Maximizing the Estate: It's Not Just Avoidance Actions Anymore!

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MAXIMIZING THE ESTATE

It's Not Just Avoidance Actions Anymore? Analysis of Potential Claims and Assets, including D&O Claims, Corporate Waste, Net Operating Loss Carrybacks and Carryforwards, Parent and Affiliate Issues, What Can the Bankruptcy Court Decide and Do You Want to Be There? How Do You Get Paid?

About the Panel

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Landing the Case: How Does a Trustee Approach Maximizing the Estate When a Case Comes in the Door

- Process of a trustee in understanding the estate, potential recoveries and ways to maximize estate: who is involved in the process, what does process look like?
- How much money do avoidance actions typically garner? What are the problems with over-reliance on these? (Collectability, cost, etc.)
- From your experience, and recognizing that all cases are different, what is the *typical* composition of estate assets?
- How do trustees and Chapter 11 debtors deal with *cost* of maximizing estate --- contingent fees; hybrid fees; special counsel arrangements; other

I. Avenues for Recovery: Non-Avoidance Litigation Claims a Trustee Can Pursue

A. Common law tort claims: A trustee or debtor-in-possession can pursue traditional tort claims

Kapila v. Militzok et al. (In re Edelsten), Case No. 15-60764 (S.D. Fla. Nov. 18, 2015). The Chapter 7 trustee sued the debtor's former attorneys for negligently advising and representing the debtor in connection with various business disputes at a time the law firm had a conflict of interest. Claim were brought under various theories including professional negligence, breach of contract, breach of fiduciary duty, constructive fraud, and violation of Florida's Deceptive and Unfair Trade Practices Act ("FDUTPA"). Defendants moved to dismiss the counts alleging breach of contract, constructive fraud, and violation of FDUTPA. Upon removal, the district court found that the trustee properly stated claims for breach of contract and constructive fraud, but that FDUPTA was inapplicable because the law firm did not engage in "trade or commerce" as required by the statute.

Bakst v. Moyle, Flanigan, Katz, Brenton, White & Krasker, P.A., 2013 U.S. Dist. LEXIS 104280 (S.D. Fla. July 25, 2013). The court denied defendant law firm's motion to dismiss trustee's claims for attorney malpractice and aiding and abetting breach of fiduciary duty. The court rejected the defendant's argument that the trustee lacked standing to pursue the claims and that the court lacked subject matter jurisdiction.

Welt v. EfloorTrade, LLC (In re Phoenix Diversified Inv. Corp.), 439 B.R. 231 (Bankr. S.D. Fla. 2010). The court held that the trustee had standing to bring negligence, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and successor liability claims against various defendants including the debtor's former business advisors and accountants.

- Note: The *in pari delicto* may prevent recovery from when the debtor acted in concert with the defendant to perpetrate the illegal, fraudulent

to inequitable conduct underlying the cause of action. For example, in *Ueker v. Zentil (In re Zentil)*, BAP No. CC-15-1109 (Dec. 22, 2015), the trustee sued the debtor company's former attorney, claiming that the attorney helped managers of the debtor perpetrate a fraud. The trial court dismissed the action on the basis that the claims were barred by the *in pari delicto* doctrine. The decision was affirmed on appeal. The court focused on the language of § 541 that limits property of the estate to "all legal or equitable interests of the debtor in property *as of the commencement of the case.*" (emphasis added). The court followed the 3d Circuit (and noted consistent decisions from other circuits) in finding that the plain language of § 541 prevents a court from considering post-petition events, such as the appointment of a bankruptcy trustee as an innocent successor.

- The availability of the *in pari delicto* defense is "an essentially equitable and necessarily factbound apportionment of responsibility." *In re Phoenix Diversified*, 439 B.R. at ** 25-26. Accordingly, it is not an issue that should not be decided on a motion to dismiss. *Id.*

B. Veil Piercing: *Politte v. United States*, 2015 U.S. App. LEXIS 2380 (9th Cir. Feb. 17, 2015). The 9th Circuit affirmed the district court's finding that individuals and another corporate entity owned by the individuals were alter egos of the debtor and liable for the debtor's IRS debt for unpaid taxes.

1. Traditional Veil-Piercing: "The usual result of piercing the corporate veil is that the controlling shareholder or shareholders become liable for the corporate liabilities." *Estudios v. Swiss Bank Corp.*, 507 So. 2d 1119, 1120 (Fla. 3d DCA 1987).

2. Reverse Veil-Piercing: The opposite situation, however, is equally available as a remedy "[w]here a creditor proves that a controlling shareholder organized or used the corporation to deceive or defraud his personal creditors, the separate corporate existence will be disregarded and the corporation and the shareholder will be treated as one and the same." Frequently referred to as "reverse corporate piercing," the primae facie case involves the same showing as a "normal" cause of action to pierce the corporate veil. *Braswell v. Ryan Investments*, 989 So. 2d 38, 38 (Fla. 3d DCA 2008).

3. Test/Standard for Veil-Piercing: The essential elements are that: (1) the corporation is a mere instrumentality of the shareholder; (2) the shareholder engaged in improper conduct using the corporate form; and (3) the improper use caused injury to the claimant.

    a. The corporation is a mere instrumentality of the shareholder: "[T]he shareholder dominated and controlled the corporation to such an extent that it did not have an independent existence and the

shareholder was in fact an alter ego of the corporation . . . ." *In re Big Foot Properties, Inc.*, 2012 WL 6892645, *4 (U.S. Bankruptcy Court M.D. Fla. May 25, 2012). A showing that corporate funds were used for the individual's benefit is an important factor relevant to whether the individual dominated the corporate "to such an extent as to negate its separate identity." *Eckhardt v. U.S., 463 Fed. Appx*. 852, 856 (11th Cir. 2012) (applying Florida law).

b. The shareholder engaged in "improper conduct" using the corporate form: Improper conduct must be shown in order to have the corporate veil pierced. *John Daly Enterprises, LLC v. Hippo Golf Co.*, 646 F. Supp. 2d 1347 (S.D. Fla. 2009) (Florida courts require proof of "deliberate misuse of the corporate form tantamount to fraud before they will pierce the corporate veil."); *Dania Jai-Alai Palace, Inc. v. Sykes*, 450 So. 2d 1114, 11121 (Fla. 1984) (making clear that the Florida Supreme Court has always held that an improper showing is required before a court will pierce the corporate veil). Need to prove that the shareholder organized or used the corporation to mislead or defraud his creditors.

c. The improper or fraudulent use of the corporation caused injury to the claimant:

C. Recovery of intercompany receivables: *Liscinski v. Freeport Paper, Inc. (In re Princeton Paper Prods.)*, 2015 Bankr. LEXIS 3831 (Bankr. D.N.J. Nov. 6, 2015). Prior to the petition date, and on the advice of debtor's accountant, the debtor and two affiliates consolidated intercompany obligations, resulting in the elimination of two receivables (totaling more than $1.2 million) owed to the debtor by affiliates. Post-petition, the trustee sought to recover the receivables under § 548 as having been constructively fraudulent. The court found that although the "accounting manipulation may have been prudent from an accounting perspective," it was "deleterious to creditors." The court found that all of the elements for a finding of constructive fraud were present, and judgment was entered against the affiliates.

