International Aspects of U.S. Bankruptcy Cases: Is a U.S. Bankruptcy Court the Proverbial Roaring Deaf Lion in the International Forest?

Daniel J. Saval, Moderator
Brown Rudnick LLP; New York

Lisa G. Beckerman
Akin Gump Strauss Hauer & Feld LLP; New York

Robert G. Burns
Bracewell LLP; New York

Hon. Bruce A. Harwood
U.S. Bankruptcy Court (D. N.H.); Manchester

Grant Lyon
KRyS Global; New York

Panel Discussion
A Welcome Mat or Not: Foreign Debtors and Chapter 11, Uses and Limitations

by David J. Molton

The Bankruptcy Code enables a foreign debtor to commence a plenary insolvency proceeding in the United States under Chapter 11, allowing the foreign debtor to eschew filing its principal insolvency case in its home country. Simply put, under Section 109 (a) of the Bankruptcy Code, a debtor that has ***any*** property in the United States is statutorily eligible to file a plenary case under Chapter 11. The courts have been extremely lenient in setting a relatively low threshold as to how much and/or what kind of property will be sufficient for eligibility purposes.

A foreign debtor is often incented to choose the Chapter 11 route based on the perception, much of it based on fact, that Chapter 11 provides the debtor with substantial advantages not available in the home jurisdiction. These advantages include:

- The United States offers a mature and globally respected insolvency regime supervised by a sophisticated, specialized and respected Bankruptcy Court (experienced in and knowledgeable of complex capital restructurings) and supported by a talented and creative bar.

- The Chapter 11 regime is one directed to the "rescue" of a business as opposed to "liquidation", the latter of which is the default and often only option in the insolvency laws of foreign jurisdictions.

- Chapter 11 allows management to continue in place as the "debtor-in-possession", which in most cases is not permitted in the insolvency laws of foreign jurisdictions. A “debtor in possession” means “debtor” in a Chapter 11 case (see 11 U.S.C. § 1101(1) (unless a trustee is appointed)) and holds all rights and powers as a trustee in bankruptcy (see 11 U.S.C. § 1107(a)). In many cases, the debtor changes management shortly before filing, so the managers for the debtor in possession are not necessarily the same as those who may have contributed to the debtor’s insolvency, and allowing current managers to continue the debtor’s business encourages managers to utilize the Bankruptcy Code when necessary because the current managers will not immediately lose their jobs if they decide that a bankruptcy case is the most value accretive option. Further, a debtor in possession is already familiar with the debtor’s business and can take quick corrective actions without needing additional time to understand the business. Of course, the safety valve of 11 U.S.C. § 1104 remains: if the debtor in possession continues to mismanage the debtor, the U.S. Trustee's office or any other interested party can seek to have a trustee appointed to replace management.

- Chapter 11 allows confirmation of reorganization plans with less than unanimous creditor or stakeholder support. The procedure for voting on a plan of reorganization provides that all members of a voting class must generally be provided with the same treatment (see 11 U.S.C. § 1123(a)(4)), so that the minority within a given class is treated the same as the majority. The majority of creditors in a given class consists of those class creditors holding at least 2/3 in amount and

more than 1/2 in number of the allowed claims within that class that have voted to accept or reject the plan (see 11 U.S.C. § 1126(c)). The majority of a class of interests in a given class consists of those holding at least 2/3 in amount of the allowed interests within the particular class of interests that have voted to accept or reject the plan (see 11 U.S.C. § 1126(d)). Simply put, the voting requirements are measured in the number and amount of claims or interests that actually vote (non-voting claims are not counted). Further, under the U.S. Bankruptcy Code's so-called "cramdown" provision (see 11 U.S.C. § 1129(b)), a plan of reorganization can be confirmed over, among other classes, a senior-priority rejecting class (*i.e.*, the majority of such class), even though the U.S. Bankruptcy Code's priority scheme requires those with higher priority to be paid in full before lower priority creditors/equity holders receive any value.

- Together, the eligibility (Section 109) and venue provisions (28 U.S.C. 1408) governing Chapter 11 cases enable the Bankruptcy Courts effectively to handle enterprise/corporate group insolvencies, a continuing and nagging problem besetting other insolvency regimes, including the Insolvency Regulation of the European Union.

- The Bankruptcy Code provides the Bankruptcy Courts, per Section 541(a), with worldwide jurisdiction over assets of the estate (whether a U.S. Bankruptcy Court can actually exercise that jurisdiction is another question).

