

Chapter 15: the US cross-border insolvency law



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In October 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2005 Act) became effective and amended some important provisions governing Chapter 11 corporate reorganisations, and in particular, cross-border restructurings and insolvencies. The 2005 Act supplants former section 304 of the United States Bankruptcy Code with an entirely new chapter to the Bankruptcy Code, Chapter 15. Chapter 15 governs not only US bankruptcy cases that are ancillary to a foreign case, but also plenary cases in the US that have significant cross-border issues.

In a large part, Chapter 15 adopted the Model Law for Cross-Border Insolvency (Model Law) drafted by the United Nations Commission on International Trade Law (UNCITRAL), which long ago recognised the need for a regime to govern the conduct of cross-border insolvencies. The Model Law has also been adopted in the British Virgin Islands, Eritrea, Japan, Mexico, Montenegro, Poland, Romania, South Africa, the United Kingdom (including Northern Ireland), and is in the process of being implemented in many other countries.

This chapter provides an overview of Chapter 15 and its effect on US cross-border insolvency law, and in particular looks at:

- The purposes of Chapter 15.
- Commencing a Chapter 15 case.
- Contesting recognition of a foreign proceeding.
- Recognition of foreign proceeding as main or non-main.
- Relief on recognition of a foreign proceeding.
- Debtors still eligible to commence a plenary US Chapter 7 or 11 case.
- Concurrent proceedings.

PURPOSES OF CHAPTER 15

The stated purposes of Chapter 15 are to achieve:

- Co-operation between US and foreign courts and representatives.
- Greater legal certainty for trade and investment.
- Fair and efficient administration of estates.
- Protection and maximisation of assets.
- Facilitation of the rescue of financially troubled businesses.

COMMENCING A CHAPTER 15 CASE

To commence a Chapter 15 case, a “representative” of the foreign insolvency proceeding must file a petition for recognition, accompanied by a copy of the document commencing the foreign proceeding and appointing the representative, or some other acceptable form of certification of the existence of the foreign proceeding. The petition must include a statement identifying all known foreign proceedings involving the debtor and the foreign representative must provide English translations of all supporting documents.

Chapter 15 requires US bankruptcy courts to recognise a foreign proceeding when each of the following conditions is satisfied:

- The foreign proceeding is main or non-main (*see below, Recognition of foreign proceeding as main or non-main*).
- The foreign representative is a person or body.
- The petition includes the required documentation.

In addition, a foreign insolvency proceeding is recognised in the US only if the “foreign representative” and “foreign proceeding” are qualified for recognition under Chapter 15. The scope of foreign proceedings and foreign representatives entitled to US recognition has been broadened under Chapter 15:

- **Foreign proceeding.** A foreign proceeding now qualifies for recognition in the US if the proceeding is a collective judicial or administrative proceeding in a foreign country. This includes an interim proceeding, under a law relating to insolvency or adjustment of debt in which the assets and affairs of the debtor are subject to control or supervision by a foreign court for the purpose of liquidation or organisation. With the implementation of Chapter 15, the ambit of foreign proceedings entitled to recognition in the US was increased to include interim proceedings as well as non-judicial proceedings supervised by a court. The latter is a major advance because many countries do not have a bankruptcy court system as in the US, and many foreign administrative proceedings will now be entitled to recognition.
- **Foreign representative.** A foreign representative includes a person or body, including a person or body appointed on an interim basis, authorised in a foreign proceeding to administer the reorganisation or liquidation of the debtor’s assets or affairs or to act as a representative of such foreign proceeding. Here, recognition has again been broadened to include interim representatives who, for example, may be appointed in an involuntary insolvency case, as well as corporate bodies, such as a debtor-in-possession or the board of directors of the debtor-in-possession.

CONTESTING RECOGNITION OF A FOREIGN PROCEEDING

Powerful legal relief can be afforded to foreign debtors and creditors on US recognition of a foreign representative and insolvency proceeding (see below, *Relief on recognition of a foreign proceeding*). Therefore, creditors and debtors alike may have an incentive to contest recognition.