D. Assigned claims: "A trustee has standing to sue on assigned creditors' claims where recovery of damages would inure to the benefit of the bankruptcy estate." *Tulis v. M.E.-R.E. Holding, LLC, et al, (In re Barnett)*, Adv. No. 14-09036(CGM) (Bankr. S.D.N.Y. Dec. 29, 2015). In *Barnett*, a creditor of the debtor assigned its security interest in certain notes to the trustee. The trustee agreed to enforce the notes at the expense of the estate and then pay the creditor a sum recovered from the litigation. The obligator on the notes objected to the trustee's standing in an action to collect, and the court found that the trustee did have standing as he was seeking to enforce the notes for the benefit of the estate. The amount the trustee agreed to pay the assignor was much less than the total amount due on the notes so the primary recovery would be to the estate.

E. Surcharge for abandoned assets: *Southwest Securities, FSB v. Segner (In re Domistyle, Inc.)*, Case No. 14-41463 (5th Cir. Dec. 29, 2015). The debtor owned property encumbered by several mortgages, but the trustee believed he could sell the property for an amount sufficient to bring additional recovery into the estate. Ultimately, the trustee was unsuccessful and filed a motion to abandon the property. While this motion was pending the trustee sought to surcharge one of the creditors for ongoing expenses incurred in preserving the property, and the creditor objected. The question before the court was: Should the estate or the secured creditor pay the property's maintenance expenses incurred while the trustee was trying to sell the property? The court answered in the affirmative. The testimony of an experienced real estate broker demonstrated that the value preserved was at least as much as the amount expended by the trustee.

F. Punitive damage claims for violation of the automatic stay: *See Parker v. Credit Cent. South, Inc. (In re Parker)*, 2015 U.S. App. LEXIS 21987 (11th Cir. Dec. 17, 2015) (affirming award of punitive damages and attorney's fees against creditor for acting in reckless disregard of the automatic stay); *In re WVF Acquisition, LLC*, 420 B.R. 902 (Bankr. S.D. Fla. 2009) (granting debtor's motion to hold creditor in contempt for willfully violating the automatic stay and awarding actual and punitive damages).

G. Distributions from spendthrift trusts: *Thompson-Rossbach v. Doeling (In re Thompson-Rossbach)*, Case No. 15-6012 (8th Cir. Dec. 2, 2015). The debtor was the beneficiary of a spendthrift trust providing that any principal could be distributed to a beneficiary, and be fully alienable, once the beneficiary reached the age of 21. The 8th Circuit upheld the bankruptcy court's decision that the debtor's interest in the trust was property of the estate because the debtor was over the age of 21 and, therefore, the spendthrift clause had no effect. The debtor's interest in the trust was fully alienable on the petition date and was properly distributed to the debtor's creditors.

H. Objections to administrative expenses: *The Bankruptcy Law Firm, PC v. Siegil*, BAP No. CC-15-1109-TaKuKi (9th Cir. BAP Dec. 22, 2015). The debtor's case began in Chapter 11 and later converted to Chapter 7. A law firm holding a Chapter 11 administrative expense claim for fees opposed the trustee's motion for substantive consolidation. The bankruptcy court allowed consolidation, but was subsequently reversed by the BAP. The law firm later filed a motion seeking its fees and costs incurred in opposing consolidation as a Chapter 7 administrative expense under § 503(b)(1)(A). The trustee objected to the motion, and argued that the fees and costs being sought were grossly inflated. The bankruptcy court found that the law firm did provide a benefit to the estate, but the fees and costs being sought were excessive. Accordingly, the motion was granted in a reduced amount. The BAP affirmed, finding that the bankruptcy court did not abuse its discretion in reducing counsel's hourly rate, or in finding that some of the time spent by counsel was not necessary within the meaning of § 503(b)(1)(A). In addition, the bankruptcy court did not err in denying fees and costs for preparing and litigating the § 503(b) motion.

I. Personal injury claims: *Anderson v. Seven Falls Co. (In re Davies)*, No. 14-1515 (10th Cir. Dec. 31, 2015). The trustee was allowed to pursue the debtor's personal injury action and recover to the extent of the total amount of creditors' claims plus the trustee's expenses. The trustee could not recover any amounts that would have been surrendered to the debtor as the debtor initially failed to disclose the existence of the personal injury action prior to receiving her discharge.

II. Litigation Issues

A. Legal Impediments to Avoidance Claims

- Mere Conduit Defense: An avoidable transfer cannot be recovered under § 550(a) from an entity that acted as a mere conduit for the transfer. Such an entity, lacking any control or independent direction over the transfer, is not an "initial transferee" under the statute. *See Menotte v. United States (In re Custom Contractors, LLC),* 745 F.3d 1342 (11th Cir. 2014) (The mere conduit or control test operates as a judicially created equitable exception to § 550(a). Where an initial transferee lacks dominion and control over the transferred property, cannot ascertain the transferor's solvency, or lacks knowledge of the source of the funds, it would be inequitable to hold it liable in an avoidance action. Accordingly, courts look at the totality of the circumstances surrounding the transfer to be sure the result is equitable). *See Nordberg v. Sanchez (In re Chase & Sanborn Corp.)*, 813 F.2d 1177 (11th Cir. 1987) (finding that debtor did not have sufficient control over transferred funds to render them property of the estate); *Nordberg v. Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196, 1199 (11th Cir. 1988) (explaining that it would be inequitable to hold a defendant bank responsible for a fraudulent transfer as "initial transferee" when it never controlled funds that passed through a customer's account); *IBT Int'l, Inc. v. Northern (In re Int'l Admin. Servs., Inc.)*, 408 F.3d 689 (11th Cir. 2005) (noting that the mere conduit rule presumes that the conduit is acting in good faith, and is an innocent participant in the underlying fraud).

