

Recent Challenges Faced by Foreign Representatives Seeking Relief Under Chapter 15

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Chapter 15 Overview

- Chapter 15 was enacted as part of the 2005 amendments to the Bankruptcy Code.
- Implements the UNCITRAL Model Law on Cross-Border Insolvency.
- Objectives include:
 - Facilitating cooperation between U.S. and foreign courts; and
 - Promoting the “fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor.” 11 U.S.C. § 1501.
- Recognition of a foreign proceeding may pave the way for the enforcement of a foreign plan, depending on circumstances.

Key Definitions

- The term “foreign proceeding” means 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. See 11 U.S.C. § 101(23).
- The term “foreign representative” means a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor’s assets or affairs or to act as a representative of such foreign proceeding. See 11 U.S.C. § 101(24).



Requirements for Recognition

- Under section 1517, a foreign proceeding will be recognized as long as:
 - (1) the foreign proceeding is foreign main or foreign nonmain proceeding;
 - (2) the petition for recognition was filed by a foreign representative; and
 - (3) the petition satisfies all of section 1515’s procedural requirements.
- Additionally, in the Second Circuit (as set forth in *In re Barnet*), a foreign debtor must satisfy section 109(a)’s eligibility requirements.
 - Under section 109(a), a person must reside, or have a domicile, place of business or property in the United States to be eligible to be a debtor.



Bases for Recognition: Main Proceeding vs. Nonmain Proceeding

- A foreign main proceeding is defined as “a foreign proceeding pending in a country where the debtor has the center of its main interests” (its “COMI”).
- A foreign nonmain proceeding is defined as a foreign proceeding pending in a country where the debtor has an “establishment.”
 - An establishment is “any place of operations where the debtor carries out a nontransitory economic activity.” Presence of assets alone is insufficient.



Recognition of Foreign Main Proceeding

- Recognition of a foreign main proceeding triggers certain automatic relief, including a stay enjoining actions against the debtor and its property in the U.S.
- Upon recognition, a foreign representative:
 - Has the capacity to sue and be sued in the U.S.;
 - May apply directly for appropriate relief; and
 - Shall be granted comity or cooperation by U.S. courts.
- Because the determination of whether a foreign proceeding should be recognized as a foreign main proceeding is dependent on the location of a debtor's COMI, establishing COMI is critical.



Recognition of Foreign Nonmain Proceeding

- When a nonmain proceeding is recognized, a court may (but is not required to) grant relief, including:
 - Relief automatically available to foreign main proceeding;
 - Entrust the foreign representative with administration and realization of U.S. assets;
 - Discovery; and
 - Other relief that would be available to a trustee, except relief under §§ 522, 544, 545, 547, 548, 550 and 724(a) (which relate to avoidance actions).
- Recognition of a nonmain proceeding also gives the foreign representative access to U.S. courts (the same as in a main proceeding).
- Discretionary relief granted only if the interests of creditors and other interested entities, including the debtor, are sufficiently protected.



How is COMI Determined?

- A corporate debtor's registered office is presumed to be its COMI, but this presumption is rebuttable.
- To determine a debtor's COMI, U.S. courts have considered the following factors, among others:
 - The location of the debtor's headquarters;
 - The location of those who actually manage the debtor;
 - The location of the debtor's primary assets;
 - The location of a majority of the debtor's creditors;
 - The jurisdiction whose law would apply in most disputes; and
 - The debtor's "nerve center," including where the debtor's activities are located and controlled.



When Should COMI Be Determined? – U.S. Courts

- In April 2013, the Second Circuit held in *In re Fairfield Sentry Ltd.* that a debtor's COMI should be determined as of the date of the Chapter 15 filing and not the commencement of the foreign proceeding.
- This resolved an apparent split at the lower level.
 - In *In re Millennium Global Emerging Credit Master Fund Ltd.*, the bankruptcy court held that COMI should be determined as of the date of commencement of the foreign proceeding.
 - In *Fairfield*, the lower courts held that COMI should be determined as of the date of the Chapter 15 filing.
- Under the Second Circuit's ruling, a court should consider the foreign representative's actions in determining the debtor's COMI.
 - A liquidator's insolvency-related activities may result in a shift of the debtor's COMI.



When Should COMI Be Determined? - UNCITRAL

- In July 2013, UNCITRAL adopted the following revision to the Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency:
 - "A main proceeding is one taking place where the debtor had its centre of main interests (COMI) at the date of commencement of the foreign proceeding."
- Based on the revision to the Guide, it is unclear how courts outside the Second Circuit (i.e., those not compelled to follow *Fairfield*) might rule on the issue of "timing."



