By Joao F. Magalhaes

Chapter 15 Primer: Learning the Global Chess Game

For many bankruptcy and restructuring practitioners, the procedures underlying chapter 15 of the Bankruptcy Code are largely unfamiliar. Depending on the locale of one's practice, chapter 15 cases are rarely encountered. This article provides a base level of familiarity though a brief discussion of recent cases addressing debtor eligibility and foreign case recognition concepts under chapter 15. Also, given the state of international relations and recent events, attention is increasingly being given to the issue of how courts might address allegations of corruption abroad.

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Chapter 15 Overview

Chapter 15, enacted pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), incorporated the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law (UNCITRAL).[1] Unlike other chapters of the Bankruptcy Code, chapter 15 features an express statement of purpose, at § 1501(a), setting forth objectives such as (among others) cooperation between U.S. courts/authorities and those of foreign countries involved in cross-border insolvency cases.[2] "A central tenet of Chapter 15 is the importance of comity in cross-border insolvency proceedings."[3]

A chapter 15 case is commenced by the filing of a petition for recognition of a foreign proceeding under § 1515.[4] The petition must be filed by a "foreign representative," which is "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."[5]

Following notice and a hearing, recognition of the foreign proceeding shall be entered if (1) the "foreign proceeding for which recognition is sought is a foreign main proceeding or foreign nonmain proceeding within the meaning" of § 1502, (2) "the foreign representative applying for recognition is a person or body," and (3) § 1515 is satisfied.[6] Upon recognition, the automatic stay of § 362 of the Bankruptcy Code is triggered and made applicable pursuant to § 1520(a)(1), and the foreign entity represented might pursue various types of relief afforded by, among other provisions, § 1521.[7]

Eligibility Concerns: Evaluating "Property" of a Foreign Debtor

Section 109(a) of the Bankruptcy Code establishes a baseline eligibility standard by providing 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 this title."[8] The U.S. Court of Appeals for the Second Circuit applied § 109(a) to chapter 15, holding that before a bankruptcy court may grant recognition of a foreign proceeding, the debtor must meet the requirements of § 109(a).[9] The Second Circuit's reasoning was straightforward: Section 103(a) provides that chapter 1 applies to chapter 15.[10]

With § 109(a) being deemed applicable to chapter 15, the analysis often segues to the type and extent of property required to support recognition in chapter 15 cases. For example, in *In re B.C.I. Finances Pty. Ltd.*, the U.S. Bankruptcy Court for the Southern District of New York (SDNY) addressed § 109(a)'s property requirement in a matter involving debtors in Australian liquidation proceedings who were part of an intercompany borrowing and lending group whose principals had left Australia, with two taking up residence in New York.[11] The liquidators appointed in those proceedings, acting as foreign representatives, sought recognition under chapter 15 to facilitate the administration of the debtors' estates in Australia.

In particular, the liquidators, in their search for assets, sought a means by which to obtain discovery against the principals who had moved to New York.[12] A related nondebtor entity and one of the debtors' principals objected on the basis of § 109(a).[13] Prior to seeking recognition, however, the foreign debtors had each placed retainers of $1,250 in the trust account of the liquidators'

1 *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd. (In Provisional Liquidation)*, 374 B.R. 122, 126 (Bankr. S.D.N.Y. 2007) (citing H.R. Rep. No. 109-31, at 105-07 (2005); U.S. Code Cong. & Admin. News 2005, p. 88)).
2 11 U.S.C. § 1501(a)(1).
3 *In re Cozumel Caribe SA de CV*, 482 B.R. 96, 114–15 (Bankr. S.D.N.Y. 2012) ("Comity is not defined in Chapter 15 but it pervades the statute."). *See id.*
4 11 U.S.C. § 1504.
5 11 U.S.C. §§ 101(24), 1515.
6 11 U.S.C. § 1517(a).
7 11 U.S.C. §§ 362(a), 1520(a)(1), 1521.
8 11 U.S.C. § 109(a).
9 *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238, 247 (2d Cir. 2013).
10 *Id.* at 247.
11 583 B.R. 288, 290-91 (Bankr. S.D.N.Y. 2018).
12 *Id.* at 291.
13 *Id.*

counsel, and contended that the placement of such funds satisfied § 109(a).[14]