- "Control" has two components:[1]
  a. The power to designate which party will receive the funds; and
  b. The power to actually disburse the funds at issue to that party

- Good Faith Requirement: The 11th Circuit recognized a good faith requirement to the mere conduit defense in *Martinez v. Hutton (In re Harwell)*, 628 F.3d 1312 (11th Cir. 2011). The debtor's attorney was assumed to be the mastermind of a fraudulent transfer scheme involving his client and his firm's trust account. The attorney sought summary judgment on a fraudulent transfer action on the basis that he was not an initial transferee under § 550(a) because he lacked control over the funds. The bankruptcy

[1] *Kapila v. Phillips Buick-Pontiac-GMC Truck, Inc. (In re ATM Fin. Servs., LLC)*, 2011 Bankr. LEXIS 2394 at *25 (Bankr. M.D. Fla. 2011) (citing *In re Bankest Capital Corp.)*, 374 B.R. 333 (Bankr. S.D. Fla. 2007).

court agreed despite the attorney's involvement in the fraudulent transfer scheme and granted summary judgment. The district court affirmed. On further appeal, the 11th Circuit reversed, finding that the attorney was an initial transferee under the statute because he received the subject funds and deposited them into his trust account. Next the court considered whether the attorney was entitled to equitably escape his "initial transferee" status. The court recognized that the mere conduit defense is meant to protect innocent participants in the transfer; therefore, the attorney must have acted in good faith. The court ultimately determined that the attorney was not entitled to summary judgment because an issue of fact existed as to whether the attorney acted in good faith. The court noted:

> In the vast majority of cases, a client's settlement funds transferred in and out of a lawyer's trust account will be just like bank transfers, and lawyers as intermediaries will be entitled to mere conduit status because they lack control over the funds. Mere conduits, such as lawyers and banks, do not have an affirmative duty to investigate the underlying actions or intentions of the transferor.

- Avoidance plaintiffs are frequently able to defeat the "mere conduit" defense with evidence refuting the alleged conduit's "good faith." But there may be a question whether "good faith" is truly an element of the defense. Many of the later Eleventh Circuit cases say that it is. *Harwell*, *supra*; *Perlman v. Wells Fargo Bank, N.A.*, 559 Fed. App'x 988 (11th Cir. 2014); *Custom Contractors*, *supra*. But earlier Eleventh Circuit cases do not mention good faith as an element of the defense. *In re Chase & Sanborn Corp. (Nordberg v. Sanchez)*, 813 F.2d 1177 (11th Cir. 1987); *In re Chase & Sanborn Corp. (Nordberg v. Societe Generale)*, 848 F.2d 1196, 1200-01 (11th Cir. 1988); *In re Pony Express Delivery Services, Inc. (Andreini & Co. v. Pony Express Delivery Services)*, 440 F.3d 1296, 1302-04 (11th Cir. 2006). When presented with conflicting panel decisions, the one that "was first in time . . . controls." *Akins v. Fulton Cty.*, 420 F.3d 1293, 1307 n.5 (11th Cir. 2005); *see also*, *e.g.*, *Cohen v. Office Depot, Inc.*, 204 F.3d 1069, 1073 (11th Cir. 2000) ("where two prior panel decisions conflict[,] we are bound to follow the oldest one.").

  The seminal "mere conduit" case in the modern era is *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890 (7th Cir. 1988). Neither Bonded nor the circuit level decisions following it[2] has imposed a

[2] *See Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988) (The minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes."); *see also*, *e.g.*, *In re Bullion Reserve of N. Am)*, 922 F.2d 544, 548-49 (9th Cir. 1991)(adopting reasoning of *Bonded Financial* and holding that corporate director was not a transferee when under a contractual duty to pledge stock immediately to another party); *In re Coutee*, 984 F.2d 138, 141 (5th Cir. 1993) (adopting *Bonded Financial*; bank held to be initial transferee because it applied deposit to satisfaction of loan; intermediary who transmitted debtor's funds to bank, however, was a mere conduit); *In re First Sec. Mortg. Co.*, 33 F.3d 42, 43-44 (10th Cir. 1994) (adopting *Bonded Financial* and holding that defendant bank was a mere conduit where it was

"good faith" requirement for assertion of the defense; these decisions focus solely on the element of dominion and control.

Examples: A bank can be a mere conduit in some instances, and an initial transferee in others. For example, a bank is an initial transferee if it received the transfer in satisfaction of a debt. *Menotte v. United States (In re Custom Contractors, LLC)*, 745 F.3d 1342, 1350 (11th Cir. 2014) In contrast, a bank that merely receives funds as a deposit into a customer's account does not exercise control over those funds, and is not an initial transferee. *Id.* at 1350.

- IRS as an initial transferee: *Kane & Kane v. United States*, 479 B.R. 617 (Bankr. S.D. Fla. 2010)(J. Kimball): The court held that principals who directed the debtor corporation to issue checks to the IRS to satisfy personal tax obligations were not initial transferees. The IRS argued that the transfers effectively involved two steps: first, a distribution by the debtor to the principals; and second, payment by the principals to the IRS. According to the IRS, it was a subsequent transferee that took for value in good faith. Quoting from the 11th Circuit's opinion in *Nordberg v. Arab Banking Corp. (In re Chase & Sanborn Corp.)*, 904 F.2d 588, 598 (11th Cir. 1990), the court recognized that the extent of a principal's control over a debtor, including the principal's direction of the transfers, is irrelevant to the "initial transferee" issue. Therefore, the IRS was the initial transferee for purposes of § 550(a).

- IRS as a mere conduit: *Menotte v. United States (In re Custom Contractors, LLC)*, 745 F.3d 1342 (11th Cir. 2014). The debtor corporation made payments to the IRS on behalf of the debtor's principal for personal income tax liability. The transfers were actually *pre*-payments for the principal's *expected* tax liability. The trustee sought to recover the payments and the bankruptcy court ruled that the IRS was an initial transferee from whom recovery could be sought. The district court affirmed, but the 11th Circuit reversed upon finding that the IRS was a mere conduit for the transfers because the IRS ultimately refunded the money once it was determined that the debtor operated at a loss for that tax year, and the principal had no tax liability. The court likened the IRS to a bank holding a deposit for its customer.