Recent Uses of Chapter 15

- Chapter 15 can be used to meet a wide variety of objectives.
- In recent years, Chapter 15 has been used to, among other things:
 - Enforce a foreign restructuring plan – *see, e.g., In re Rede Energia S.A.*
 - Block enforcement of judgments in the U.S. and channel claims to foreign proceedings – *see, e.g., In re A.B.C. Learning Centres, Ltd.*
 - Provide access to U.S. courts to prosecute recovery actions – *see, e.g., In re Hellas Telcomms. (Lux.) II SCA; In re Fairfield Sentry Ltd.*
 - Sell assets located in the U.S. – *see, e.g., In re A.B.C. Learning Centres, Ltd.*
 - Obtain discovery – *see, e.g., In re Pioneer Freight Futures Company Ltd.* (discovery from intermediary banks)



Recent Challenges to Chapter 15 Relief

- As foreign representatives have begun using Chapter 15 more creatively, an increasing number of challenges have been raised by parties in the United States.
- Recent cases highlight certain of these challenges to Chapter 15.
 - Objections to satisfaction of the eligibility requirements of section 109(a).
 - *In re Octavio Admin. Pty Ltd.*
 - *In re Suntech Power Holdings Co. Ltd.*
 - Objections related to the debtors' center of main interest.
 - *In re Suntech Power Holdings Co. Ltd.*
 - Objections to the enforcement of the foreign debtor's plan.
 - *In re Vitro SAB de CV*
 - *In re Rede Energia, S.A.*



In re Octaviar Administration Pty Ltd.

- The Second Circuit in *Barnet*, held that a foreign debtor under Chapter 15 must be eligible to be a debtor under section 109(a) before its foreign proceeding can be recognized under Chapter 15.
- Following the Second Circuit's ruling in *Barnet*, the Australian liquidators of Octaviar decided to refile the Chapter 15 case.
 - Prior to filing the second petition for recognition, and to further support the argument that Octaviar had property in the United States (i.e., in the form of claims or causes of action), the Australian liquidators transferred funds to U.S. counsel to be held as a retainer.
- The same party that appealed the initial recognition order to the Second Circuit objected to the second Chapter 15 petition arguing again that the debtor failed to satisfy section 109(a)'s eligibility requirements.



In re Octaviar Administration Pty Ltd.

- The bankruptcy court concluded that because the liquidators had demonstrated that Octaviar had property in the U.S., Octaviar was eligible to be a debtor in the U.S. and the Australian liquidation could be recognized under Chapter 15.
 - The bankruptcy court found that the debtor had property in the U.S. consisting of (1) claims and causes of action and (2) funds in the form of a retainer held by U.S. counsel.
- The court noted that the circumstances surrounding the transfer of the funds into the retainer account were irrelevant to the court's determination.
 - Any property, including minimal funds, in the U.S. can satisfy the debtor-eligibility requirement.



In re Suntech Power Holdings Co., Ltd.

- The debtor was incorporated in the Cayman Islands and therefore its COMI was presumed to be the Cayman Islands.
 - However, as of the time the Cayman Islands liquidation had commenced, the debtor had no business activities in the Cayman Islands. Its principal executive offices were in China.
- Following their appointment, the liquidators took steps to shift the debtor's COMI to the Cayman Islands.
 - The steps included centralizing the administration of the debtor in the Cayman Islands by taking control of the debtor's assets, publishing notices informing parties to contact them in the Cayman Islands, changing the debtor's address to the Cayman Islands, obtaining loans on the company's behalf, conducting Board meetings telephonically from the Cayman Islands, and appointing a Cayman Islands director.


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In re Suntech Power Holdings Co., Ltd.

- A little more than 3 months after their appointment, the liquidators filed a Chapter 15 petition seeking recognition of the Cayman Islands proceeding.
- Creditors opposed Suntech's chapter 15 filing arguing that the liquidators manipulated the debtor's COMI.
- Relying on *Fairfield*, the bankruptcy court granted recognition of the Cayman Islands proceeding finding that the COMI shift to the Cayman Islands was consistent with the order appointing the liquidators.
- Relying on the second *Octaviani* Chapter 15 case, the bankruptcy court also determined that the transfer of funds to the U.S. on the eve of the Chapter 15 filing (albeit held in the name of an agent) was sufficient to satisfy the section 109(a) debtor eligibility requirements.


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In re Rede Energia S.A.

- Under Chapter 15, a foreign representative may request an order enforcing a foreign “plan” in the United States.
- An ad hoc group of U.S. noteholders objected to a request to enforce the Brazilian plan of Rede Energia S.A. arguing that the plan was contrary to U.S. public policy and that their rights were being trampled.
 - In particular, they argued that the Brazilian law plan was “fraught with infirmities,” including that the plan:
 - Violated the absolute priority rule by preserving equity at the expense of creditors.
 - Permitted insiders (equity holders-turned-creditors) to vote on the plan.
 - Consolidated debtors’ estates for voting and plan distribution purposes.



In re Rede Energia S.A.

