INSOLVENCY & RESTRUCTURING - USA

Chapter 15 at 11: threshold requirements for recognition

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March 24 2017 | Contributed by Caplin & Drysdale, Chartered

This is the third instalment in a series on the US cross-border insolvency statute, Chapter 15 of the Bankruptcy Code, which took effect 11 years ago (for further details please see "Chapter 15 at 11: Bankruptcy Code's cross-border insolvency law approaches 11th anniversary" and "Chapter 15 at 11: Chapter 15 provides provisional relief in *Hanjin Shipping*").

Introduction

The previous update reported on the interim relief that may be granted while a petition for recognition is pending before the bankruptcy court. This update looks at a few threshold requirements for obtaining recognition itself. Recognition of a foreign proceeding opens the door to mandatory or discretionary relief from the bankruptcy court, depending on whether the foreign proceeding is a foreign main proceeding or a foreign non-main proceeding.(1) Recognition also enables the foreign representative to apply to a court in the United States for appropriate relief.(2) Additionally, if recognition is granted, a court in the United States must grant comity or cooperation to the foreign representative, subject to any limitation that the court may impose consistent with public policy.(3)

Obtaining recognition from a US bankruptcy court is not a "rubber stamp exercise".(4) As the petitioning party, the foreign representative has the burden of establishing the elements for recognition through evidence.(5) Two threshold requirements for recognition that are discussed below are the existence of:

- a duly designated foreign representative; and
- a foreign proceeding.

Moreover, the US Court of Appeals for the Second Circuit has held that a foreign debtor must establish its eligibility to be a debtor under the Bankruptcy Code in order for recognition to be granted.(6) As explained below, this eligibility requirement is typically satisfied in practice by showing that the foreign debtor has property in the United States.

Foreign representative

Only foreign representatives have the requisite standing to petition a bankruptcy court for recognition under Chapter 15.(7) Once recognition is granted, foreign representatives are entitled to participate in the Chapter 15 case as parties in interest and have the capacity to sue and be sued in a court in the United States.(8) Foreign representatives are also empowered to file an involuntary bankruptcy case under a different chapter of the Bankruptcy Code against a debtor in a foreign proceeding.(9) Moreover, foreign representatives may seek the dismissal or suspension of a Chapter 15 case where recognition has been granted and the purposes of Chapter 15 would be best served by

such dismissal or suspension.(10)

The Bankruptcy Code defines a 'foreign representative' as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or liquidation of the debtor's assets or affairs or to act as a representative of such proceeding".(11) The term 'person' in the Bankruptcy Code includes individuals, partnerships and corporations.(12) As these definitions make clear, the foreign representative need not be an individual, although it is not uncommon for one or more individuals to act as foreign representatives if they are the US equivalent of a receiver or liquidator under foreign insolvency law.

Courts have held that it is not necessary for a foreign representative to be appointed by a foreign court. For example, in *Vitro SAB*,(13) the board of directors of a Mexican debtor appointed two individuals to act as co-foreign representatives in the US bankruptcy court to obtain recognition of the debtor's Mexican *concurso* proceeding, which is analogous to a US reorganisation case under Chapter 11. The debtor's noteholders challenged the authority of these individuals to act as foreign representatives on the ground that a Mexican court had not appointed the individuals. The US Court of Appeals for the Fifth Circuit rejected this challenge, holding that a foreign representative need not be appointed by a foreign court.(14) The Fifth Circuit further determined that the foreign representatives had been properly appointed by the debtor's board of directors based on the debtor's authority under Mexican law to manage its business during the *concurso* proceeding.(15)

A bankruptcy court in New York reached a similar determination in *OAS SA*.(16) In that case three foreign debtors had selected an individual to act as foreign representative in the US bankruptcy court. Certain noteholders challenged the individual's standing to act in that capacity because he had not been appointed by the Brazilian insolvency court. The bankruptcy court followed the Fifth Circuit's decision in *Vitro*, holding that it is not necessary for a foreign representative to be appointed by a foreign court.(17) The court also determined that because the foreign debtors, under Brazilian law, retained control of their assets and affairs during the Brazilian insolvency proceeding, in a manner akin to a debtor in possession in the United States, the debtors had the power to appoint a foreign representative.(18)