First, a party can argue that the foreign representative or foreign proceeding do not qualify for recognition (see above, *Commencing a Chapter 15 case*).

Second, a party can also seek to prevent recognition of a foreign representative or proceeding under Chapter 15 by arguing the following:

- The US bankruptcy court should abstain and not recognise the foreign proceeding because the purposes of Chapter 15 would best be served by abstention (see above, *Purposes of Chapter 15*). For example, if the value of the debtor's assets can be maximised by a successful reorganisation, and reorganisation is not an alternative in the debtor's home jurisdiction, it is possible that a US court would abstain from recognition of the foreign proceeding.
- Chapter 15 provides an entirely new statutory basis to deny recognition or relief – the public policy exception. Chapter 15 provides that a US bankruptcy court must not take any action that would be manifestly contrary to the public policy of the US. The public policy exception is a familiar principle in US jurisprudence. When enacting Chapter 15, Congress made it clear that the public policy exception should be restricted to the most fundamental policies of the US. An example that would likely trigger the policy exception is the disparate treatment of creditors based on the nationality of the creditor alone. If the laws of the foreign jurisdiction allow for such discriminatory treatment, a court would likely find that the foreign proceeding should not be recognised because it is manifestly contrary to US public policy.

RECOGNITION OF FOREIGN PROCEEDING AS MAIN OR NON-MAIN

If the US bankruptcy court recognises the foreign proceeding, it must recognise it as a main or non-main proceeding. A debtor enjoys certain automatic relief, such as a limited automatic stay, if the foreign proceeding is recognised as the main proceeding (see below, *Relief on recognition of a foreign proceeding: Automatic relief*). However, recognition of a main proceeding also significantly affects a debtor's options to file a plenary case under Chapters 7 and 11 of the US Bankruptcy Code (see below, *Concurrent proceedings*).

A foreign proceeding is a main proceeding if it is pending in the country where the debtor has its "centre of main interests" (COMI). A proceeding is non-main if it is pending in a country where the debtor merely has an establishment.

Main proceeding

Chapter 15 does not define COMI, and the interpretation of this phrase has already been the subject of litigation in the US. Chap-

ter 15 does provide that there is a presumption that a debtor's COMI is in the country of its registered office, but this presumption is rebuttable.

Chapter 15 permits the US bankruptcy courts to consider the interpretation of similar statutes adopted by foreign jurisdictions and the UNCITRAL's guide to enactment of the Model Law in construing Chapter 15, including with respect to determining the COMI. The UNCITRAL guide indicates that the phrase "centre of main interests" has its origins in the EU's regulations on cross-border insolvencies.

In *In re Tri-Continental Exchange Ltd.*, 349 B.R. 627 (Bankr. E.D. Calif. 2006), the US bankruptcy court had to determine whether a particular foreign proceeding was main or non-main. Noting that Chapter 15 did not define COMI, the court examined the definition in the EU regulations. The US court observed that the EU defined COMI as "the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties". Adopting this rule, the US court then found that the proceeding in the country where the debtor had its principal office and primary concentration of employees was the COMI of the debtor.

Similarly, in *In re SPhinX, Ltd.*, 351 B.R. 103 (Bankr. S.D.N.Y. 2006), the US bankruptcy court embraced the decision and reasoning by the Irish Supreme Court in *EuroFoods*, and held that the presumption that a debtor's COMI is in the location of its registered office may be rebutted "particular[ly] in the case of a 'letterbox' company not carrying out any business in the territory of the [country] in which its registered office is situated". Using this reasoning, the bankruptcy court found that a hedge fund registered in the Cayman Islands actually had its COMI in the US because most of its assets were located in the US and the debtor conducted most of its business in the US.

Non-main proceeding

If a foreign proceeding is not recognised as a main proceeding, it must receive recognition as non-main if the proceeding is from a country where the debtor has an "establishment". Chapter 15 defines an "establishment" as any place where the debtor "carries out a nontransitory economic activity".