- The bankruptcy court concluded that an order enforcing the plan could be issued under both sections 1521 and 1507 of the Bankruptcy Code.
- Section 1521 permits the granting of “appropriate relief,” including relief available to a trustee. In determining whether to grant such relief, a court must ensure that the interests of the debtor and other interested parties, including creditors, are sufficiently protected.
- Section 1507 permits the granting of “additional assistance.” However, Section 1507 requires consideration of the following factors:
 - (1) just treatment of all holders of claims against or interests in the debtor’s property;
 - (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
 - (3) prevention of preferential or fraudulent dispositions of property of the debtor;
 - (4) distribution of proceeds of the debtor’s property substantially in accordance with the order prescribed by this title; and
 - (5) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.
- It is unclear whether the relief available under section 1507 is independent from the relief available under section 1521.



In re Rede Energia S.A.

- The bankruptcy court found that granting the enforcement order satisfied section 1521.
 - The interests of the debtors and creditors would be sufficiently protected by enforcing the plan, which was supported by votes of non-insider creditors.
- Additionally, the court determined that the requirements of section 1507 were satisfied.
 - Upon review of the section 1507 factors, the creditors were justly treated in the foreign proceeding and the distribution of proceeds was substantially in accordance with U.S. law.
- The bankruptcy court was not troubled that Brazilian law was not identical to U.S. law or that the plan did not yield the same results that a U.S. plan would.
- The Court was focused more on the fairness of the Brazilian plan process than any purported difference in outcome based on application of U.S. law.
- Brazilian law provided creditors with protections similar to those available in the U.S. and, in the bankruptcy court's opinion, any differing treatment had a reasonable basis and was necessary to consummate the plan.



Comparing *Vitro* and *Rede*

Issue	<i>In re Vitro SAB de CV</i>	<i>In re Rede Energia S.A.</i>
Law of Foreign Proceeding	Mexican	Brazilian
Plan Enforced in Chapter 15?	No	Yes
Challenged Features of the Foreign Plan	<ul style="list-style-type: none"> • Violated the absolute priority rule. • Allowed insiders to vote on the plan. • Permitted single-class voting (failed to distinguish disparate interests of creditors) • Granted non-consensual release to third party guarantors 	<ul style="list-style-type: none"> • Violated the absolute priority rule by preserving equity at the expense of creditors. • Permitted insiders (equity holders-turned-creditors) to vote on the plan. • Consolidated debtors' estates for voting and plan distribution purposes.
Section 1521 Determination	Requested relief was not "any appropriate relief" because the non-consensual non-debtor release was not generally available under U.S. law (explicitly prohibited in the Fifth Circuit).	The interests of the debtors and creditors would be sufficiently protected by enforcing the plan supported by votes from non-insider creditors. Denying the relief would merely provide creditors with a chance to renegotiate the terms and there was no evidence they would be successful.
Section 1507 Determination	Although the relief was theoretically available under section 1507, relief was precluded because the distribution of the debtor's property would not be substantially in accordance with U.S. law as required by section 1507(b)(4). The foreign representatives failed to demonstrate extraordinary circumstance that would make enforcement of the plan containing non-consensual non-debtor releases possible in the United States.	Although the court did not need to reach this issue, section 1507 factors were satisfied. The creditors were justly treated in the foreign proceeding and the distribution of proceeds was substantially in accordance with U.S. law.



Whether Chapter 15 is a Prerequisite to Relief in Other Courts

- Courts are currently divided as to whether Chapter 15 is a prerequisite for foreign representatives to seek relief in U.S. courts.
- Section 1509 is unclear.
 - Section 1509(b) provides that upon recognition, a foreign representative has the capacity to sue and be sued in a court in the U.S.
 - Accordingly, one reading is that without obtaining recognition, a foreign representative does not have the capacity to sue or be sued.
 - Section 1509(f) provides that notwithstanding any other provision of section 1509, the failure of a foreign representative to commence a chapter 15 case or obtain recognition does not affect any right the foreign representative has to sue in a court in the U.S. to collect or recover a claim which is the property of the debtor.
 - Although the legislative history of section 1509(f) suggests that it applies only to claims of a foreign debtor to recover accounts receivable (or similar claims), the plain language of the statute is not so limited.
- The majority of cases that have addressed the issue have concluded or suggested that recognition is required before a foreign representative may commence litigation in a U.S. court.
- Unless Congress amends section 1509 to clarify its meaning or the case law further develops, there will continue to be uncertainty as to whether recognition is required before a foreign representative may sue in the U.S.



Cases Discussed

- *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013)
- *In re Fairfield Sentry Ltd.*, 440 B.R. 60 (Bankr. S.D.N.Y. 2010) *aff'd*, 714 F.3d 137 (2d Cir. 2013)
- *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011), *aff'd*, 474 B.R. 88 (S.D.N.Y. 2012)
- *In re Octaviar Administration Pty Ltd*, 511 B.R. 361 (Bankr. S.D.N.Y. 2014)
- *In re Rede Energia S.A.*, 515 B.R. 69 (Bankr. S.D.N.Y. 2014)
- *In re Suntech Power Holdings Co., Ltd.*, 520 B.R. 399 (Bankr. S.D.N.Y. 2014)
- *In re Vitro SAB de CV*, 701 F.3d 1031 (5th Cir. 2012)