Under the Bankruptcy Code, a foreign representative must be a person or body "authorized...in a foreign proceeding".(19) Thus, whether a foreign representative has been duly authorised hinges on whether a "foreign proceeding" exists.(20)

Foreign proceeding

Under Chapter 15, a bankruptcy court may recognise only those insolvency matters that fit the Bankruptcy Code's definition of a 'foreign proceeding'. If an insolvency process fails to qualify as a foreign proceeding, "no recognition will be given".(21) The Bankruptcy Code defines a 'foreign proceeding' as "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation".(22) Moreover, the code defines 'foreign court' as "a judicial or other authority competent to control or supervise a foreign proceeding".(23) The term 'foreign court' includes administrative agencies.(24)

Courts have interpreted the term 'foreign proceeding' broadly. In *Betcorp*,(25) for example, the bankruptcy court concluded that a voluntary winding up under the Australian Corporations Act qualified as a foreign proceeding, even though it did not involve a lawsuit or other legal proceeding before an Australian court. The court in *Betcorp* reasoned that the winding up was a statutory process for liquidating a company that required, among other things, the appointment of a liquidator who was registered with and regulated by the Australian Securities and Investments Commission. Additionally, the court found that judicial involvement was not entirely divorced from the winding-up process, since Australian law specified certain instances or events that could trigger the intervention of an Australian court.(26)

Nevertheless, even an expansive interpretation of 'foreign proceeding' has limits. The court in *Betcorp* recognised as much when it noted in *dictum* that "a receivership remedy instigated at the request, and for the benefit, of a single secured creditor" was not a collective proceeding and thus

could not qualify as a foreign proceeding.(27) Moreover, in *Gold & Honey*,(28) the bankruptcy court determined that an Israeli receivership proceeding instigated by the debtors' pre-bankruptcy lender was not a foreign proceeding because it was not collective in nature. The court explained that the receivership was "more akin to a [*sic*] individual creditor's replevin or repossession action than it is to a reorganization or liquidation by an independent trustee".(29) The court also stated that the receivership was "primarily designed to allow [the lender] to collect its debts".(30) By contrast, collective proceedings such as "a scheme of arrangement or a winding up proceeding" are different because "both...are instituted by a debtor for the purposes of paying off all creditors with court supervision to ensure evenhandedness".(31)

Although the existence of a 'foreign proceeding', as defined in the Bankruptcy Code, is necessary to obtain recognition, not all foreign proceedings are eligible for recognition. Chapter 15 does not apply to foreign proceedings involving entities, other than foreign insurance companies, that would not be eligible for relief in a plenary bankruptcy case, such as regulated banks.(32) This exclusion is intended to prohibit entities that are not deemed an appropriate subject of bankruptcy relief from attempting to obtain some benefits of that relief indirectly by initiating an insolvency proceeding in another country and then seeking ancillary relief under Chapter 15.(33)

Property in the United States

In 2013, the US Court of Appeals for the Second Circuit held in *In re Barnet* that the threshold eligibility requirements for bankruptcy relief that are contained in Section 109(a) of the Bankruptcy Code apply to foreign debtors in Chapter 15.(34) Section 109(a) provides that "only a person that resides or has a domicile, a place of business, or property in the United States...may be a debtor" under the Bankruptcy Code.(35) The Model Law on Cross-Border Insolvency,(36) on which Chapter 15 is based, has no provision resembling Section 109(a). In *Barnet*, the foreign representatives sought and obtained Chapter 15 recognition of an Australian liquidation proceeding. The foreign representatives then used recognition as the basis for obtaining leave to take discovery of certain entities in the United States. The Second Circuit, however, concluded that recognition should not have been granted in the first place because the foreign representatives had made no attempt to show that the Australian debtor had a domicile, place of business or property in the United States. The court reached this determination based on a "straightforward" exercise of statutory interpretation: Section 103(a) of the code makes all of Chapter 1 of the code applicable to Chapter 15. And Section 109(a), which is within Chapter 1, creates a requirement that any debtor must meet.(37)

Other statutes suggested that the requirements of Section 109(a) should not apply to foreign debtors in Chapter 15, but the Second Circuit in *Barnet* was unpersuaded by those provisions. For example, one statute designates a venue for Chapter 15 cases even when "the debtor does not have a place of business or assets in the United States". The Second Circuit, however, was unconvinced that a "purely procedural" venue statute could overcome the "unambiguous" language in Sections 103(a) and 109 (a). "[T]o allow the venue statute to control the outcome," said the court, "would be to allow the tail to wag the dog."(38)