Relying on prior case law, including *Poymanov* (discussed herein),[15] the court concurred with the foreign debtors and their representatives, holding that retainer funds deposited by foreign debtors in a trust account located in the U.S. to pay for the foreign representatives' counsel constituted property located within the U.S. for purposes of satisfying § 109(a)'s eligibility requirement.[16] The court observed that "[a]s a general matter, courts that have construed the 'property' requirement in Section 109 'with respect to foreign corporations and individuals have found the eligibility requirement satisfied by even a *minimal* amount of property located in the United States.'"[17] The court collected additional case law to emphasize how even nominal amounts of property enable a foreign corporation to qualify under § 109(a).[18]

The *B.C.I.* court also considered the liquidators' assertion that additional property of the debtors under § 109(a) was furnished by existing breach-of-fiduciary-duty claims in the U.S. against the principals.[19] The court agreed, but noted the parties' disagreement as to where such claims were located, and what law to apply in making such a determination.[20] The court noted that "the nature or scope of a debtor's interest in property is determined by 'local' or 'state' law," and that under New York choice-of-law rules, Australian law should govern the fiduciary duty claims given the strong connections to Australia.[21] As to the location of the claims, the court cited the liquidators' argument that "as a general matter, where a court has both subject-matter and personal jurisdiction, the claim subject to the litigation is present in that court."[22] Applying these principles, the court concluded that the fiduciary-duty claims were located in New York and governed by Australian law.[23]

Determining the "Main" Foreign Proceeding

In addition to threshold eligibility determinations, a chapter 15 petition for recognition will necessarily require analysis as to the nature of the foreign proceeding to be recognized. Given how global entities have interests in many jurisdictions, the analysis can become complicated if multiple petitions for recognition are presented in connection with the same debtor.

This was the scenario in *In re Oi Brasil Holdings Coöperatief UA*, which involved a petition seeking not only the recognition of one foreign bankruptcy proceeding, but also the modification of a prior recognition order finding a foreign main proceeding to be located in Brazil.[24] The petitioner, Oi Brasil Holdings Coöperatief UA (hereinafter, "Coop"), was a Dutch entity related to a group of Brazilian telecommunications companies (the "Oi Group") that had initiated bankruptcy proceedings in Brazil in 2016, then sought and received recognition in the SDNY.[25]

Given that Coop was a special-purpose financing vehicle for the Oi Group, the court had previously deemed its "center of main interests" (COMI) to be in Brazil.[26] Subsequent to the Brazilian proceedings and chapter 15 recognition in the SDNY, creditors had taken action against Coop in the Netherlands, which resulted in a Dutch bankruptcy proceeding.

Thereafter, the trustee in the Dutch proceedings filed a competing petition with the SDNY seeking recognition under chapter 15.[27] To grant the petition and declare the Dutch proceedings as a foreign main proceeding, the court would have to find that Coop's COMI was in the Netherlands and, in turn, undo the prior recognition of the Brazilian bankruptcy proceedings.

After further analyzing factual and procedural background,[28] the court turned to § 1517(a) of the Bankruptcy Code, the first prong of which provides that an order recognizing a foreign proceeding shall be entered if "(1) such foreign proceeding ... is a foreign main proceeding or foreign nonmain proceeding within the meaning" of § 1502.[29] A foreign main proceeding is defined as "a foreign proceeding pending in the country where the debtor has" its COMI.[30]

A COMI is itself not statutorily defined by the Bankruptcy Code,[31] thus courts have developed nondispositive factors for analysis, such as the location of the debtor's headquarters, managers, primary assets, creditors and/or the jurisdiction whose law would apply to most disputes.[32] On a parallel track with establishing the framework for assessing Coop's nerve center, the court next considered the standard for reviewing its prior grant of recognition under § 1517(d), which provides that "[t]he provisions of this subchapter do not prevent modification or termination of recognition if it is shown that the grounds for granting it were fully or partially lacking or have ceased to exist."[33]