- Finally, insolvency itself is not an eligibility requirement for a business to be a debtor under the U.S. Bankruptcy Code. *See In re Johns-Manville Corp.*, 36 B.R. 727 (Bankr. S.D.N.Y. 1984) (holding that insolvency is not required because open access policy of the U.S. Bankruptcy Code helps to encourage debtors to file before their condition deteriorates so much that they cannot be reorganized).

A Look at The Liberal Eligibility Threshold for Chapter 11

Any person, including a foreign corporation (there is no requirement that a debtor be a US domestic entity), *see* 11 U.S.C. § 101(41)), is eligible to file for Chapter 11 if it "resides or has a domicile, a place of business, or property in the United States." 11 U.S.C. § 109(a). Most often, foreign debtors use the "property in the United States" provision to buy their ticket into the Chapter 11 sandbox. Unlike the European context, where the entity must have its "centre of main interest" in the jurisdiction in which a debtor seeks to pursue its plenary insolvency proceeding, Section 109(a) allows for the commencement of a plenary Chapter 11 case in the United States even though that debtor ***does not*** have its headquarters (nerve center), significant assets or employees in the United States.

The "property" requirement with respect to foreign corporations and individuals can be satisfied by even a minimal amount of property located in the United States. Courts have found that several thousand dollars in a U.S. bank account and the unearned retainers of U.S. attorneys are sufficient "property" for a U.S. filing. Some examples follow:

- Arcapita Bank, a Bahrain-based investment bank, was not a domestic bank licensed in the United States and did not have any branches or agencies in the United States,

but nevertheless could file as a debtor under the U.S. Bankruptcy Code because it had over $100K of an unearned retainer held by its attorneys at Gibson Dunn. See *In re Arcapita Bank B.S.C. (C)*, Case No. 12-11076 (Bankr. S.D.N.Y. Mar. 19, 2012).

- Avianca, the national airline of Colombia, had its principal office in Santa Fé de Bogotá in Colombia, but maintained a few offices in the United States and flew a total of 28 routes in the United States. The bankruptcy court found that these were sufficient ties with the United States to file a plenary case under the U.S. Bankruptcy Code. *See In re Aerovias Nacionales de Colombia S.A. Avianca*, 303 B.R. 1, 8 (Bankr. S.D.N.Y. 2003).

- *Cf. In re Global Ocean Carriers*, 251 B.R. 31, 36 (Bankr. D. Del. 2000) (although finding that the debtor's funds in various U.S. bank accounts were sufficient, the court also noted that that copies of business documents -- *i.e.*, not originals -- in the hands of U.S. persons alone would not be sufficient).

These flexible eligibility requirements effectively enable foreign corporations to "forum shop" and choose the United States if they determine that Chapter 11 can best achieve the desired restructuring. Simply put, "since depositing money in a U.S. bank the day before a petition is filed would also render a debtor eligible, it simply illustrates that there is virtually no formal barrier to a foreign entity commencing a case under [the U.S. Bankruptcy Code]." See 2 Collier on Bankruptcy, ¶ 109.02[3] (16th ed. rev. 2015).

Practical and Legal Constraints Affecting Foreign Chapter 11 Debtors

Some key issues:

- What is the situs of the obligations being addressed or impaired, and can the debtor enforce U.S. bankruptcy orders against creditors and assets offshore?
- Will the Chapter 11 proceeding be recognized and afforded comity in foreign jurisdictions where the debtor's creditors and assets are sited, and, significantly, will the automatic stay of Section 362 be respected? Will parallel plenary or ancillary proceedings in the foreign jurisdiction be required to achieve the Chapter 11 restructuring?
- What are the consequences on the Chapter 11 case if its restructuring plan cannot be implemented or effectuated abroad?
- Can Chapter 5 avoidance claims be used to claw back offshore (foreign transferor to foreign transferee) fraudulent transfers and preferences?

The first three issues are addressed in the other written materials delivered in connection with this panel, so we will conclude with the issue of extraterritoriality and Chapter 5 remedies, which are one of the most important tools (weapons) available to a debtor in a Chapter 11 case. The rationale for a foreign debtor filing a Chapter 11 case may be undermined if, by doing so, it is unable to employ Chapter 5 claw back claims against foreign transfers.