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obligated to make funds transferred into checking account available to owner of account on demand); *In re Reeves*, 65 F.3d 670, 676 (8th Cir. 1995) (approving *Bonded Financial* and noting that "[a]t least seven other circuits have held that, to be an initial transferee, a party must have dominion and control over the transferred funds"); *In re S.E. Hotel Props. L.P.*, 99 F.3d 151, 154 (4th Cir. 1996) (adopting and quoting *Bonded Financial*: "[T]he minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purpose."); *In re Finley*, 130 F.3d 52, 57-59 (2d Cir. 1997) (adopting *Bonded Financial*; holding that insurance broker was not a transferee where it promptly remitted funds received from debtor, usually within a matter of days, and did not retain commissions); *In re Anton Noll, Inc.*, 277 B.R. 875, 879 (1st Cir. 2002) (adopting *Bonded Financial*, *infra*; "[T]o be held to the standard of the initial transferee, a transferee must have the legal right to use the funds to whatever purpose he or she wishes, be it to invest in 'lottery tickets or uranium stocks.'"); *In re Hurtado*, 342 F.3d 528, 533 (6th Cir. 2003) (accepting rule of *Bonded Financial* and referring to test as "widely adopted"; "an initial transferee must have 'dominion' over the funds to be an 'initial transferee' under the statute").

- § 546(e) Defense: The § 546(e) "safe harbor" defense provides, in relevant part, that except where a trustee proceeds under § 548(a)(1)(A) for actual fraud, a trustee may not avoid a transfer that is:

    - A settlement payment or other payment made in connection with a securities contract; and

    - Made by or to (or for the benefit of) a financial institution.

    - There has been a split among the circuit courts as to the breadth of the protection afforded by this safe harbor provision.

- Majority View: Most circuit courts having addressed this provision have taken such an expansive view of § 546(e) that nearly any type of transfer connected to a securities contract will be protected. *See Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329 (2d Cir. 2011) (finding that Enron's redemption of commercial paper prior to maturity qualified as a settlement payment entitled to protection); *Grede v. FCStone, LLC*, 746 F.3d 244 (7th Cir. 2014) (declining to "depart from the deliberately broad text of § 546(e)" because it applies only to the securities section of the economy, and there is a need for finality in securities transactions); *In re Plassein Int'l Corp.*, 590 F.3d 252 (3d Cir. 2009) (holding that a transfer was protected even though the bank was acting as a mere conduit); *In re QSI Holdings, Inc.*, 571 F.3d 545 (6th Cir. 2009) (holding that financial institutions need not have a benefit interest in the funds at issue for the transfer to be protected under § 545(e)).

    Even when the securities do not exist, such as in the Madoff Securities Ponzi scheme, payments to customers may be protected. *See Picard v. Katz*, 466 B.R. 208 (S.D.N.Y. 2012).

- Minority View: The Eleventh Circuit's decision in *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996), is considered the minority view. In *Munford*, the 11th Circuit held that a transaction is not protected by § 546(e) when the financial institution acts simply as a conduit or intermediary, and has no beneficial interest in the funds being transferred.

- The Bankruptcy Court for the Southern District of Florida retreated from *Munford* in *Parcside Equity, LLC v. Menotte (In re CLSF III IV, Inc. et al.)*, Case No. 14-01600-EPK, Adv. No. 13-01479-EPK, Sept. 11, 2015 (Doc. No. 57). The trustee sought to recover payments made by the debtor to defendant Parcside. The court determined that the transfers were protected by § 546(e) because the transfers were made from the debtor's trust accounts at TD Bank and/or Wells Fargo to Parcside's bank accounts at Chase. The court reasoned

that TD Bank, Wells Fargo, and Chase are all "financial institutions" within the meaning of § 101(22) and, therefore, the transfer at issue was both "from" and "to" a financial institution for purposes of the safe harbor protection. The court, noting other circuits' disagreement with *Munford*, found that Congress disavowed *Munford* when it amended the statute in 2006 by adding the parenthetical "(or for the benefit of)" after "made by or to." In other words, any settlement payment or other payment made in connection with a securities contract is protected if it is made through a bank, even if the bank acts as a mere conduit.

- The Supreme Court denied review of a case implicating this issue in the context of a Ponzi scheme. In *Picard v. Fishman Trust*, Case No. 14-1128; 1129 (June 22, 2015). The trustee of Madoff Securities and the Securities Investor Protection Corporation ("SIPC") appealed the Second Circuit's decision rejecting a *per se* exception to § 546(e) for transfers arising from a Ponzi scheme.

B. Other Limitations to Avoidance Actions

- Limited scope of the "Ponzi Scheme Presumption": In *Kapila v. Phillips*, *supra*, the court held that the presumption allowing an inference of fraudulent intent in Ponzi scheme and other fraud cases does not apply to all transfers made by a debtor. In that case, the trustee filed an action under § 548 to recover payments made to the defendant for vehicles the debtor never owned or possessed. The trustee argued, among other things, that the debtor engaged in a Ponzi scheme and relied on the Ponzi scheme presumption to establish that the debtor had the requisite fraudulent intent when making the transfers. The court rejected the trustee's broad interpretation of the Ponzi scheme presumption, explaining that the presumption establishes fraudulent intent only when the subject transfer is made "in furtherance of" the scheme. Even though the funds transferred were obtained by the debtor fraudulently, the trustee had not demonstrated that the payments at issue were made in furtherance of the fraudulent scheme.

- Payments made by an insolvent debtor to satisfy the obligations of a third party are not "*per se*" fraudulent transfers. In *In re PSN USA, Inc.*, Case No. 14-15352 (11th Cir. Sept. 4, 2015), the Eleventh Circuit held that the debtor, a cable television channel, received reasonably equivalent value in exchange for payments made to a satellite services company on behalf of its parent corporation. Although the debtor subsidiary was not a party to the satellite services contract between the parent and satellite services company, the debtor received an indirect benefit that was sufficient to satisfy the "reasonably equivalent value" requirement. The transfers were not avoidable.

