 11: Bankruptcy Code's cross-border insolvency law approaches 11th anniversary

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Introduction

Chapter 15 of the Bankruptcy Code, which deals with cross-border insolvency cases, took effect nearly 11 years ago.(1) Congress enacted Chapter 15 in 2005 to replace Bankruptcy Code Section 304, which previously addressed transnational insolvencies.(2) Chapter 15 largely incorporates the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, which was promulgated in May 1997. The Model Law is designed:

> *"to assist States to equip their insolvency laws with a modern, harmonized and fair framework to address more effectively instances of cross-border proceedings concerning debtors experiencing severe financial distress or insolvency."*(3)

The Model Law has been enacted in one form or another in more than 40 countries, including Canada, Colombia, Japan and Mexico.(4) This update focuses on the US version of the Model Law – Chapter 15. A series of updates to be published here will explore key components of Chapter 15, how courts in the United States have interpreted those provisions over the past decade and the areas of Chapter 15 where the decisional law is split. Among other things, they will:

- cover the requirements for obtaining recognition by the US bankruptcy court of a foreign insolvency proceeding;
- consider the various forms of judicial relief that become available once recognition is granted; and
- examine discrete issues that have occupied the courts' attention during the past 11 years, such as the treatment of third-party releases in cross-border insolvency cases.

Theoretical underpinnings

There is no single approach to handling cross-border insolvency cases, so it is worth considering the competing schools of thought as to how countries and tribunals should approach such cases and where Chapter 15 fits on the theoretical spectrum. At one end of the spectrum is 'territorialism' – also known as the 'grab rule' – which generally holds that courts should administer and distribute assets within their own jurisdiction according to the local laws and priorities existing in those jurisdictions.(5) This can lead to creditors in the home country receiving preferred treatment over foreign creditors.(6) Territorialism further contemplates that multinational debtors will file multiple insolvency proceedings in multiple countries, thereby incurring the cost of separate counsel and insolvency professionals in each country and creating uncertainty, as assets are administered and disbursed by different tribunals under different insolvency regimens.(7)

At the other end of the spectrum is 'universalism', which posits that one court applying one country's insolvency laws should direct multinational proceedings. Under a pure universalist approach, only one court – that of the debtor's home country – should have a role in cross-border proceedings.(8)

In its modified form, universalism contemplates a main proceeding filed in one country, with ancillary proceedings filed in other countries as necessary to assist the administration of the main case and to maximise asset values.(9) Courts in the ancillary proceedings should defer to the main proceeding and support the centralised governance in accordance with the laws of the main jurisdiction.(10) In this regard, universalism ties in with the doctrine of international comity.(11) Proponents of universalism posit that their approach leads to the more efficient allocation of capital, maximisation of liquidation value, reduced costs and greater predictability, among other benefits.(12) On the other hand, universalism has drawbacks insofar as it:

> "*may ask that creditors give up their own notions as to what they are expecting to receive and what their remedies typically are, substituting them with the public policy of a foreign jurisdiction*."(13)

Moreover, universalism may usher in complicated issues over how the laws of one jurisdiction can be applied to assets located in other jurisdictions, most notably 'difficult' assets, such as:

> "*real property encumbered with charges, intellectual property and intangible moral rights, other intangible assets... and even ordinary assets where peculiarities attached to those assets make their negotiation and realisation difficult*."(14)

Chapter 15 overview

Chapter 15 embodies the modified universalist approach and the related doctrine of international comity.(15) The statute "emanates from and was designed around this central concept of comity, as evidenced by its primary purpose and deferential framework for international judicial cooperation".(16)

There are two ways to invoke Chapter 15. First, a trustee or another entity in a plenary US bankruptcy case involving assets in a foreign country can ask the US bankruptcy court for authorisation to act on behalf of the bankruptcy estate in that country.(17) More common, however, is the second option, in which a representative of a foreign insolvency proceeding asks the US bankruptcy court to recognise and give effect to that proceeding, particularly as it pertains to assets and creditors located in the United States.(18) Foreign representatives commence Chapter 15 ancillary cases by petitioning the bankruptcy court for recognition.(19) If the statutory requirements for recognition are met, the bankruptcy courts will recognise the foreign proceedings as a foreign main proceeding or a foreign non-main proceeding.(20) Once recognition is granted, the foreign representative will have the capacity to sue and be sued and to apply directly to a court for relief.(21) Moreover, if the foreign proceeding is recognised as a foreign main proceeding, certain forms of relief under the US Bankruptcy Code will become available automatically. These include the automatic stay to shield the debtor and assets located in the United States from the collection and enforcement actions of creditors and the authority to transfer property located in the United States free and clear of interests if the requirements of Section 363 of the Bankruptcy Code are met.(22) Other forms of relief are also within the discretion of the bankruptcy court to grant, regardless of whether the foreign proceeding is recognised as a main proceeding or a non-main proceeding.(23)