In *Morrison* v. *National Australia Bank Ltd.,* 561 U.S. 247 (2010), the Supreme Court established that barring a clear congressional intent to the contrary, federal legislation is only intended to apply (and is presumed to only apply) within the United States. The question whether

Chapter 5 claims have extraterritorial application has arisen most recently in the Southern District of New York in connection with Irving Picard's Chapter 5 claims in the Madoff proceeding and in the Lyondell case, and these cases have now produced conflicting and inconsistent decisions that likely can only be resolved by the Second Circuit (and then, possibly, by the Supreme Court).

Unless a contrary intent appears, federal legislation, such as the avoidance claim regime contained in Chapter 5 of the Bankruptcy Code, is intended only to apply within the territorial jurisdiction of the United States. *Morrison*, 561 U.S. at 255. Simply put, "[w]hen a statute gives no clear indication of extraterritorial application, it has none." *Id.* "Rather than guess anew in each case, this Court applies the presumption in all cases, preserving a stable background against which Congress can legislate with predictable effects." *Id.* at 248.

In *SIPC v. Bernard L, Madoff Inv. Sec. LLC,* 513 B.R. 222 (S.D.N.Y. 2014) (Rakoff J.), *supp'd by,* No. 12-mc-115 (JSR), 2014 WL 3778155 (S.D.N.Y. July 28, 2014) (Rakoff J.), Madoff SIPA trustee sought to recover against various foreign subsequent transferees. These transferees had not directly invested with Madoff but with offshore Madoff feeder funds that in turn invested then those funds with Madoff. The defendants moved to dismiss arguing that section 550(a)(2) of the Bankruptcy Code does not apply extraterritorially and, therefore, does not reach the subsequent transfers made abroad by one foreign entity to another. Focusing on the subsequent transferee component of the transfer (the transfer from the foreign feeder fund to its foreign subscriber), the court held that since the were transfers of assets abroad and the component events of the transaction occurred internationally, recovery of these transfers required extraterritorial application of section 550(a). The court then held that this extraterritorial application was not intended by

Congress because nothing in the language of section 550(a) suggests that the section was intended to apply abroad.

A more recent decision in the U.S. Bankruptcy Court for the Southern District of New York, *In re Lyondell Chemical Co.,* 543 B.R. 127 (Bankr. S.D.N.Y. 2016), did not follow Judge Rakoff's lead in the Madoff case and instead held that extraterritorial application of Chapter 5 claims fell within the scope of congressional intent, and therefore foreign transfers were fair game for these claims. This case concerned the extraterritorial application of section 548 and section 550 of the Bankruptcy Code governing fraudulent transfer claims. The court held that section 548 can be applied extraterritorially, departing from the Madoff decision and a much earlier Bankruptcy Court decision in *In re Maxwell Communication Corp.,* 170 B.R. 800 (Bankr. S.D.N.Y. 1994) (the Second Circuit affirmed the dismissal of the Maxwell avoidance claims on comity grounds and did not reach the extraterritorial application issued). Although the Lyondell court concluded that the subject transaction was extraterritorial, the court, relying in part on a broad and global definition of estate property, determined that there was evidence of a congressional intent for section 548 to apply extraterritorially.

In the Madoff litigation, presiding Bankruptcy Judge Bernstein presently has the issue *sub judice* on remand from Judge Rakoff and in other cases which were not before Judge Rakoff. All sides are awaiting his decision with high anticipation.

Chapter 11 As An Option For Foreign Companies: Sometimes It Works and Sometimes It Doesn't

Lisa G. Beckerman
Partner
Akin Gump Strauss Hauer & Feld LLP
New York, NY

Certain companies organized under laws other than the United States with some or most of their assets located outside of the United States have filed for Chapter 11 protection. Sometimes, the Chapter 11 cases have been dismissed by the United States Bankruptcy Court (the "Bankruptcy Court") and sometimes the cases have not been dismissed by the Bankruptcy Court. A key factor appears to be the location of their major creditors and whether those creditors are subject to the jurisdiction of the Bankruptcy Court and/or choose to participate in the Chapter 11 process.

Avianca: In 2003, Aerovias Nacionales de Colombia S.A. Avianca ("Avianca"), an airline in Colombia organized under the laws of Colombia, filed Chapter 11 in the United States Bankruptcy Court for the Southern District of New York. Avianca's wholly-owned subsidiary and agent in the United States, Avianca, Inc., also filed Chapter 11. A motion to dismiss was filed by a creditor. The movant argued that that it would not be in the "best interests" of the two debtors or their creditors to allow the Chapter 11 cases to proceed and that Avianca should be compelled to file an insolvency proceeding in Colombia. The Bankruptcy Court denied the motion to dismiss.

