



## **Current Issues and Developments in Cross-Border Insolvencies**<sup>1</sup>

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### **I. Origins of Chapter 15**

#### **A. Section 304 –Cases Ancillary to Foreign Proceedings**

- Statutory Framework of section 304

Prior to its repeal with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act, section 304 provided authority for adjudicating international insolvency issues before the U.S. Bankruptcy Courts where a proceeding had already been filed or would be more appropriately filed in a foreign jurisdiction. The purpose of this section was to shield American creditors and assets located within the United States from piecemeal distribution of assets resulting from foreign reorganization or liquidation procedures. Section 304 acted as a jurisdictional aid to foreign bankruptcy representatives by providing for discovery and a structured distribution of assets.

Pursuant to subsection (a), only a “foreign representative” could commence a case “ancillary” to a foreign proceeding. Ancillary proceedings were conducted as adversary proceedings and did not result in a conventional reorganization or liquidation, did not create a bankruptcy estate and did not result in the appointment of a U.S. Trustee. While many of the powers granted trustees and debtors in possession under the Bankruptcy Code were not available to foreign representatives in the context of section 304 ancillary proceedings, many courts interpreted subsection (b) of section 304 to provide a basis for granting relief similar to the relief available to trustees, such as authorizing asset dispositions consistent with section 363, issuing injunctions to the same effect as the automatic stay, and permitting the pursuit of avoidance type actions not based on the bankruptcy code but on choice of law rules. Subsection (c) qualified the expansive powers of subsection (b) by enumerating factors to be weighed when fashioning judicial relief such as ordering the turnover of property, enjoining the disposition or transfer of property or authorizing the taking of discovery. Specifically, subsection (c) provided:

In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with –

- (1) just treatment of all holders of claims against or interests in such estate
- (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding
- (3) prevention of preferential or fraudulent dispositions of property of such estate

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- (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title
- (5) comity
- (6) If appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceedings concerns.

- Important Section 304 Cases

Foreign Representative Gaining Recognition for the Foreign Proceeding

- *In re Master Home Furniture Co., Ltd.*, 261 B.R. 671 (Bankr. C.D. Ca. 2001) – The court refused to grant recognition under section 304 to a foreign reorganization proceeding, holding that comity did not require recognition of a Taiwanese proceeding because no fiduciary existed in Taiwan and no orderly distribution to creditors existed in Taiwan.
- *In re Empresa de Transportes Aero del Peru, S.A.*, 263 B.R. 367 (S.D. Fla. 2001) – The district court ruled that for a US Court to have jurisdiction under section 304, there had to be a “foreign proceeding” and remanded the case back to the bankruptcy court to determine whether there existed a foreign proceeding under Peruvian law in a context where the foreign reorganization efforts had failed.
- *In re Petition of Caldas*, 272 B.R. 583 (Bankr. S.D.N.Y. 2002) – A “foreign proceeding” under section 304 was recognized where petitioners were appointed by the Superintendency of Banking and Insurance and were members of a Peruvian bank in an intervention proceeding in Peru, and where the applicable provisions of Peruvian law were fully explained to the court.

Scope of Section 304

- *In re Treco*, 240 F.3d 148 (2<sup>nd</sup> Cir. 2001) – The court concluded that the turnover of funds would be improper because the distribution of proceeds in a Bahamian bankruptcy would not be substantially in accordance with the United States Code where (i) under American law, the bank’s security interest would not be charged with the costs of administration of insolvency proceedings, whereas under Bahamian law the liquidators would be able to access all of the collateral to satisfy administrative costs, and (ii) the liquidators’ fees had already consumed \$8million of the \$10 million of receivables collected and were likely to increase to the point that they would consume all of the bank’s collateral and leave it with no recovery at all.
- *In re Petition of Garcia Avila*, 269 B.R. 95 (Bankr. S.D. N.Y. 2003) – The court found that section 304 does not require that a creditor receive the same distribution as it would have received in a hypothetical American

bankruptcy, only that the foreign law be sufficiently close to the American law to meet section 304(c) standards.