- In Pari Delecto

A. Definition. The doctrine of *in pari delicto* is an equitable doctrine that states a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing. *In re Fuzion Technologies Group, Inc.*, 322 B.R. 225 (Bankr. S.D. Fla. 2005).

B. Policy. The doctrine of *in pari delicto* is based on the policy that "courts should not lend their good offices to mediating disputes among wrongdoers"; moreover, "denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306 (1985).

C. Application.

1. Actions under Sections 544 and 548: In determining whether the doctrine of *in pari delicto* applies to a debtor-in-possession or trustee seeking to avoid fraudulent transfers, courts have found that the *in pari delicto* defense is inapplicable when a trustee brings an action under Sections 544(b) and Section 548. *In re Fuzion Technologies Group, Inc.*, 322 B.R. 225 (Bankr. S.D. Fla. 2005). When acting under Sections 544 and 548, a trustee is vested with the rights of creditors and is not limited to the rights of the debtor as of the commencement of the case. *See Official Committee of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145, 1152 (11th Cir. 2006) (stating that Section 544(b) provides that the trustee may void pre-petition fraudulent conveyances after the commencement of the bankruptcy); *In re Fuzion Technologies Group, Inc.*, 322 B.R. 225 (Bankr. S.D. Fla. 2005) (stating that the *in pari delicto* defense is inapplicable when a trustee brings an action under Sections 544(b) and Section 548);

2. Actions under Section 541: Courts have found the defense applicable to causes of action acquired under Section 541. *In re Fuzion Technologies Group, Inc.*, 322 B.R. 225 (Bankr. S.D. Fla. 2005). Section 541 of the Bankruptcy Code provides that property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). "Legal interests or equitable interests" include any causes of action that the debtor possesses. *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 356 (3d Cir. 2001). Upon the filing of a petition, "[a] bankruptcy trustee stands in the shoes of the debtor and has standing to bring any suit that the debtor could have instituted." *O'Halloran v. First Union Nat'l Bank*, 350 F.3d 1197, 1202 (11th Cir. 2003). Thus, if a claim of the debtor pre-petition would have been subject to the *in pari delicto* defense, then the same claim, when asserted by the trustee subsequent to the commencement of the case, is subject to the same affirmative defense. *Id*.

III. Substantive Consolidation

A. Substantive Consolidation of Debtors in Bankruptcy

1. Concept/Definition: Substantive consolidation involves the pooling of the assets and liabilities of two or more related entities. The liabilities of the entities involved are then satisfied from the common pool of assets created by consolidation. *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245, 248 (11th Cir.1991). Substantively consolidating debtors' claims simplifies the administration of interrelated bankruptcies by eliminating inter-company claims between related debtors and duplicative claims filed against related debtors by creditors uncertain as to where the liability should be allocated. *In re Pearlman*, 462 B.R. 849 (2012).

2. Relevant Test/Standard: The applicable test for substantive consolidation requires a showing that (1) there is substantial identity between the entities to be consolidated; and (2) consolidation is necessary to avoid some harm or to realize some benefit. *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245, 248 (11th Cir.1991). Once this prima facie showing is made, the burden shifts to an objecting party to show it will be prejudiced by the consolidation.

B. Substantive Consolidation of a Debtor with a Non-Debtor

1. Cases that Do Not Permit Consolidation with Non-Debtor:

a. *In re Pearlman*, 462 B.R. 849 (2012). Section 105 does not give Court sufficient authority; circumvents the stringent procedures and protections relating to involuntary bankruptcy cases imposed by Section 303; and state law provides remedies for parties who can establish that a non-debtor entity truly is an "alter ego" of a debtor.

2. Cases that Do Permit Consolidation with Non-Debtor:

a. *In re Bolze*, 2009 WL 2232802 (Bankr. E.D.Tenn. July 23, 2009) (failing to draw a distinction between sub con and piercing the corporate veil)

IV. NOLs, Refunds, and Other Tax Assets

A. Election to treat LLCs as separate C corporations

Chapter 11 debtors consisted of a parent corporation and two wholly owned subsidiaries, all three of which were LLCs, reporting for tax purposes as a single S corporation. The group was structured as parent with two qualified sub-chapter S subsidiaries. The Chapter group's sole shareholder elected to terminate the S election in order to avoid anticipated gain on the sale of the business. The result would have been a large tax liability for the group.

In order to separate the C corporations each of the single member LLCs elected to be treated as a C corporation by filing Form 8832, Entity Election Classification. Each of the three LLCs filed a separate bankruptcy and each had separate business assets and creditor bodies. None of the LLCs had liabilities that exceeded the bases of their assets. Reporting of the sale by each corporation separately made it possible for two of the corporations to pay their share of the tax as well as their creditors' claims.

B. IRS payroll tax audit claim – amending pre-petition tax return

Consolidated group of related corporations files a Chapter 11 proceeding and Chapter 11 Trustee was appointed by the Court. During the initial stages of the Trustee's administration IRS auditors were investigating the corporations' books and records. A payroll tax audit was conducted and report issued after the Petition Date taxing significant executive compensation that was the result of stock issued pre- petition to the Debtors' officers. Debtor did not transmit payroll tax withholding. Additionally the debtors had paid significant personal expenses of senior management. The value of newly issues stock, that determined the amount of wages paid, was suspect.

As a result of the payroll audit IRS asserted a sizeable priority claim for taxes and a GUC for related penalties. In order to enhance distributions to general unsecured creditors it was necessary to reduce or eliminate that claim.

During that same year, the consolidated group sustained a significant net operating loss ("NOL"). That NOL and was carried back pre-petition to recoup a tax refund in millions of dollars. The Trustee amended such tax return to reverse the officers' compensation deduction among other items, substantially decreasing the NOL while preserving the refund previously issued for preceding tax years. The amended tax return reduced the vast majority of the priority payroll tax claim allowing for a distribution to other GUCs.

C. Recovery by Investor/Victims can take priority over IRS tax claim

Where there is no statutory lien for federal tax or loss by investor/victim it may be possible to settle competing claims in favor of the investor/victims. When the investor/victim claim can be traced to the fund in question, the Department of Justice will recognize the priority of the investor/victim's claim.

D. Carryback of NOLs to pre-petition tax years

An individual estate with NOLs **that are not administrative NOLs**, e.g. losses from K-1 pass-through or other business operations such as rentals or sole proprietorships, can carry the loss back two (2) years to recoup tax paid by the debtor

pre-petition or to reduce federal income tax claims. It is important to consider any allocation of taxable income in the pre-petition years to a non-debtor working spouse.