Applying this framework, the court found that it had previously been presented with a "broad picture" of relevant facts, including Coop's ties to the Netherlands, at the time it recognized Coop's COMI as Brazil.[34] As to the second prong of § 1517(d) — whether recognition of the Brazilian proceeding should be modified or terminated because the grounds for granting recognition "have ceased to exist" — the court examined whether the activity of the Dutch trustee had been of sufficient significance to produce a change in the COMI.[35] Despite steps taken in the Dutch proceeding, the court found that such activity did

14 *Id.* at 291-98.
15 *Id.* at 293 (citing *In re Poymanov*, 571 B.R. 24, 29 (Bankr. S.D.N.Y. 2017)).
16 *Id.* Accordingly, the *B.C.I.* court granted the petition for recognition. *Id.* A couple of months prior to B.C.I., the U.S. District Court for the Northern District of California had reached the same conclusion. *See Power Pty. Ltd. v. APR Energy Holdings Ltd. (In re Forge Group Power Pty. Ltd.)*, 2018 WL 827913, at **11, 13 (N.D. Cal. Feb. 12, 2018) (holding that debtor-eligibility requirements of § 109(a) apply in chapter 15 cases and that the requirement of "property in the United States" is satisfied by a security retainer that remains the property of the debtor until the funds are applied by the attorney for services actually rendered).
17 583 B.R. at 294 (emphasis added).
18 *Id.* at 298.
19 *Id.* at 292.
20 *Id.* at 296.
21 *Id.* at 296-98 (internal citations omitted). The only New York connection to the fiduciary-duty claims was that the principals had taken residence there. *Id.* at 298.
22 *Id.* at 303.
23 *Id.* at 296-300.
24 578 B.R. 169 (2017).
25 *Id.* at 175.
26 *Id.*
27 *Id.*
28 *Id.*
29 11 U.S.C. § 1517(a).
30 11 U.S.C. § 1502(4).
31 578 B.R. at 195.
32 *Id.* (citing *In re SPhinX Ltd.*, 351 B.R. 103, 117 (Bankr. S.D.N.Y. 2006)).
33 11 U.S.C. § 1517(d).
34 578 B.R. at 216-17.
35 *Id.* at 222.

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not change "the economic realities associated with Coop's status as a special-purpose financing vehicle and the related expectations of its creditors."[36]

Critically, while it is permissible in a matter involving a debtor without significant operations in a jurisdiction to use a foreign representative's work to operate or liquidate a foreign debtor as a basis for chapter 15 recognition of "letterbox" jurisdiction for insolvency proceedings, it is another matter to *change a debtor's COMI on such a basis*.[37] The court also noted the legal and practical limits on the Dutch trustee's powers, and the reality that Coop's largest assets are intercompany claims against fellow Oi Group entities, which are located in Brazil.[38]

The court also deemed as relevant the fact that a major creditor stayed silent — purposefully, as a matter of strategy — during the first recognition phase.[39] For these and other reasons, the Dutch petition for recognition was denied.[40]

Treatment of Allegations of Foreign Corruption in a Foreign Proceeding

Given the reality of geopolitical differences among the various jurisdictions where international commerce is conducted, it follows that concerns regarding the propriety of foreign proceedings will arise under chapter 15. In *In re Poymanov*, the SDNY Bankruptcy Court was faced with serious allegations of corruption in a foreign proceeding.[41]

Poymanov involved a petition for recognition filed by a financial administrator appointed to oversee a Russian insolvency proceeding pending in the Commercial Court of the Moscow Region.[42] The Russian debtor was a former majority shareholder in a granite company, who apparently caused a series of transactions between this and his investment company that resulted in loans totaling $43.5 million. The companies defaulted on these loans, which then resulted in creditors commencing insolvency proceedings, first in September 2011 against his companies, then against Sergey Poymanov in October 2015.[43]