- *In re Petition of Kyu-Byung Hwang*, 309 B.R. 842 (Bankr. S.D.N.Y. 2004) – The court granted recognition of a Korean proceeding because Korean law was substantially similar to American law, did not discriminate against foreign creditors, comported with notions of fairness and due process, and provided many of the procedural safeguards of an American Chapter 11 case.
- *In re Petition of Gross*, 278 BR 557 (Bankr. M.D. Fla. 2002) – The court held that in a section 304 case, a petition may be brought to set aside a transaction based on foreign law, that it is not necessary for the foreign debtor to have physical property in the district, and that discovery is appropriate.

## **B. Model Law on Cross Border Insolvency**

- Formulated and Adopted by UNCITRAL

The United Nations Commissions on International Trade Law (UNCITRAL) was created in 1967 as a legal body within the United Nations General Assembly in an effort to help unify commercial and trade law. In 1997, UNCITRAL adopted the “Model Law” of cross-border insolvency.

- Cornerstones of the Model Law
  - Access – to establish a principal that a foreign representative, holding office under an insolvency proceeding opened under the law of one state, has a right of direct access to the courts of other states where it may be expedient to take action of some kind.
  - Recognition – to establish basic principals and procedures for the recognition of foreign insolvency proceedings and for the provision of relief and assistance in cross-border cases.
  - Relief – to establish a positive legal framework, sanctioning cooperation between courts in different jurisdictions, and between courts and foreign representatives.
  - Co-operation – to establish a framework of basic rules to be applied in cases where concurrent insolvency proceedings take place, so that co-ordination can be optimized in the interest of attaining the fairest possible outcome for all creditors and other parties concerned.
- Issues addressed by the Model Law

- Recognition in the enacting State of foreign insolvency proceedings, and the effects therefore.
  - Direct rights of access to the courts and legal processes within the enacting State for foreign representatives and creditors.
  - The correlative rights of courts and office-holders within the enacting State and to make outward-bound requests to courts in foreign jurisdictions for recognition of proceedings commenced in the enacting states and to apply for assistance and relief, and for office-holders to commence or participate in proceedings under the insolvency laws of the other State.
  - Co-operation between courts and office holders from different jurisdictions.
  - Co-ordination of concurrent proceedings taking place in two or more different jurisdictions.
- Who uses the Model Law
    - Eritrea
    - Japan
    - Mexico
    - Poland
    - Romania
    - South Africa
    - Serbia
    - Montenegro
    - British Virgin Islands
    - United States of America (Chapter 15)

### **C. European Insolvency Regulation**

The EU Insolvency Regulation came into effect on May 31, 2002. This regulation applies to all EU Member states, except Denmark, and is automatically law in the relevant member states, overriding where necessary any conflicting provisions in national laws. The primary function of the regulation is to codify the manner in which a member state determines whether it has jurisdiction to open insolvency pleadings. Also, the regulation seeks to propose a uniform approach to the choice of governing law. After these factors have been determined, the procedural rules of the relevant member state will generally apply.

The regulation applies to collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator. It only applies to entities that have their centre of main interests within an EU member state, including those whose place of incorporation may be outside the European Union, but whose centre of main interests is within a member state.

As provided by the regulation, the applicable jurisdiction for insolvency proceedings is the court of the member state where the debtor's center of main interests is located. There is a rebuttable presumption that the center of main interest for a company or other legal person is where the registered office of the company is located. The regulation provides for secondary proceeding in certain restricted circumstances in countries other than the state in which the center of main interests is located.

The courts of member states have jurisdiction to open insolvency proceedings against the debtor only where the debtor is established within the territory of that other member state. Unlike a main proceedings, which in the absence of a secondary proceeding has effect throughout the European Union, secondary proceedings are restricted to the assets of the debtor situated in that specific member state and are limited to winding-up procedures. The general rule with respect to choice of law under the regulation is that the law applicable to the insolvency proceeding and its effects shall be that of the member state within the territory in which such proceedings are opened. However, this general rule is subject to a number of exceptions.