Carryback is accomplished by filing Form 1045 or 1040X for the pre-petition year(s) such loss is carried to and to attach Trustee's appointment documents, specific disclosures and a copy of the Estate's tax return for the year such loss was generated.

A debtor corporation with an NOL can also carryback an NOL to recoup corporate tax paid pre-petition or to reduce federal income tax claims. This is accomplished by filing Form 1139 or 1120X.

NOLs can be carried back two (2) years and forward twenty (20) years. If the bankruptcy estate or the Trustee determines that such NOL may be of greater value in the future, to reduce projected tax on anticipated sales or settlements in the future, it is possible to elect to relinquish the 2 year carryback period.

E. Eliminating Section 382 limitation of net operating loss ("NOL") carryover

When reorganization of a C corporation debtor results in an ownership change, NOL and certain other attribute carryovers are severely limited going forward. Two kinds of ownership changes can trigger such limitation: a change involving a 5% shareholder and a tax-free reorganization, other than a divisive or F reorganization.

The debtor and its subsidiaries was originally involved in a number of businesses making it easier to meet the continuing business requirement. After confirming that the debtor could meet ownership requirements, the Chapter 7 debtor converted to a Chapter 11 and continuing the existing real estate operations, sought funding to continue that branch of the business in order to utilize significant NOLs.

F. Rescission of Debtor's pre-petition elections

A debtor may make certain elections in a pre-petition tax return that adversely affects the bankruptcy estate. Relinquishment of the two (2) year NOL carryback or in the case of an individual debtor application of a tax overpayment to future years. Depending on the circumstances and/or the locale of the bankruptcy, it may be possible to reverse such elections for the benefit of the bankruptcy estate. (See attached)

G. Other Considerations

1. *Alternative Minimum Tax ("AMT"):* Individual estates are not subject to this tax however, corporate estates with significant gain from property/business sales and/or income from D&O or other taxable settlements may trigger this tax. **This is because AMT NOL carryovers are limited to 90% of AMT income**. It may be possible to eliminate or minimize such tax with careful timing of payments or write-offs, especially in the case of cash basis taxpayers.

2. *Burdensome property:* The debtor or bankruptcy trustee should be aware that property with a low tax basis and significant debt, foreclosed property, sale of right, title and interest in highly leveraged property, partnership LLC and S corporations with negative capital accounts that indicate potential for phantom income could all spell trouble for a bankruptcy estate. Abandonment of such property is critical to avoid an unexpected tax bite.

3. *Liquidating Trusts:* Transfer of debtor assets to a liquidating trust is deemed to pay allowed claims in full. The value of such payment is dependent on the fair market value of the assets on the date transferred. The transfer is reportable in the debtor's final tax return and, therefore, tax positions reported in the debtor's final tax return will likely affect the tax consequences of transactions that will later be reported by the Trust to its grantors. To the extent a Liquidating Trustee is tasked with filing of the Debtor's final return, proper planning regarding accruals and tax reporting may benefit the Trust beneficiaries in later years. For example, a debtor may have a significant NOL in its final year and be very close to a D&O or other major taxable settlement. Accrual of the receivable in the debtor's final return could shelter the income in the corporation and eliminate taxable income pass-through in the Trust's initial year of operation.

4. *Request Prompt Determination under 505(b):* Requesting prompt determination allows a trustee, bankruptcy estate and any successor to the debtor to shorten the statute of limitations when filing an annual tax return. Such request gives the IRS **90 days** to select the return for audit or to accept such return as filed.

V. Property in the Hands of Third Parties – Spendthrift Trusts and Other Similar Devices

A. Definition of Spendthrift Trust: A spendthrift trust is a trust that restrains voluntary and involuntary alienation of all or any of the beneficiary's interest.

B. Exclusion from Property of the Estate:

1. Section 541(c)(2). Section 541(c)(2) excludes the interest of a debtor which holds a beneficial interest in spendthrift trusts from property of the estate. Section 541(c)(2) specifically states that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law [i.e., state law] is enforceable in a case under this title." 11 U.S.C. § 541(c)(2).

a. If the terms of a trust provide that a beneficial interest shall not be transferable by the beneficiary or subject to claims of the beneficiary's creditors, the restraint on voluntary and involuntary alienation of the interest is valid and respected, and therefore, the beneficiary's interest of the property held in trust is not property of the estate. *See Jensen v. Davis (In re Davis)*, 110 B.R. 573, 575 (Bankr. M.D. Fla. 1989).

2. Application: When the beneficiary of a spendthrift trust files bankruptcy, the only rights of the debtor-beneficiary that become property of the estate are the right to the proceeds of causes of action against the trustee and the rights to cash distributed to the debtor pre-petition, assuming that the debtor held such funds at the time the petition was filed. *In re Rogove*, 2010 Bankr. LEXIS 3298, at 12-13 (Bankr. S.D. Fla. 2010). However, funds received post-petition from a valid testamentary spendthrift trust within 180 days after the petition date are property of the estate under section 541(a)(5)(A). *See In re Hunter*, 261 B.R. 789, 793 (Bankr. M.D.Fla. 2001); *Birdsell v. Coumbe (In re Coumbe)*, 304 B.R. 378 (B.A.P. 9th Cir. 2003).

3. No Valid Spendthrift Provision: If the trust does not have a spendthrift clause (or the spendthrift provision is not valid under applicable law), every right of the debtor under the trust becomes property of the estate. *See Yorke v. Bank One Wisconsin Trust Co., N.A. (In re Smith)*, 189 B.R. 8 (N.D. Ill. 1995). To the extent that the spendthrift provision is not valid under state law, giving the beneficiaries the ability to control the disposition of the trust property, the debtor's beneficial interest in the trust property is property of the estate. *See Shurley v. Texas Commerce Bank- Austin, N.A. (In re Shurley)*, 115 F.3d 333 (5th Cir. 1997) (finding spendthrift provision not valid under Texas law because of the "self-settlor" rule against establishing a spendthrift trust for yourself, and therefore the portion of the trust contributed by the debtor was part of the debtor's bankruptcy estate); *In re Neuton*, 922 F.2d 1379 (9th Cir. 1990) (75% of trust protected by spendthrift restriction and excluded from debtor's estate while remaining 25% which was not protected by spendthrift restriction was part of debtor's estate).