The Bankruptcy Court held that Avianca, which had substantial property in the United States, was eligible to file Chapter 11 under section 109(b) of the United States Bankruptcy Code (the "Bankruptcy Code").[1] *In re Aerovias Nationales de Colombia S.A. Avianca and Avianca, Inc.,* 303 B.R. 1,19 (Bankr. S.D.N.Y. 2003). The creditor sought dismissal under section 305(a) of the Bankruptcy Code which provided at the time that "a court may dismiss or suspend all proceeding in a case, at any time, if

[1] There was no issue raised with respect to Avianca, Inc. as a New York corporation.

1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or

2) (A) there is pending foreign proceeding; and

(B) the factors specified in section 304(c) of this title warrant such dismissal or suspension."[2]

As there was no foreign proceeding pending, the Bankruptcy Court focused on whether both the creditors and the debtors would be better served by dismissal. The Bankruptcy Court concluded that Avianca would not be "better served" by dismissal of the Chapter 11 proceeding and the filing of a proceeding under Law 550 (Colombia's insolvency statute) because Avianca might not be able to obtain jurisdiction over its lessors and other major financial creditors (many of whom were US entities), Law 550 is a recent untested statute and does not provide for rejection of a burdensome lease, and the debtors' Colombian creditors had been participating fully in the Chapter 11 proceeding. *Id.* at 21-24. Subsequently, Avianca and Avianca, Inc. confirmed a plan of reorganization.

Yukos: Yukos Oil Company ("Yukos") filed Chapter 11 in the United States Bankruptcy Court for the Southern District of Texas in 2004. Deutsche Bank AG ("DB") moved to dismiss the Chapter 11 proceeding on six grounds: section 109(a) of the Bankruptcy Code, section 1112(b) of the Bankruptcy Code, forum non coveniens, inability to comply with the duties of a debtor, international comity, and the act of state doctrine. The Bankruptcy Court granted the motion to dismiss under section 1112(b) of the Bankruptcy Code.

[2] Section 305(a) has been amended as discussed below.

The Bankruptcy Court held that the $480,000 deposited in the Southwest Bank of Texas was sufficient property located in the United States to provide Yukos with standing to be a debtor under section 109(a) of the Bankruptcy Code.[3] *In re Yukos Oil Company*, 321 B.R. 396, 407 (Bankr. S.D. Tex. 2005). The Bankruptcy Court held that there was no basis for granting the motion to dismiss on the independent grounds of forum non coveniens, international comity, or the act of state doctrine. *Id*. at 407-409. The Bankruptcy Court then considered section 1112(b) of the Bankruptcy Code which provided at the time:

> Except as provided in subsection (i) of this section, on request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this chapter to a case under Chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause including
>
> (1) continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;
>
> (2) inability to effectuate a plan;
>
> (3) unreasonable delay by the debtor that is prejudicial to creditors;
>
> (4) failure to propose a plan under section 1121 of this title within any time fixed by the court;
>
> (5) denial of confirmation of every proposed plan and denial of a request made for additional plan or a modification of a plan;
>
> (6) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or modified plan under section 1129 of this title;
>
> (7) inability to effectuate substantial consummation of a confirmed plan;
>
> (8) material default by the debtor with respect to a confirmed plan;
>
> (9) termination of a plan by reason of the occurrence of a condition specified in the plan; or
>
> (10) nonpayment of any fees or charges required under chapter 123 of title 28.

[3] The bank account was in the name of Yukos USA, Inc., an entity created for the specific purpose of depositing such funds belonging to Yukos, but the Court held that the funds were property of Yukos.

In addition to these factors, Courts may consider the totality of the circumstances. The Bankruptcy Court held that Yukos' ability to effectuate a reorganization without the cooperation of the Russian government was extremely limited. *Id.* at 411. The Bankruptcy Court also noted that it is not clear that the Court could obtain personal jurisdiction over the pertinent parties sufficient to grant much of the relief sought. *Id.*

Arcapita: Arcapita Bank B.S.C. (c) organized under the law of Bahrain ("Arcapita") and six of its subsidiaries organized under various laws including the laws of the Cayman Islands filed for Chapter 11 in 2012 in the United States Bankruptcy Court for the Southern District of New York. A creditor moved to dismiss the Chapter 11 cases but did not provided sufficient evidence to support its motion to dismiss. The Bankruptcy Court denied the motion to dismiss. Subsequently, in 2013, the debtors confirmed a plan of reorganization that formed new corporations, transferred ownership to the creditors and restructured the debtors' obligations in a Sharia compliant manner.