## **II. Impact of Chapter 15**

### **A. Overview of Chapter 15**

Pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Chapter 15 titled "Ancillary and Other Cross-Border Cases" was enacted to provide a mechanism for dealing with cross-border insolvency cases. Chapter 15 substantially adopts the form and substance of the Model Law and replaces former code section 304. Chapter 15 applies to cases filed on and after October 17, 2005.

Chapter 15 applies in the following four situations:

- (1) where assistance is sought in the United States by a foreign court or a foreign representative in connection with a foreign proceeding,
- (2) where assistance is sought in a foreign country in connection with a case under the Bankruptcy Code,
- (3) where a foreign proceeding and a case under the Bankruptcy Code with respect to the same debtor are pending concurrently, and
- (4) where creditors or other interested persons in a foreign country have an interest in requesting the commencement of, or participating in, a case proceeding under the Bankruptcy Code.

To commence a case under Chapter 15, a petition for recognition of a foreign proceeding must be filed pursuant to the procedural requirements listed in section 1515. A court must enter an order recognizing a foreign proceeding if (i) such foreign proceeding for which recognition is sought is a foreign main proceeding (a foreign

proceeding pending in the country where the debtor has its center of main interests) or a foreign nonmain proceeding (a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment), (ii) the foreign representative applying for recognition is a person or body, and (iii) the petition meets the requirements of section 1515. However, any order recognizing a foreign proceeding is subject to the public policy exception codified in section 1506, which provides “[n]othing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States.”

A foreign representative is not entitled to any automatic relief upon filing the petition; however, a foreign representative may request, and the court may grant on a provisional basis if the relief is needed to protect the assets of the debtor or the interests of creditors, the relief specified in section 1519.

Upon entry of the order recognizing a foreign main proceeding, the foreign representative is automatically entitled to the following specified relief under section 1520:

- (1) Sections 361 and 362 apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States.
- (2) Sections 363, 549, 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the sections would apply to property of an estate
- (3) Unless the court orders otherwise, the foreign representative may operate the debtor’s business and may exercise the rights and powers of a trustee under and to the extent provided by sections 363 and 552
- (4) Section 552 applies to property of the debtor that is within the territorial jurisdiction of the United States

A foreign representative in a nonmain proceeding is not entitled to automatic relief; however, he may seek relief pursuant to section 1521. At the request of the foreign representative, whether a main or nonmain proceeding, the court may grant other relief specified in section 1521 if the court is “satisfied that the relief relates to assets that, under the law of the United States, should be administered in the foreign nonmain proceedings or concerns information required in that proceeding.” In addition, section 1507 specifies:

in determining if the court will provide “additional assistance” to a foreign representative, the court will consider such additional assistance, consistent with the principles of comity, which will reasonably assure (1) just treatment of all holders of claims against interests in debtor’s property; (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceedings; (3) prevention of preferential or fraudulent

dispositions of property of the debtor; (4) distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by the Bankruptcy Code; and if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

Also, upon recognition, a foreign representative may commence an involuntary case under section 303 or a voluntary case under section 301 and 302 if the foreign proceeding is a foreign main proceeding. However, a case under a chapter other than Chapter 15 may only be commenced if the debtor has assets in the United States.

Pursuant to 28 U.S.C. §157(b)(2)(P), recognition of foreign proceedings and other matters under Chapter 15 are core proceedings. Venue is governed by 28 U.S.C. §1410.

## **B. Changes on Section 304 Practice by Chapter 15**

Chapter 15 replaced Bankruptcy Code section 304 and made significant changes to the ancillary proceeding practice. While many of the principals of section 304 are still recognizable in Chapter 15, Chapter 15 offers a much more sophisticated tool for addressing cross-border insolvencies.

First, certain definitions under section 304 were amended to be more expansive. The definition of "foreign proceeding" in section 101(23) was amended to recognize as a foreign proceeding: (i) a collective proceeding, (ii) a judicial or administrative proceeding, (iii) an interim or final proceeding, and (iv) a proceeding in which the assets and affairs of the debtor are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation. In addition, the definition of "foreign representative" was changed to a broader version that includes "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

Second, Chapter 15 now provides for the automatic application of several provisions of the Bankruptcy Code upon the recognition of a foreign main proceeding, such as section 362 automatic stay, the right of a foreign representative to operate a business, section 361 defining "adequate protection" for the interests of secured creditors and the provisions of section 363 regarding the use, sale or lease of the debtor's property.

