By Howard Seife

Cross-Border Professionals Respond to Chapter 15 Proposals

Editor's Note: *An article in the October 2018 issue described several amendments to chapter 15 as proposed by the National Bankruptcy Conference (NBC) in a letter to Congress dated Aug. 20, 2018. Reprinted here are excerpts from a letter with competing views by Howard Seife (Norton Rose Fulbright; New York) on behalf of other cross-border practitioners and organizations. To read the previous article, visit abi.org/abi-journal.*

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While we are generally supportive of the NBC's proposed changes to chapter 15, we disagree with the proposed change to the date of determining a foreign debtor's center of main interests (COMI). A change in the timing of the COMI determination would limit — if not foreclose — the ability of U.S. bankruptcy courts to aid foreign restructurings and liquidations pending in offshore jurisdictions. This would run counter to the stated goals of chapter 15, which includes facilitating cooperation between courts in the U.S. and foreign courts overseeing cross-border insolvency proceedings and maximizing asset value for the benefit of a debtor's creditors.

Companies often incorporate in offshore jurisdictions — including the British Virgin Islands, Bermuda and the Cayman Islands — to, among other things, ensure that they have the benefits of a well-established legal system that is equipped to deal with specialized organizations, such as investment funds and insurance companies. A significant number of companies are registered in the offshore jurisdictions but do not conduct any actual business in their place of registration. In many instances, these companies might have assets, creditors and operations in the U.S. When facing financial distress, an offshore company — whether as a result of an involuntary filing or because of the requirements of local law — might become subject to insolvency or restructuring proceedings in its jurisdiction of incorporation. Because of a company's ties to the U.S., the company or its foreign representative may reasonably need the assistance of a U.S. court to facilitate a restructuring or liquidation. Such assistance may include a stay of litigation in the U.S., centralizing disputes and the claims-resolution process in the foreign jurisdiction, and the issuance of orders enforcing a restructuring plan on creditors and other parties that are subject to the jurisdiction of the U.S. courts, but that might not be subject to the foreign court's jurisdiction. The NBC's proposal on the timing of the COMI determination would severely limit a U.S. court's ability to grant offshore debtors (including their court-appointed foreign representatives) the critical assistance necessary for a successful reorganization or liquidation, as well as the protections benefiting creditors that reside in the U.S.

Under chapter 15, a foreign proceeding can be recognized only if it is a "foreign main proceeding" or a "foreign nonmain proceeding." A foreign main proceeding is a proceeding pending where the debtor has its COMI. A foreign nonmain proceeding is a proceeding pending where the debtor has an establishment, which is defined as "any place of operations where the debtor carries out nontransitory economic activity."

Consequently, in order for a foreign proceeding to be recognized under chapter 15, the foreign debtor must have either its COMI or an establishment in the country where the foreign proceeding is pending. Given recent technological advances and the "virtual" nature of certain businesses, a company incorporated in an offshore jurisdiction may not have a physical place of operations or otherwise engage in traditional business activities in its place of incorporation, thereby creating certain challenges for recognition of offshore foreign proceedings. In particular, it might be difficult for an offshore company, such as a fund with employees working remotely, to demonstrate that it has an establishment for purposes of obtaining foreign nonmain recognition. Moreover, to the extent an offshore company has meaningful operations elsewhere, it may be difficult for it to establish that the place of its incorporation is its COMI at the time of the commencement of the foreign proceeding. Indeed, it was under these precise circumstances that the late Chief Judge **Burton Lifland** of the U.S. Bankruptcy Court for the Southern District of New York denied the chapter 15 petitions filed by two Bear Stearns funds.[1]

Following the *Bear Stearns* decision, there were inconsistent decisions by the courts in the Southern District of New York addressing the timing of the COMI determination. The bankruptcy court in *Millennium Global Emerging Credit Master Fund*

1 *See In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd.*, 374 B.R. 122 (Bankr. S.D.N.Y. 2007), *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008).

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Ltd. held that COMI should be determined as of the commencement of the foreign proceeding.[2] Other courts, including the district court in *Fairfield Sentry Ltd.*, held that a bankruptcy court should determine COMI as of the chapter 15 filing date. The Second Circuit resolved this issue and held that a court (1) should determine COMI as of the date of the filing of the chapter 15 petition, and (2) may consider actions taken in the foreign proceeding when determining COMI.[3]

Following the Second Circuit's ruling, foreign representatives from the offshore jurisdictions have on numerous occasions sought and obtained recognition under chapter 15 based on activities occurring in the foreign proceeding.[4] If the NBC's proposed amendment regarding COMI is adopted and those proceeding-based activities can no longer be considered when determining COMI, many offshore foreign proceedings will not be entitled to recognition.