It has been said that because Chapter 15 was designed simply to assist a foreign representative, the statute is bereft of "substantive provisions applicable to a plenary case under other chapters of the Bankruptcy Code".(24) For example, Chapter 15 by itself does not provide for a discharge of post-petition liabilities. No juridical estate is established in Chapter 15 and no trustee with avoidance and strong-arm powers is appointed. In addition, no official committees of unsecured creditors or equity security holders are formed. In general, US laws governing the avoidance and recovery of preferential transfers and fraudulent conveyances do not apply.(25) Nevertheless, the principal benefit of Chapter 15 arises when a foreign representative:

> "*obtains the assistance of a bankruptcy court through its recognition and enforcement (generally, as pertaining to assets and creditors located in the United States) of orders or decrees previously granted by a Foreign Court*."(26)

The threshold remedy to be obtained in Chapter 15 is the bankruptcy court's recognition of the foreign insolvency proceeding. However, while the request for recognition is pending, the foreign

representative may require expedited interim relief to stay litigation, prevent the seizure of assets or halt other actions threatening to diminish the debtor's value.

The next update in the series will cover the topic of interim relief.

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Endnotes

(1) See Bankruptcy Abuse Prevention and Consumer Protection Act 2005, Pub L 109-8, § 801, 119 Stat 23 (2005). Chapter 15 was enacted on April 20 2005, but took effect on October 17 2005. *Id* §§ 801-802.

(2) *Id* § 802 (repealing Section 304 of the Bankruptcy Code).

(3) United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation, Pt 2, ¶ 1 (2014), available at www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf.

(4) Peter M Gilhuly *et al*, "Bankruptcy Without Borders: A Comprehensive Guide to the First Decade of Chapter 15", 24 *ABI L Rev* 47, 48 n 2 (2016). Although a handful of EU member states have adopted the Model Law – in particular, the United Kingdom, Greece, Poland, Romania and Slovenia – the European Union as an organisation has not done so. Instead, the EU Council adopted the Regulation on Insolvency Proceedings (1346/2000, 2000 OJ (L 160) 1-18 (EC)), which applies to cross-border cases among all EU member states except Denmark. *Id* at 51 and n 16. Nevertheless, the EU regulation – which was finalised a year before the Model Law – uses common concepts, such as 'centre of main interest', so legal opinions applying the EU regulation may inform a US court's application of Chapter 15. *Id*; Louise DeCarl Adler, "Managing the Chapter 15 Cross-Border Insolvency Case" 1-2 (Fed Jud Ctr 2011), available at www.fjc.gov/public/pdf.nsf/lookup/adlerchap15.pdf/$file/adlerchap15.pdf; see also 11 USC § 1508 (providing that, in interpreting Chapter 15, courts "shall consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions").

(5) Daniel M Glosband *et al*, "The American Bankruptcy Institute Guide to Cross-Border Insolvency in the United States" 6 (2008).

(6) *Id*; see also Paul J Omar, "The Landscape of International Insolvency Law", 11 *Int'l Insolvency Rev* 173, 176 (2002).

(7) *Supra* note 5, at 6.

(8) "Developments in the Law—Extraterritoriality", 124 *Harv L Rev* 1226, 1292, 1294 (2011).

(9) *Supra* note 5; *supra* note 8, at 1294.

(10) *Supra* note 5.

(11) The Supreme Court has described international comity as:

> *"the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws."* (*Hilton v Guyot*, 159 US 113, 164 (1895).)

(12) *Supra* note 8, at 1294-95.

(13) *Supra* note 5.

(14) Omar, *supra* note 6, at 179.

(15) But see Jeremy Leong, "Is Chapter 15 Universalist or Territorialist? Empirical Evidence from United States Bankruptcy Court Cases", 29 *Wis Int'l LJ* 110, 137 (2011) (arguing that "Chapter 15 is not as universalist as its proponents claim it to be").

(16) *In re Fairfield Sentry Ltd*, 484 BR 615, 627 (Bankr SDNY 2013), vacated on other grounds, 768 F3d 239 (2d Cir 2014).

(17) 11 USC § 1505; Adler, *supra* note 4, at 2. In Chapter 15, the term 'trustee' includes "a trustee, a debtor in possession in a case under any chapter of this title, or a debtor under chapter 9 [municipal bankruptcies] of this title" (11 USC § 1502(6)).

(18) *In re Elpida Memory, Inc*, 12-10947, 2012 WL 6090194, at *3 (Bankr D Del November 20 2012); Adler, *supra* note 4, at 3.

(19) 11 USC § 1504.

(20) *Id* § 1517.

(21) *Id* § 1509(b)(1), (2).

(22) *Id* § 1520(a)(1), (2).

(23) *Id* §§ 1507, 1521.

(24) Shelley C Chapman *et al*, "Recent Developments in Cross-Border Insolvencies", 102414 *ABI-CLE* 15, 20 (October 24 2014).

(25) *Id* at 20.

(26) *Id* at 20-21.