The *Barnet* decision has drawn criticism. According to one leading bankruptcy treatise, *Barnet* is inconsistent "with the purpose of the Model Law, which is designed to lower, rather than raise, the bar for ancillary relief".(39) "It seems unlikely," the treatise explains, "that Congress intended to bar ancillary relief to a foreign debtor solely on grounds that it is 'too foreign' to qualify to be a debtor under [the Bankruptcy Code]."(40) *Barnet* has also been criticised by two US commentators who were involved in the development of the Model Law on Cross-Border Insolvency and the enactment of Chapter 15.(41) These commentators have argued that the Second Circuit's literal reading of the Bankruptcy Code in *Barnet* was not appropriate because, among other things, it overlooked the command of Section 1508 of the Bankruptcy Code, which provides: "In interpreting [Chapter 15], the court shall consider its international origin, and the need to promote an application... that is consistent with the application of similar statutes adopted by foreign jurisdictions."(42) In their view, the *Barnet* decision "represents an ostensibly stubborn adherence to literal statutory interpretation when the statutory provisions at issue *prima facie* were not susceptible to literal interpretation and when Congress instructed courts to look beyond the statute for guidance in harmonizing chapter 15 to the Model Law".(43)

In the wake of *Barnet*, foreign representatives have found ways to establish eligibility under Section

109(a), particularly by showing the existence of tangible or intangible property in the United States, and bankruptcy courts have upheld these approaches. For example, in the proceedings that followed the Second Circuit's ruling, the Australian debtor in *Barnet* was found to have satisfied Section 109(a) because it had property in the United States in the form of "claims or causes of action" and "an undrawn retainer in the possession of the Foreign Representatives' counsel".(44) In *Berau Capital*, the bankruptcy court determined that certain contractual rights of the foreign debtor under a bond indenture constituted intangible property sited in the United States, which was sufficient to meet Section 109(a) eligibility.(45) In *Suntech Power*,(46) on the day before the Chapter 15 filing, the foreign representatives transferred $500,000 from the foreign debtor's Cayman Islands account to a New York bank account held by a third party. The *Suntech Power* court determined that the third party held title to the bank account as agent for the debtor and on this basis the foreign debtor satisfied Section 109(a). The court rejected arguments that the foreign representatives had acted improperly by opening a bank account on the eve of filing to meet Section 109 eligibility.(47) The court explained that preventing an ineligible foreign debtor from establishing eligibility for needed Chapter 15 relief would contravene the purposes of Chapter 15 "to provide legal certainty, maximize value, protect creditors and other parties in interests and rescue financially troubled businesses".(48)

Barnet is by no means settled law outside the Second Circuit. Other federal courts of appeals have yet to weigh in on the issue and there is no assurance that they will follow *Barnet*.(49) However, given the relative ease with which foreign representatives have been able to establish Section 109(a) eligibility – through US bank accounts, unearned retainers held by US counsel and even intangible property sited in the United States – it remains to be seen whether parties will continue to cross swords on this issue and prompt courts outside the Second Circuit to address it.

Comment

This update addresses only a few of the threshold requirements for obtaining recognition under Chapter 15; other prerequisites for recognition include those establishing whether the foreign proceeding in question is a foreign main proceeding or a foreign non-main proceeding. The next instalment in this series will examine the elements for obtaining recognition of a foreign main proceeding.

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Endnotes

(1) 11 USC §§ 1520, 1521.

(2) *Id* § 1509(b)(2).

(3) *Id* § 1509(b)(3).

(4) *Armada (Singapore) Pte Ltd v Shah (In re Ashapura Minechem Ltd)*, 480 BR 129, 135 (SDNY 2012) (quoting *In re Gold & Honey, Ltd*, 410 BR 357, 366 (Bankr EDNY 2009)); see also *Ad Hoc Grp of Vitro Noteholders v Vitro SAB de CV (In re Vitro SAB de CV)*, 701 F 3d 1031, 1046 (5th Cir 2012) ("Even in the absence of an objection, courts must undertake their own jurisdictional analysis and grant or deny recognition under Chapter 15 as the facts of each case warrant" (citation omitted)).