U.S. courts have repeatedly noted that the risk of not recognizing a foreign proceeding is that it "may forestall needed inter-nation cooperation."[5] If a foreign proceeding is not recognized, a foreign debtor or representative might be forced to pursue one of several unappealing options to protect the debtor's assets and maximize value for the estate. First, a foreign debtor could choose to commence a concurrent plenary proceeding (like a chapter 11 case) in the U.S. to administer the debtor's assets or deal with creditors located in the U.S. However, such a proceeding, even with the implementation of a cross-border protocol, would be unnecessarily complex, expensive and burdensome relative to an ancillary case under chapter 15.

Alternatively, if filing a plenary case is not feasible, a foreign representative or debtor might need to pursue piecemeal litigation in the U.S. to halt creditor enforcement and collection actions or to seek other protective relief. This is exactly the "race to the courthouse" that bankruptcy is intended to prevent. Chasing and defending claims throughout the U.S. would be expensive and time-consuming, and for some foreign debtors would simply be economically and/or practically impossible.

Finally, a foreign representative or debtor could also decide to do nothing in the U.S., thereby allowing creditors to bring litigation against the debtor or attach a debtor's assets in the U.S. (again facilitating a race to the courthouse creditor scramble). Such an outcome would be inconsistent with the express purposes of chapter 15, including the protection of creditors' interests and the maximization of the value of the debtor's assets. It appears that the NBC's sole reason to propose legislation to address COMI is to make chapter 15 consistent with recent revisions to the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency. The inclusion of the COMI concept in the Model Law was designed to prevent forum-shopping, and so-called COMI manipulation has been at the heart of discussions regarding when COMI should be determined.

While abusive forum-shopping should not be countenanced, legislatively repealing the practical and effective approach taken in *Fairfield* is not the answer. Under *Fairfield*, a U.S. court retains the discretion necessary to avoid improper forum-shopping and might deny recognition if it finds that COMI was manipulated in bad faith.[6] Courts may also refuse to grant recognition if there is insufficient activity in the offshore jurisdiction to establish COMI there. For example, in *Creative Finance*, the court denied recognition to a BVI liquidation after finding that the liquidators did not engage in activities sufficient to shift the debtor's COMI to the BVI prior to the chapter 15 filing date. In denying recognition, the court further noted that "a bad-faith invocation of the [Bankruptcy] Code, even in the face of a literal compliance with the requirements of section 1517, can trump any apparent COMI premised on the locale of a foreign representative's activities."[7] Companies can, and indeed have, shifted COMI prior to commencing a foreign proceeding to obtain the benefits of the foreign country's laws.

In short, under existing law courts have the discretion, and have used that discretion, to deny recognition if the circumstances warrant denial. Repealing *Fairfield* would not solve a purported problem, but it would instead create a real and significant problem by foreclosing chapter 15 relief for many financially distressed offshore companies, and have adverse consequences for creditors in the U.S. abi

2 *See Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011).

3 *See In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d Cir. 2013).

4 *See, e.g., In re Pioneer Freight Futures Co. Ltd.*, Case No. 13-12324 (Bankr. S.D.N.Y. Aug. 13, 2014) (recognizing BVI liquidation); *In re Suntech Power Holdings Co. Ltd.*, 520 B.R. 399, 416-17 (Bankr. S.D.N.Y. 2014) (finding that debtor's COMI was not in the Cayman Islands when the foreign proceeding was commenced, but shifted there as a result of liquidation activities); *In re Platinum Partners Arbitrage Fund LP*, Case No. 16-12925 (Bankr. S.D.N.Y. Nov. 22, 2016) (recognizing Cayman Islands liquidation); *cf., In re Creative Finance Ltd.*, 543 B.R. 498, 518 (Bankr. S.D.N.Y. 2016) (denying recognition, but noting that "*Fairfield Sentry* now provides a means for U.S. recognition of letterbox jurisdiction insolvency proceedings — so long as the estate fiduciaries in those jurisdictions do enough work").

5 *See In re Fairfield*, 440 B.R. at 66 (citations omitted).

6 *See In re Fairfield*, 714 F.3d at 137 (holding that "a court may consider the period between the commencement of the foreign insolvency proceeding and the filing of the Chapter 15 petition to ensure that a debtor has not manipulated its COMI in bad faith").

7 *See In re Creative Finance Ltd.*, 543 B.R. 498, 523 (Bankr. S.D.N.Y. 2016). Moreover, amending chapter 15 so that a debtor's COMI is determined at the time of the filing of the foreign proceeding would not eliminate forum-shopping. As Judge Lifland opined, fixing the date for determining COMI as the commencement of the foreign proceeding "leaves the door open for an untoward gaming of the proceedings." *In re Fairfield*, 440 B.R. at 67 n.3.