Scrub Island: Two British Virgin Islands corporations, Scrub Island Development Group, Limited ("Scrub Island") and Scrub Island Construction Limited ("Scrub Island Construction") filed Chapter 11 in 2013 in the United States Bankruptcy Court for the Middle District of Florida, 18 days after a receivership proceeding was filed by FirstBank of Puerto Rico ("FirstBank"), a U.S. bank, in the High Court of the BVI Eastern Caribbean Supreme Court and a receiver was appointed. The debtors owned an island in the BVI which operated as a Marriott Autograph Collection hotel, condominiums, villas, retail shops and a marina. The debtors' headquarters were in Tampa, Florida. All of the shareholders and directors of Scrub Island were U.S. citizens. The management functions were performed by Mainsail Lodging & Development, a Florida corporation. In addition, the debtors had bank accounts in the United States.

FirstBank filed a motion to dismiss under sections 305(a) and 1112 of the Bankruptcy Code which was opposed by the debtors and other creditors. Section 305(a) provides that the Bankruptcy Court "after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time, if – (1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or (2) (A) a petition under section 1515 for recognition of a foreign proceeding has been granted; and (B) the purposes of chapter 15 of this title would be best served by such dismissal or suspension." 11 U.S.C. §305(a). The Bankruptcy Court denied the motion on the grounds that the receivership proceeding pending in the BVI is not a "collective proceeding," the receivership only benefits FirstBank, and the Bankruptcy Court has jurisdiction over all of the major creditors. In connection with section 1112, the Bankruptcy Court held that the evidence did not show so early in the cases that a plan of reorganization could not be confirmed or that the cases were filed in bad faith.[4] The Bankruptcy Court held that dismissal would not be in the best interest of the other creditors in the estates, only in the best interest of FirstBank.

Baha Mar: In 2015, Baha Mar Ltd. ("BML"), a Bahamian company, and fourteen affiliated debtors (all but one of which were organized under the laws of the Bahamas) filed Chapter 11 in the United States Bankruptcy Court for the District of Delaware. Two separate motions were filed to dismiss under sections 105(a), 109(a), 305(a) and 1112(b). The Bankruptcy Court granted the motions to dismiss with respect to all of the debtors other than Northshore Mainland Services, Inc. ("Northshore") which was incorporated under the laws of Delaware.

[4] Tr. of Hr'g at 17-20, In re Scrub Island Development Group Limited., No. 13-15285 (MGW) (Bankr. M.D. Fla. Dec. 6, 2013)

Because each debtor had a bank account in the United States, Northshore and BML had other property in the United States, and Northshore had employees and a place of business in the United States, the Bankruptcy Court held that the debtors met the eligibility requirements of section 109(a) of the Bankruptcy Code. *In re Northshore Mainland Services, Inc., et al.*, 537 B.R. 192, 201 (Bankr. D. Del. 2015). The Bankruptcy Court held that "cause" under section 1112(b) did not exist to dismiss the Chapter 11 proceedings because the petitions had been filed in good faith. *Id.* at 202-203. "The Debtors admit that they filed Chapter 11 cases in an effort to maintain control of the Project and to reorganize, rather than liquidate. Without more, this is not the type of "tactical advantage" that constitutes bad faith." *Id.* at 203.

The movants argued that the winding up petitions filed by the Bahamian Attorney General in the Bahamian Supreme Court would better serve the interests of both the debtors and the creditors.[5] *Id.* at 204. The debtors objected to abstention and argued that "The Bahamas are not necessarily the most economic and efficient location for restructuring since a number of the stakeholders have connections and interests outside of the Bahamas." *Id.* The Bankruptcy Court held that the debtors' preference for restructuring under the Bankruptcy Code "is understandable and entitled to some weight." *Id.* at 206. However, the Bankruptcy Court noted:

> I agree with Justice Winder's determination in his July 31, 2015 ruling that many stakeholders in the Project would expect that any insolvency proceedings would likely take place in the Bahamas, the location of this major development Project. I perceive no reason – and have not been presented with any evidence – that the parties expected that any "main" insolvency proceeding would take place in the United States. In business transactions, particularly now in today's global economy, the parties, as one goal, seek certainty. Expectations of various factors – including the expectations surrounding the question of *where* ultimately

[5] On June 29, 2015, the debtors filed an Originating Summons with the Supreme Court of the Commonwealth of The Bahamas (the "Bahamian Supreme Court") seeking recognition of the Chapter 11 cases and a stay of all legal proceedings involving the debtors. On July 22, 2015, the Bahamian Supreme Court rejected the Originating Summons with reasons to follow. On July 31, 2015, Justice Winder of the Bahamian Supreme Court issued a written judgment memorializing the Court's reasons for denying and dismissing the Originating Summons.