VI. D&O Claims

a. Investigation of claims:
   i. Ensure coverage is in place.
   ii. Obtain copies of insurance policies.
   iii. Make demand on policy/put on notice.
   iv. Determine if claims made policy.
   v. Legal counsel investigation - needs to be funded.
   vi. Fraud or criminal proceedings may be problematic.

b. Evaluate any potential competing claims [e.g. private shareholder asserted claims]:

c. Cooperation agreements:

d. Selection, retention of counsel and compensation negotiations:
   i. Contingency
   ii. Hourly
   iii. Hybrid
   iv. Other- tiered (incentivizing professionals).

e. Settlement negotiations:
   i. Mediation and mediator selection.
   ii. Role of the insurance carriers.
   iii. Tiered/stacked coverage.
   iv. Managing burn rate – consider getting a court order to cap fees.
   v. Claims waiver to maximize distribution to creditors.
   vi. Evaluation of D&O's ability to pay.
      1. Financial affidavits
      2. Insolvency
      3. Criminal investigation

f. Obtaining court approval of settlement:
   i. Justice Oaks Factors
      1. Probability of success
      2. Collectability
      3. Complexity
      4. Paramount Interest of Creditors
   ii. Bar orders

VII. Other Types of Insurance Claims

a. Owner Controlled Insurance Program [Construction industry]:
   i. Workers compensation and general liability insurance through owner controlled insurance program.
   ii. Pre-funded the collateral used to pay claims.
   iii. Debtor ceased building structure and filed bankruptcy.
   iv. Insurance carrier left with millions of dollars and claims activity essentially ceased.
   v. State law governs duration of potential claims exposure into the future even though construction ceased and project abandoned.
   vi. Funds are held in a cloud. Insurance company offers a pittance to settle with the Trustee.
   vii. Trustee must negotiate a way to liquidate the asset.
      1. Role of a risk management consultant with industry expertise.
      2. Considered litigation versus settlement.
      3. Possible exit by portfolio sale of exposure to alternate insurance company to step into the shoes of existing carrier, relieve claims exposure.

b. Financial institution bond claims:

VIII. Chapter 15 and Cross-Border Insolvencies

A. Foreign Collections – Initial Analysis:

a. Cross border bankruptcy requires cooperation among jurisdictions.
b. Trustee must retain counsel in and bring ancillary proceeding in cross border jurisdiction.
c. Specific protocols must be followed. In some jurisdictions, local counsel must be retained.
d. Bankruptcy estate must fund the costs of bringing the proceeding and the investigation.
e. Asset investigation is challenging
    i. Access to information may be limited.
    ii. Difficult to gain authority to inspect or examine assets.
    iii. Securing assets in lesser developed countries can be challenging or impossible.
f. May need a local, trust worthy "boots on the ground" representative familiar with customs, crime factor, local politics.
g. Prolonged time to accomplish tasks.

B. Jurisdictional Issues:

A bankruptcy court can assert jurisdiction over a foreign defendant if there is a statutory basis for exercising jurisdiction, and the exercise of jurisdiction over the defendant will comport with due process.

1. Statutory basis for jurisdiction:

Fed.R.Bankr.P. 7004(f), applicable in all adversary proceedings, provides: If the exercise of jurisdiction is consistent with the Constitution and laws of the United States, serving a summons or filing a waiver of service in accordance with this rule or the subdivisions of Rule 4 F.R.Civ.P. made applicable by these rules is effective to establish personal jurisdiction over the person of any defendant with respect to a case under the Code or a civil proceeding arising under the Code, or arising in or related to a case under the Code.

Fed.R.Civ.P. 4(k) allows for worldwide service of process.

2. Personal Jurisdiction and Due Process:

The question of whether the bankruptcy court can obtain personal jurisdiction over a foreign defendant is governed by federal law. The

analysis, governed by the Fifth Amendment to the U.S. Constitution, has two elements:

a. Whether the defendant has sufficient minimum contacts with the United States; and
b. Whether the exercise of jurisdiction is reasonable such that it would not offend traditional notions of fair play and substantial justice.

3. Alter ego jurisdiction.

The foreign defendant may be the alter ego of a local defendant for jurisdictional purposes. Alter ego jurisdiction allows a court to pierce the corporate veil jurisdictionally such that the "minimum contacts" of the local entity can be attributed to the foreign defendant. *See Status Int'l S.A. v. M & D Maritime Ltd*., 944 F.Supp. 182, 186 (S.D.N.Y. 1998) (explaining that the corporate veil can be pierced if a corporation uses its alter-ego status to perpetrate a fraud or "where it so dominates and disregards its alter-ego's corporate form that the alter-ego was actually carrying on the controlling corporation's business instead of its own."). *See also SEC v. Montle*, 65 Fed. Appx. 749, 752 (2d Cir. 2003) recognizing that contacts of a shareholder can be imputed to an alter ego corporation); *In re Chocolate Confectionary Antitrust Litigation*, 674 F.Supp. 2d 580, 599 n. 25 (M.D. Pa. 2009) (alter ego jurisdiction can be exercised over a foreign parent *or* subsidiary).

4. Extraterritorial Reach of Section 548: Circuits are split on whether § 548 can reach foreign assets, and the decision usually turns on the specific facts of the case.

Courts allowing § 548 to be applied to extraterritorial transfers include:

French v. Liebmann (In re French), 440 F.3d 145 (4th Cir. 2006). The issue before the court was whether a bankruptcy court could avoid the fraudulent transfer of foreign real property between two U.S. resident. The court recognized that not every transaction with a foreign element should be considered extraterritorial. The court found that it should apply a flexible test considering whether the participants, acts, targets and effects of the transaction are primarily foreign or domestic. In addition, the court should apply an equally flexible test taking into account all component events of the transfer. In this case, the perpetrator and most of the victims of the transfer were domestic such that the effects of the transfer were felt most strongly in the U.S. Considering the facts surrounding the transfer, the court found that § 548 was applicable. The court noted that the focus should be on the fraudulent activity, not the location of the

asset. The court further determined "property of the estate" as defined by the Code includes both foreign and domestic property. "Congress thus demonstrated an affirmative intention to allow avoidance of transfers of foreign property that, but for a fraudulent transfer, would have been property of the debtor's estate." Id. at 152.