In November 2016, PPF Management LLC filed a complaint in the SDNY against, among others, the successor-in-interest to the primary lender of Poymanov's companies, the receiver appointed in Russia to oversee the estate of Poymanov's investment company, and the financial administrator appointed by the Russian bankruptcy court to oversee Poymanov's insolvency.[44] PPF alleged a form of corporate raiding known as *reiderstvo* in Russia, which involves the illicit acquisition of a business or assets, at times with the involvement of governmental authorities.[45] PPF asserted that it had been assigned such claims by Poymanov and his former wife.[46]

The financial administrator appointed by the Russian court filed a chapter 15 petition and invoked the automatic stay as a shield against PPF's lawsuit.[47] PPF objected to the chapter 15 petition, arguing that the court should use its discretion to deny recognition of the Russian insolvency proceeding as a matter contrary to public policy because (1) the administrator had concealed certain information and failed to perform due diligence on matters allegedly relating to money laundering, (2) the nature in which retainer funds were wired could have been illegal, (3) conflicts of interest existed, and (4) there existed "the significant risk that the Poymanov bankruptcy is part of a Russian corporate raiding scheme, the pervasive problem of *Reiderstvo*."[48]

The core of PPF's allegations concerned agreements for the repayment of debts, which PPF characterized as a "mock and sham," because the purchaser of the debt had little likelihood of recovery.[49] PPF also argued that the administrator was conflicted and thus could not qualify as a foreign representative, given that he was a target of PPF's lawsuit as a participant in the scheme to strip assets from Poymanov and his former wife.[50]

As to the applicable legal framework for these issues, § 1517(a) is made subject to the exception in § 1506, which provides that "[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 U.S.[51] The court explained that "[c]ourts may only refuse to take actions under section 1506 if granting the relief at issue would be '*manifestly*' contrary to U.S. public policy," and further that "[t]he public policy exception set forth in section 1506 is narrowly construed and invoked only under exceptional circumstances that concern matters of fundamental importance" to the U.S.[52]

Applying this standard to the facts before it, the court found a lack of evidence that the petitioner engaged in bad faith or criminal activity, or that there was corruption attributable to the Russian court. Although PPF's expert witness had provided testimony as to the occurrence of *reiderstvo* in Russia in general, there was nothing on the record showing that the petitioning administrator was conflicted, or that the Russian insolvency proceeding was a part of a corporate-raiding scheme.[53] As stated by the court, "There is simply no evidence that the Russian Insolvency Proceeding is the result of anything other than the undisputed defaults under [credit agreements], the foreign debtor's failure to make the payments under [a personal guarantee], and [a judgment] that was upheld on

36 *Id.* at 225.
37 *See id.* at 222-23.
38 *Id.* at 232-34.
39 *Id.* at 221, 235-44.
40 *Id.* at 244.
41 571 B.R. at 24.
42 *Id.* at 26.
43 *Id.* at 27-28.
44 *Id.* at 29, n.4.
45 *Id.* at 26, 29.
46 *Id.* at 29.
47 *Id.*
48 *Id.* at 36, 38 (internal citations omitted).
49 *Id.* at 30-31.
50 *Id.* at 33-34.
51 11 U.S.C. § 1506.
52 571 B.R. at 38 (internal citations omitted; emphasis in original).
53 *Id.* at 39.

appeal."[54] The court thus concluded that recognition of the Russian insolvency proceeding would not be manifestly contrary to U.S. public policy.[55]

Conclusion

It bears emphasizing that the foregoing is only a snapshot of the various moving parts involved in the cases discussed, let alone the entirety of chapter 15. In approaching chapter 15 practice, one should brace for a high level of complexity given the far-reaching nature of the issues presented.

Even separate and apart from the contours of chapter 15 itself, the law of many other sovereigns potentially lies in wait similar to the manner in which the law of 50 states is potentially relevant pursuant to *Butner v. U.S.*[56] Nevertheless (and now in keeping with the spirit of the opening), the fundamentals of eligibility and recognition are excellent starting points to understand chapter 15 practice and procedure. As shown here, the facts of many chapter 15 cases are diverse and, in some cases, thoroughly intriguing, which certainly smooths the process of learning this practice area. abi

54 *Id.*
55 *Id.*
56 440 U.S. 48, 55 (1979).