> disputes will be resolved – are importantly should respected, and not disrupted unless a greater good is to be accomplished. *Id.* at 206.

The Bankruptcy Court also considered comity and held that "considerations of comity support abstention pursuant to section *305(a)*. The proceedings that have occurred to date in the Bahamian Supreme Court demonstrate that the Debtors are being treated fairly and impartially." *Id.* at 207.

Primorsk: In 2016, Primorsk International Shipping Limited ("Primorsk"), a Cyprus corporation, and twelve of its subsidiaries organized under the laws of Cyprus and Liberia filed Chapter 11 in the United States Bankruptcy Court for the Southern District of New York.[6] Primorsk is managed by a Singapore corporation. The debtors have $350,000 on account with Sullivan & Cromwell LLP in New York and $330,000 on account with AlixPartners in New York, each as retainers and its ships sometimes call at ports in the United States. Its debt is issued in U.S. dollars and many of the holders of such debts are located in the United States. No motion to dismiss has been filed by any of the creditors to date. The debtors attempted to confirm a plan of reorganization but were unsuccessful and so filed a motion seeking to sell their assets pursuant to section 363 of the Bankruptcy Code which is pending before the Bankruptcy Court.

[6] The facts are set forth in the *Declaration of Holly Felder Etlin Pursuant to Rule 1007-2 of the Local Bankruptcy Rules for the Southern District of New York in Support of First Day Motions and Applications*, In re Primorsk International Shipping Limited (No. 16-10073), ECF No. 2.

Panel Discussion
International Aspects of U.S. Bankruptcy Cases: Is a U.S. Bankruptcy Court the Proverbial Roaring Deaf Lion in the International Forest?

by Robert G. Burns

From 2000 to 2007, the international freight market was flooded with demand for maritime shipping, which produced record-setting charter hire rates. To keep pace with demand, the shipping community went on a shopping spree, financed with low-cost debt, to acquire existing vessels at astonishing premiums and commence building new vessels at equally eye-popping prices. But the shipping sector utterly rammed the proverbial shoals in 2008, when a worldwide global recession halted demand. Vessel charter rates plummeted to historical lows due to massive overcapacity in the existing fleet. The situation was exacerbated by the aggressive building program, which was delivering new tonnage to the market on a steady basis. Under the weight of extremely low charter rates, shipping companies lacked the vital cash needed to fund daily vessel operating expenses, meet their new-build contract obligations or service their existing debt. By 2010, shipping companies began to regularly default on their loans, and inevitably, many shipping companies were left with no choice but to commence insolvency proceedings.

Many shipping companies are organized in jurisdictions where insolvency proceedings are simple liquidations conducted by a court-ordered trustee. Having invested millions of dollars in equity during the boom years, liquidation was a suboptimal outcome. The focus ultimately shifted overseas to the United States. While U.S. bankruptcy courts are not logical restructuring venues for foreigners, there is ample precedent where jurisdiction is granted to entities with seemingly no contacts to the U.S. Even where the company's assets, operations and employees are outside the U.S., a shipping company may utilize U.S. bankruptcy courts to commence

insolvency proceedings. Several factors unique to the shipping industry create rich jurisdictional questions. First, the company's primary assets – the vessels – constantly move from one jurisdiction to another. Second, the company's creditors are typically located all over the world. Third, the company may be organized under the laws of one country but subject to loan documentation governed by the laws of another. Given a shipping company's global reach, the developments during the shipping depression created a large body of law substantiating that a shipping company with even a peppercorn of U.S. property may be eligible to file for Chapter 11 protection in the U.S. However, while shippers found safe harbor in U.S. courts, the relief had its legal and practical limitations.

Jurisdiction – Eligibility

U.S. Courts have long accommodated international companies because the threshold for jurisdiction is very low. The shipping cases established how low that threshold is. Under the Bankruptcy Code, to be eligible for relief under Chapter 11 a debtor must have a domicile, a place of business, or property in the U.S.[1] Marco Polo[2] and TMT[3] are examples of the nominal "property" requirements for Chapter 11 eligibility.