Weisfelner v. Blavatnik (In re Lyondell Chemical Co. et al.), supra. The court denied a foreign defendant's motion to dismiss, finding that Congress intended to extend the scope of § 548 to reach extraterritorial conduct. In this particular case, a foreign company made distributions to foreign shareholders prior to merging with a United States company in a leveraged buyout. After the U.S. company sought bankruptcy relief, the trustee sought to avoid the distributions as fraudulent transfers. Following the 4th Circuit's decision in *French*, the court held that § 548 could be used to reach the foreign transfers, even though they were extraterritorial because property of the estate under § 541 includes "property, wherever located."

In contrast, extraterritorial application of the avoidance statutes was rejected in:

Midland Euro Exchange Inc. v. Swiss Finance Corp. (In re Midland Euro Exchange Inc.), 347 B.R. 708 (Bankr. C.D. Ca. 2006). The trustee brought fraudulent transfer actions against a foreign exchange broker and others. The broker sought dismissal, which was granted without leave to amend. The court recognized the split among the circuits and ultimately decided that:

- "Property of the estate" does not include fraudulently transferred assets until they are recovered. Therefore, the reach of § 541 to "property, wherever located" cannot be used to reach foreign assets subject to an avoidance action.

- Neither the plain reading of § 548, nor its reading in conjunction with other provisions, establishes congressional intent to apply § 548 extraterritorially.

- Although policy considerations favor the extraterritorial application of § 548, this alone is not enough to overcome the presumption against extraterritoriality.

Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 513 B.R. 222 (S.D.N.Y. 2014). The trustee sought to recover funds transferred from Madoff Securities to foreign customers, and then further transferred to the foreign defendants. Thus, the defendants were not immediate transferees of the debtor. The defendants sought dismissal, arguing that §550 did not apply extraterritorially. The matter was removed to the district court with respect to that particular issue. Rejecting the trustee's invitation to follow the 4th Circuit's

opinion in *French*, the court found that the answer could not lie in § 541 because "fraudulently transferred property becomes property of the estate only after it has been recovered by the Trustee, so section 541 cannot supply an extraterritorial authority that" § 548 and § 550 lack on their own. *Id*. at 229. Transferred property does not become property of the estate until it is recovered. *Id*. (following *In re Colonial Realty Co.*, 980 F.2d 125, 131 (2d Cir. 1992)). Accordingly, the trustee could not utilize § 550(a) to recover purely foreign subsequent transfers. Alternatively, the court found that that the trustee's use of § 550(a) was precluded by concerns of international comity as many of the initial transferees were in foreign liquidation proceedings.

Chapter 15 and Cross-Border Insolvencies

Added to the Bankruptcy Code in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), Chapter 15 was enacted to address certain objections set forth in § 1501:

- Cooperation between the United States and foreign courts;
- Greater legal certainty for trade and investment;
- Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and interested parties, including the debtor;
- Protection and maximization of the value of the debtor's assets; and
- Facilitation of the rescue of financially troubled businesses.

Chapter 15 was designed to be the "exclusive door to ancillary assistance to foreign proceedings." U.S. H.R. Rep. 109-031, 110 (2005).

How it works:

Cases are commenced by the filing of a petition. § 1504. This petition is not as comprehensive as petitions under chapter 7, 11, and 13, and it does not constitute an "order for relief." Nor does it result in the imposition of the automatic stay, or the creation of a bankruptcy estate under § 541. Essentially, a chapter 15 petition seeks recognition of a foreign proceeding. § 1502.

A "foreign proceeding" is defined as "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation." § 101(23).

Pursuant to § 1517, a foreign proceeding shall be recognized if (1) the foreign proceeding is a foreign main or foreign nonmain proceeding; (2) the petition for recognition was filed by a foreign representative; and (3) the petition satisfies the requirements of § 1515 [requiring the attachment of certain documents, and that the documents be translated into English].

A foreign main proceeding is defined as "a foreign proceeding pending in the country where the debtor has the center of its main interests." § 1502(4). In determining a debtor's "center of main interests" or COMI, courts may consider several factors, including the location of the debtor's headquarters, primary assets, creditors and those who manage the debtor. In addition, courts consider the jurisdiction whose law would apply in most disputes and the jurisdiction in which the debtor is organized. *See e.g., In re Bear Stearns High Grade Structured Credit Strategies Master Fund Ltd.*, 389 B.R. 325 336 (S.D.N.Y. 2008); *In re Basis Yield Alpha Fund (Master)*, 381 B.R. 37, 56-57 (Bankr. S.D.N.Y. 2008); *In re Loy*, 380 B.R. 154, 162 (Bankr. E.D. Va. 2007).

A foreign nonmain proceeding is a foreign proceeding pending in a country where the debtor has an "establishment," which is defined as "any place of operations where the debtor carries out a non-transitory economic activity." § 1502(2), (5). At least one court has read this to mean a "local place of business." *In re Bear Stearns High Grade Structured Credit Strategies Master Fund Ltd.*, 347 B.R. 122, 131 (Bankr. S.D.N.Y. 2007).

If the petition is properly filed, the court will holding a hearing after notice of at least 21 days is provided as required by Bankruptcy Rule 2002(q). Thus, it is possible to obtain recognition of a foreign proceeding rather quickly.

Upon recognition, the foreign representative has the capacity to sue and be sued in a court in the United States, and it may apply directly to a court in the United States for appropriate relief in that court. § 1509(b). In addition, the United States court must grant comity or cooperation to the foreign representative. Id

The automatic stay protections will arise upon the recognition of a foreign main proceeding. § 1520.

A court can extend the automatic stay to a recognized foreign nonmain proceeding under its broad equitable powers recognized in § 1521: "Upon recognition of a foreign proceeding, whether main or nonmain, where necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interests of creditors, the court may grant any appropriate relief."

Courts do have the ability to refuse to take an action governed by Chapter 15 if it "would be manifestly contrary to the public policy of the United States." § 1506.

- Note: 28 U.S.C. § 1334(c)(1) was amended in 2005 to limit a court's ability to permissively abstain from Chapter 15 cases. In *Firefighters' Ret. Sys. v. Citco Grp. Ltd.*, 796 F.3d 520 (5th Cir. 2015), the 5th Circuit held that a federal court could not remand a removed action because it was related to pending Chapter 15 petitions. The Supreme Court recently denied a petition for certiorari seeking review of the circuit court's decision.