Section 1521 of Chapter 15 also provides that a foreign representative may apply for any appropriate additional relief if such relief is necessary to carry out the purpose of Chapter 15 or to protect the assets of the debtor or the interests of creditors. However, according to the House Report on the 2005 Law, the relief available under section 1521 is not intended "to expand or reduce the scope of relief currently available in ancillary cases under sections 105 and 304 ..." Section 1507 further provides "[s]ubject to the specific limitations stated elsewhere in this chapter the court, if recognition is granted, may provide additional assistance to a foreign representative under this title or under other

laws of the United States.” Section 1507 conditions any additional relief that may be granted in an ancillary proceeding on the court’s consideration of five factors, consistent with the principles of comity,: (i) just treatment of all holders of claims against or interests in such estate; (ii) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceedings; (iii) prevention of preferential or fraudulent dispositions of property of such estate; (iv) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title; and (v) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns. While these factors are identical to the factors listed in former section 304(c), comity is included as a new overarching factor. Now, in section 1507, the court must consider whether the additional assistance is consistent with the principles of comity, and then whether such relief will reasonably satisfy the five other factors.

### **III. Chapter 11 vs. Chapter 15**

An ancillary proceeding under Chapter 15 offers foreign representatives in a foreign main case many of the rights and powers of a trustee or a debtor in possession under the Bankruptcy Code without filing a full case. However certain rights, such as the right to exercise avoidance powers under the U.S. Code, are specifically excluded. A foreign representative always has the alternative to file a full or plenary proceeding under Chapter 11 or Chapter 7 of the Bankruptcy Code. However, after recognition of a foreign main proceeding, section 1528 mandates that a case under another chapter of title 11 can only be commenced if the debtor has assets in the United States. The basic scope of jurisdiction in a case commenced under title 11 after recognition of a foreign main proceeding is restricted to the assets of the debtor that are within the territorial jurisdiction of the United States.

If no foreign proceeding is pending, there do not appear to be any additional restrictions imposed by Chapter 15 on the right of a foreign debtor or of foreign creditors to file a voluntary or involuntary petition in the United States. Section 109 provides that a person who resides or has a domicile, place of business or property in the United States may be a debtor under title 11 unless that person falls into one of the specifically enumerated exceptions. Persons, which include individuals, partnership and corporations, are eligible to file in the United States even if they only have a small amount of property located in the United States. *In re Global Ocean Carriers Ltd.*, 251 B.R. 31 (Bankr. D. Del. 2000) (holding that a few thousand dollars in a bank account and the unearned portions of retainers provided to local counsel constituted property sufficient to form a predicate for a filing in the United States); *In re Iglesias*, 226 B.R. 721 (Bankr. S.D. Fla. 1998) (holding that \$500 in a bank account was sufficient predicate to file in the United States). See also 2 L. King, *Collier on Bankruptcy*, P 109.02[3] (15th ed. rev. 2003), (stating without qualification, "there is virtually no formal barrier to a foreign entity commencing a case under title 11 in the United States."). Once such a case is filed, all of the provisions of the

Bankruptcy Code would apply and all of the assets of the debtor worldwide would be part of the proceeding.

#### **IV. Articles of Interest on Chapter 15**

Evelyn H. Biery, Jason L. Boland and John D. Cornwell, *The Future of Chapter 11: A Look at Transnational Insolvencies and Chapter 15 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 47 B.C. L. Rev. 23 (2005).

Jay Lawrence Westbrook, *Chapter 15 at Last*, 79 Am. Bankr. L.J. 713 (Summer 2005).

*Current Developments in International Insolvency Law: A United States Perspective* by Allan L. Gropper, United States Bankruptcy Judge for the Southern District of New York.