RELIEF ON RECOGNITION OF A FOREIGN PROCEEDING

Generally, there are three forms of relief available under Chapter 15:

- Provisional relief available during the gap period between the filing of the petition and the entering of an order for recognition.
- Automatic relief on recognition of a main foreign main proceeding.
- Permissive relief available after recognition of a main or non-main foreign proceeding.

In addition, Chapter 15 enables a foreign representative to commence a plenary case under Chapter 7 or 11 of the US Bankruptcy Code. However, in certain circumstances there are limitations on the relief available to a foreign debtor under those chapters.

Provisional relief

One important distinction between a Chapter 15 petition and a voluntary petition under Chapter 7 or 11, is that a Chapter 15 petition does not provide immediate, automatic relief for a debtor. Rather, a Chapter 15 petition is essentially an application for recognition of the foreign proceeding.

During the gap period between the filing of a Chapter 15 petition and the entry of an order for recognition, the bankruptcy court can grant provisional relief, but only where relief is urgently needed to protect the assets of the debtor or the interests of creditors. Provisional relief can include, but is not limited to:

- Staying execution against the debtor's assets.
- Entrusting all or part of the assets in the US to the foreign representative where the assets are susceptible to devaluation.
- Suspending the debtor's right to transfer any right or interest in an asset.
- Providing for the examination of witnesses or documents concerning the debtor's assets, affairs, rights and obligations.
- Granting certain other relief that may be available to a trustee.

There is a high barrier for the granting of such interim relief, and the party requesting relief must show that it is "urgently needed".

Automatic relief

Some forms of relief take effect automatically on recognition of a foreign main proceeding. For example, the automatic stay of the Bankruptcy Code applies, but only with respect to the property of the debtor located within the territorial jurisdiction of the US. Provisions of the Bankruptcy Code restricting post-petition transactions, the post-petition effect of a security interest, and the use, sale or lease of property, are also in force. Subject to certain restrictions (*see below, Debtors still eligible to commence a plenary US Chapter 7 or 11 case*), the recognition of a foreign main proceeding does not affect the right of the foreign representative to commence a plenary case under Chapter 7 or 11 of the Bankruptcy Code or a proceeding in another foreign country where necessary to preserve a claim against the debtor. Automatic relief is not available for a non-main proceeding. All relief for such proceedings requires the approval of the bankruptcy court.

Permissive relief

After recognition of a foreign main or non-main proceeding, the court may grant certain relief on request of the foreign representative. A court may grant provisional and permissive relief only if the interests of creditors and other interested entities, including the debtor, are sufficiently protected. The court may place conditions on a grant of provisional or permissive relief as it deems appropriate, including the posting of security or a bond. Such permissive relief includes:

- Staying proceedings against the debtor.

- Staying executions against the debtor's assets.
- Suspending the right to transfer, encumber or dispose of the debtor's property.
- Providing for the examination of witnesses.
- Entrusting assets to the foreign representative provided the interests of creditors in the US are sufficiently protected.
- Extending provisional relief previously granted.
- Granting certain other forms of relief available to a trustee.

The permissive relief listed above is not exhaustive. Chapter 15 empowers a US bankruptcy court to grant other "appropriate relief". In the case of *In re Muscletech*, 349 B.R. 333 (S.D.N.Y. 2006), a US court granted permissive relief requested after recognition of a Canadian main proceeding, and entered an order compelling US creditors to submit to arbitration in Canada as required in the Canadian insolvency proceeding.

DEBTORS STILL ELIGIBLE TO COMMENCE A PLENARY US CHAPTER 7 OR 11 CASE

A debtor can still commence a plenary case under Chapter 7 (liquidation) or Chapter 11 (reorganisation) of the US Bankruptcy Code, as long as it meets certain eligibility requirements. The eligibility requirements are minimal – a mere "peppercorn" of an asset in US is sufficient for most courts. However, once a foreign proceeding is recognised, the options for and effect of a subsequent plenary case under Chapter 7 or 11 change in certain circumstances (*see below, Concurrent proceedings*).