Case Study – Marco Polo

Marco Polo's operations and headquarters were located in Amsterdam, The Netherlands. Marco Polo operated six vessels sailing under the Liberian flag. French and English banks made loans, and the law of the United Kingdom governed the loan documents. Marco Polo's only property in the U.S. was in the form of a prepetition retainer paid to its professionals on behalf of

[1] *See* 11 U.S.C. § 109.
[2] *In re Marco Polo Seatrade B.V., et al.*, Case No. 11-13634 (Bankr. S.D.N.Y. Sept. 27, 2011).
[3] *See In re TMT Procurement Corp. et al.*, Case No. 13-33763 (Bankr. S.D. Tex. June 20, 2013).

the company and certain affiliates, and an interest in a vessel pool account located in a New York bank. After Marco Polo defaulted on its loan obligations, one of its lenders took aggressive tactics by arresting vessels and sweeping the cash that secured the loan obligations. The company filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Southern District of New York. Marco Polo's secured lenders quickly moved to dismiss the Chapter 11 cases pursuant to section 1112(b) of the Bankruptcy Code. Among other things, the lenders contested the existence and sufficiency of the company's assets in New York. They also argued Marco Polo's connections to the U.S. were so tenuous that the Bankruptcy Court should dismiss the cases on grounds of lack of jurisdiction or the presence of a bad faith filing, or for the Bankruptcy Court to abstain from hearing the cases on the basis that the interests of the Debtors and creditors would be better served through an out of court restructuring to occur. Alternatively, the lenders alleged that the automatic stay should be lifted to permit the lenders to take actions upon the collateral.

In finding jurisdiction, the Bankruptcy Court denied the lenders' motion to dismiss, holding that the funds held in the U.S. were sufficient in Marco Polo's case to permit eligibility under the low standard required under Chapter 11. The Court explained in its bench ruling that "109(a) simply uses the word 'property' property in the United States. It doesn't say that that property needs to be significant in amount. It just has to be here."[4] Furthermore, the Bankruptcy Court declined the vociferous lender's requests for dismissal on the basis that there was no

[4] See Transcript of Motion of the Royal Bank of Scotland PLC Pursuant To 11 USC 105(A), 362(D), 305(A), and 112(B) for Entry of an Order (I)(A) Suspending Chapter 11 Cases or Granting Relief from the Automatic Stay and (B) Dismissing the Chapter 11 Cases, or Alternatively, (II) Dismissing Chapter 11 Cases or Granting Relief From the Automatic Stay Credit Agricole's Response in Opposition to Debtors' Motion For Contempt Sanctions Pursuant to Federal Rule of Bankruptcy Procedure 9020 for Violation of the Automatic Stay and Cross Motion to Dismiss or, in the Alternative, to Lift Automatic Stay Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Obtain Post-Petition Financing, (II) Granting Adequate Protection, (III) Scheduling a Final Hearing And (IV) Granting Related Relief, Volume 3 in *In re Marco Polo Seatrade B.V., et al.*, Case No. 11-13634 (Bankr. S.D.N.Y. Sept. 27, 2011).

evidence of a bad faith filing after evidence of the Debtors' true financial trouble and lack of ability to successfully reorganize in the Netherland or out of court. The Bankruptcy Court also declined to abstain from ruling or from lifting the stay due to the complete lack of legal basis for such a decision and the presence of adequate protection to the lenders. The Court stated that "it is obvious . . . the interests of creditors are better served by maintaining the case as a fully active Chapter 11 case[.]"[5]

Case Study - TMT

TMT's operations and headquarters were located in Taipei, Taiwan. The company's creditors spanned the globe. The company paid retainers to its U.S. professionals, which were held in a U.S. bank account on the company's behalf. The primary challenge to the commencement of their Chapter 11 cases in the United States Bankruptcy Court for the Southern District of Texas was, among others, that the bankruptcy court did not have subject matter jurisdiction over TMT given their *de minimis* U.S. contacts. After a two-day evidentiary hearing, the Bankruptcy Court concluded that it did, in fact, have subject matter jurisdiction over TMT's Chapter 11 cases.[6] Specifically, the bankruptcy court found that TMT was eligible to be debtors under section 109 of the Bankruptcy Code based on prepetition retainers held by the company's U.S.-based financial and legal advisors.[7]

Practical Limitations

As shown above, jurisdiction is not boundless. Courts – and aggressive creditors – have ample tools to limit the lay days in court. In practice, courts have shown a reluctance to grant

[5] *See Id*. at 494.
[6] *See In re TMT Procurement Corp. et al.*, Case No. 13-33763 (Bankr. S.D. Tex. June 20, 2013).
[7] *See Id*.

long extensions of the exclusivity period, preferring instead to keep tight lines on the restructuring timeline. Moreover, as the case matures, and in the absence of a viable restructuring alternative, courts may show an increasing willingness to lift the automatic stay to allow secured lenders to sell the assets and satisfy their claims. So while Chapter 11 is clearly a safe port in the storm, patient creditors may ultimately blockade a debtor from a successful emergence by running out the clock.