(5) See *Gold & Honey*, 410 BR at 366 ("The ultimate burden of proof on each element is on the foreign representative" (citing *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd*, 389 BR 325, 335 (SDNY 2008))).

(6) See *Drawbridge Special Opportunities Inv Fund LP v Barnet (In re Barnet)*, 737 F 3d 238 (2d Cir 2013).

(7) 11 USC § 1515(a).

(8) *Id* §§ 1509(b)(1), 1512.

(9) *Id* §§ 303(b)(4), 1511(a)(1). In addition, once recognition is granted, a foreign representative may file a voluntary petition to commence a plenary case under a different chapter of the Bankruptcy Code if the foreign proceeding is recognised as a foreign main proceeding. *Id* § 1511(a)(2).

(10) *Id* § 305(b).

(11) *Id* § 101(24).

(12) *Id* § 101(41).

(13) *Vitro SAB*, 701 F 3d 1031.

(14) *Id* at 1047-49.

(15) *Id* at 1049-51.

(16) *In re OAS SA*, 533 BR 83 (Bankr SDNY 2015).

(17) *Id* at 95.

(18) *Id* at 95-97.

(19) 11 USC § 101(24).

(20) See 2 *Collier on Bankruptcy* ¶ 101.24 (16th ed 2016) ("Generally, whether an entity is a 'foreign representative' within the meaning of section 101(24) rests on a finding that the foreign insolvency process in which such person was 'duly selected,' is a foreign proceeding").

(21) *In re Betcorp Ltd*, 400 BR 266, 275 (Bankr D Nev 2009).

(22) 11 USC § 101(23).

(23) *Id* § 1502(3).

(24) See, for example, *Ashapura*, 480 BR at 142-43 (determining that India's Board for Industrial and Financial Reconstruction was an administrative board that satisfied the definition of 'foreign court' in Chapter 15).

(25) *Betcorp*, 400 BR 266.

(26) *Id* at 277-85.

(27) *Id* at 281. But compare with *In re ABC Learning Centres Ltd*, 728 F 3d 301, 308 (3d Cir 2013) (concluding that a Australian liquidation proceeding operating in parallel to a receivership qualified as a 'foreign proceeding', even though the foreign debtor's assets were entirely leveraged, leaving nothing to distribute to unsecured creditors).

(28) *Gold & Honey*, 410 BR 357.

(29) *Id* at 370.

(30) *Id.*

(31) *Id.*

(32) 11 USC § 1501(c). But compare with *Flynn v Wallace (In re Irish Bank Res Corp Ltd)*, 538 BR 692, 696 (D Del 2015) (determining that an Irish liquidation proceeding for a failed bank was not excluded from recognition because the bank had no branch or agency in the United States when the

Chapter 15 petition was filed).

(33) 1 *Collier on Bankruptcy* ¶ 13.03[1][c] (16th ed 2016).

(34) See *Barnet*, 737 F 3d at 246-51.

(35) 11 USC § 109(a).

(36) The model law was promulgated by the United Nations Commission on International Trade Law.

(37) *Barnet*, 737 F 3d at 247.

(38) *Id* at 250.

(39) 1 *Collier on Bankruptcy* ¶ 13.03[1][c] (16th ed 2016).

(40) *Id.*

(41) Daniel M Glosband and Jay Lawrence Westbrook, "Opinion: No Debtor "Presence" Is Required for Chapter 15 Recognition", 34 *Am Bankr Instit* J 24 (May 2015).

(42) *Id* at 63 (quoting 11 USC § 1508).

(43) *Id.*

(44) *In re Octaviar Admin Pty Ltd*, 511 BR 361, 372 (Bankr SDNY 2014).

(45) *In re Berau Cap Res Pte Ltd*, 540 BR 80, 83-84 (Bankr SDNY 2015).

(46) *In re Suntech Power Holdings Co*, 520 BR 399 (Bankr SDNY 2014).

(47) *Id* at 411-13.

(48) *Id* at 413 (citing 11 USC § 1501(a)).

(49) Indeed, a bankruptcy judge in Delaware, in an unreported bench ruling, expressly rejected the *Barnet* decision and held that Section 109(a) does not apply in a Chapter 15 case. See Hr'g Tr 8-9, *In re Bemarmara Consulting AS*, 13-13037 (KG) (Bankr D Del December 17 2013).