There are some circumstances where a debtor or foreign representative may want to commence a plenary case in the US instead of seeking recognition of a foreign proceeding under Chapter 15:

- **Universal jurisdiction.** In a Chapter 7 and 11 case, US bankruptcy courts exercise (or at least attempt to exercise) jurisdiction over all of the assets of the debtor, regardless of which country the assets are located in. For example, suppose a debtor is already the subject of a foreign proceeding in its home country and that proceeding is recognised as a main proceeding under Chapter 15. The foreign representative may wish to commence a Chapter 7 or 11 case in the US in lieu of (or in addition to) a Chapter 15 ancillary case if the debtor has assets outside the US and its home country, and its home country does not exercise universal jurisdiction over the debtor's assets.
- **Greater relief.** The relief available under Chapter 15 is limited. If the debtor requires relief that is not offered by Chapter 15, then a plenary Chapter 7 or 11 case may be necessary. For example, the right to pursue preference actions and other avoidance actions is not provided in Chapter 15. Therefore, if recoveries from avoidance actions are necessary to fund a reorganisation or would provide a significant recovery for creditors, then a debtor or foreign representative should commence the appropriate plenary case.

CONCURRENT PROCEEDINGS

After recognition of a foreign non-main proceeding, a foreign representative may commence an involuntary plenary case against the debtor, or, if the foreign proceeding is recognised as a main proceeding, a foreign representative may commence a voluntary plenary case on behalf of the debtor. The reasons for commencing a plenary case that is concurrent with a Chapter 15 case may be to take advantage of the US bankruptcy court's worldwide jurisdiction and the greater relief afforded in a plenary case.

However, bankruptcy practitioners must carefully plan in advance any strategy that employs concurrent proceedings because the sequence and type of proceedings may inadvertently limit the options available to the foreign debtor.

- **Narrowed eligibility.** Section 109(a) of the Bankruptcy Code provides that a person or entity that has a domicile, place of business or property in the US is eligible to be a debtor under Chapter 7 or 11 of the Bankruptcy Code. However, once a foreign main proceeding is recognised, a case under another chapter of the Bankruptcy Code may be commenced only if the debtor has assets in the US.
- **Limited jurisdiction.** If recognition of a foreign main proceeding occurs before the Chapter 7 or 11 case is commenced, then the subsequent plenary case is restricted to the administration of the debtor's assets that are located within the territorial jurisdiction of the US. In other words, the universal jurisdiction of the US bankruptcy courts is lost.

A concurrent plenary US case also affects the relief available to a debtor under Chapter 15. Where a plenary case and a foreign proceeding are pending concurrently, a US bankruptcy court must modify the relief afforded in the two cases as follows:

- If a US plenary case is already pending at the time a petition for recognition is filed, any provisional or permissive relief that may be granted under Chapter 15 must be con-

sistent with the bankruptcy case, and automatic relief is not triggered on recognition of a foreign main proceeding.

- If a US plenary case is commenced after recognition of a foreign proceeding, any provisional or permissive relief granted under Chapter 15 must be modified or terminated to the extent inconsistent with the Chapter 7 or 11 case.

Similarly, where more than one foreign proceeding is pending, a US bankruptcy court must modify the relief afforded under Chapter 15 as follows:

- Any provisional or permissive relief granted to the foreign representative of a non-main proceeding must be made consistent with a foreign main proceeding.
- If a foreign main proceeding is recognised after a petition for recognition of a non-main proceeding is filed, the court must review any provisional or permissive relief granted under the non-main proceeding and modify or terminate such relief if inconsistent with the main proceeding.
- If two non-main proceedings are pending concurrently, the court must grant, modify or terminate relief as appropriate to facilitate co-ordination of the proceedings.

LOOKING AHEAD FOR FOREIGN DEBTORS

The use of US bankruptcy laws by foreign debtors may have real advantages, but requires careful planning. As is readily apparent, there are many hard and fast rules under Chapter 15 that simply did not exist under former section 304 of the US Bankruptcy Code. A debtor or representative planning a restructuring or liquidation using US laws should carefully plan its strategy before commencing a plenary case or seeking recognition in the US. While the relief that can be afforded under the US Bankruptcy Code is powerful, there is a complex set of rules that must be navigated to achieve the desired results.

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