Recent cases have also shown there are practical limitations to foreign enforcement of bankruptcy relief, particularly the automatic stay. The main issue with enforcing the stay is that foreign creditors – with absolutely no U.S. contacts – are not at significant risk of being subject to sanctions for violating the stay. Moreover, they often have a sympathetic local court that will grant relief, further muddying the waters on jurisdictional issues. In the TMT case, for example, the debtors had vessels arrested in multiple jurisdictions. Admiralty courts in Antwerp, China, Egypt, Gibraltar and South Africa, among others, all refused to recognize the stay and instead entered a series of orders authorizing judicial sales of the vessels. The only court to give a passing glance to the automatic stay was in Singapore. While it did enter orders to allow for the sale of an arrested vessel to satisfy a variety of maritime lien claims, the Singapore Admiralty Court, for reasons of comity, did stay the entry of the sale orders to allow the debtors to post adequate security to facilitate the vessel's release. However, some foreign courts have permitted the U.S. cases to run their course prior to permitting any further actions which violate the U.S. automatic stay or put in risk the debtor's opportunity to reorganize. In Overseas Shipholding Group, Inc.[8], the multi-jurisdictional Debtors, after filing for Chapter 11 protection in the Southern District of New York, obtained a court order from the High Court of South Africa

[8] *In re Overseas Shipholding Group, Inc. et al*., Case No. 12-20000 (Bankr. D. Del. 2012).

which recognized and fully enforced the automatic stay imposed by the S.D.N.Y. proceedings. This order also prohibited any additional or conflicting actions from being brought against the Debtors in the South African courts during the pendency of the U.S. case.

Takeaways:

- Out of court restructurings remain the less expensive option and are less threatening to lenders. This should be the first choice scenario only followed by more extreme measures if the lenders leave no other choice.

- Chapter 11 may be the only insolvency regime in the world that can offer an international shipping company with vessels around the globe a chance to reorganize. In order to demonstrate eligibility, the company must own property in the U.S., even a retainer paid on behalf of all debtors, and be able to demonstrate the cases were filed in good faith on the belief a reorganization is possible.

- If the company is seriously considering Chapter 11 as an option, the sooner the company engages restructuring professionals and get them involved in discussions with the lenders, the better, and the more restructuring options will be available.

US Restructuring Process: Problems Faced by Off-Shore Companies and Directors

1. **Concept of Debtor-in-Possession**: Because most commonwealth countries replace a debtor (and its board) with a liquidator, some non-US companies are concerned about the corporate effects of a US bankruptcy.

2. **Concept of Cram-Down**: This concept does not exist in most parts of the world. For instance, in Canada, ALL creditor classes have to approve a plan in order for it to go effective.

3. **Concept of Transparency**: The US bankruptcy process is a very transparent process. Parties are able to access financial and other information. Access to information in non-US jurisdictions is harder to come by.

4. **Concept of Consensus Building Towards a Plan of Reorganization**: Because of the lack of a cram-down option in non-US jurisdictions and the replacement of the debtor by a liquidator, the normal give and take negotiations typical in a US bankruptcy oftentimes don't occur. The skills associated with playing parties off of each other to achieve a consensual plan are not as developed in Off-shore as they are in the US.

Grant Lyon. Mr. Lyon has more than 25 years of distressed management experience and has served as the financial advisor for numerous corporate restructuring engagements. Mr. Lyon's expertise includes out-of-court restructuring, claims analysis, securities valuation, debtor-in-possession financing, solvency analysis, expert testimony on section 1129 matters and litigation support. He has served as a Chapter 11 trustee numerous times across multiple jurisdictions. Mr. Lyon also serves as an expert witness, having testified in over eight different jurisdictions on issues ranges from damages to valuation. He has also sat on over 13 boards of directors, primarily of companies in financial distress. Mr. Lyon is a Certified Public Accountant and a graduate of Brigham Young University.