CHAPTER 15 THEMES – A RETROSPECTIVE ON RECENT U.S. CROSS BORDER INSOLVENCY DECISIONS

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In considering decisions issued in cases under chapter 15 of the U.S. Bankruptcy code over the past twelve months, several themes emerge from the medley of jurisprudence. This brief highlight article discusses three such chapter 15 leitmotifs including (i) the capacious panoply of U.S. assets subject to chapter 15 protection, (ii) the relative futility of inventing public policy exceptions and (iii) the ineffectiveness of relying solely on the locus of corporate registration to determine COMI or to obtain recognition. Of course, not all decisions fit neatly into these categories; some decisions have been omitted, which might have been included, and some that have been included for one purpose might have been used to support another. Nonetheless, some valuable lessons and insights may be derived from these chapter 15 refrains.

The Panoply of Property and Related Relief Under Chapter 15

The first theme naturally focuses on one of the most fundamental aspects of chapter 15: the ability of a foreign debtor or its representative to seek and obtain relief in order to protect U.S. assets of the debtor. *See* 11 U.S.C. § 1521(a). Perhaps the most obvious reason to seek chapter 15 protection is to prevent creditors from enforcing their rights against tangible assets physically located in the United States. However, decisions issued over the past twelve months demonstrate a range of relief that might not instantly occur to advisors of a foreign debtor. Such decisions likewise demonstrate an overarching theme in recent chapter 15 jurisprudence—that foreign debtors and their representatives continue to explore the boundaries of chapter 15 interpretation by pushing the envelope in seeking relief that often has little statutory basis.

As a threshold matter, property in the U.S. often constitutes the debtor's ticket for entrance to chapter 15, without which chapter 15 would be illusory. For a foreign proceeding to be recognized under chapter 15, section 109(a) of the Code dictates that a foreign debtor must reside, have a domicile, have a place of business or have *property* in the U.S. *In re Berau Capital Res. Pte Ltd*, 540 B.R. 80, 82-83 (Bankr. S.D.N.Y. 2015) (citing *In re Barnet*, 737 F.3d 238 (2d Cir. 2013)). Where the corporate debtor lacks a place of business, property in the U.S. may be the only element it can satisfy. Moreover, where the debtor does have a place of business, it likely has property, given how capacious the definition of property is for determining eligibility. Sometimes, the property is exactly what we expect—tangible stuff. As a classic example of protecting assets in the United States, the bankruptcy court followed in the steps of *Atlas* and *STX Pan Ocean*, upholding a worldwide stay issued by a Korean court as a matter of comity upon recognition of the Korean proceeding. *In re Daebo Int'l Shipping Co., Ltd.*, 543 B.R. 47 (Bankr. S.D.N.Y. 2015) (lifting attachments on a vessel in a U.S. port filed by creditors in maritime attachment proceedings where Korean stay in recognized proceeding order barred provisional attachments and other enforcement efforts). The court found that U.S. creditors were otherwise entitled to equal treatment with other creditors in the Korean proceedings so that the Korean stay was entitled to deference and enforcement in the U.S. Other times, what constitutes the debtor's "property" may not be obvious at first blush. For example, a foreign representative in a recent Singaporean proceeding sought recognition in the U.S. under chapter 15. As has

been held in chapter 11 cases, even a retainer deposited with the debtor's attorney in the U.S. is generally sufficient to satisfy the 109(a) requirement. *In re Berau Capital*, 540 B.R. at 82-83. However, the court additionally focused on the fact that the foreign debtor had U.S. dollar denominated debt expressly governed by New York law under an indenture. The court observed that "[i]t would be ironic if a foreign debtor's creditors could sue to enforce the debt in New York, but in the event of a foreign insolvency proceeding, the foreign representative could not file and obtain protection under chapter 15 . . . ." The court concluded that "no such conundrum exists" because the debt qualifies as U.S. property for purposes of eligibility as a debtor under section 109(a). *Id.*

While property may take the form of dry bulk carriers or New York law-governed debt, recent chapter 15 cases demonstrate that the relief associated with such property is likewise varied. The foreign representative of a Brazilian debtor used chapter 15 to determine the extent of its assets, if any, in the United States—in effect protecting assets it might not even have. *See In re Petroforte Brasileiro de Petroleo Ltda.*, 530 B.R. 503, 506 (Bankr. S.D. Fla. 2015). In order to investigate allegations that insiders had defrauded the company and moved estate property to the United States, the foreign representative was permitted to avail himself of the right to conduct investigations as codified under 11 U.S.C. §1521(a) for the purposes of protecting "the assets of the debtor or the interests of the creditors." Although the investigations merely related to "suspected misappropriated assets" of the debtor located in the U.S., such *suspected* assets could significantly affect creditor recoveries. Nonetheless, such right to investigate pursuant to section 1521(a) is not unfettered; section 1522 limits such relief to circumstances where "the interests of the creditors and other interested entities, including the debtor, are sufficiently protected." Accordingly, the court declined the trustee's request to seal portions of the record and issue a gag order to protect the integrity of his investigations and to prevent further fraud. The court reasoned the U.S. procedural rules and limitations suffice to curtail fraud in U.S. cases and that, while chapter 15 permits such discovery in order to protect the foreign debtor's assets in the U.S., it is not intended as a gateway for importing non-U.S. discovery rights and procedures.

Another example of the broad range of relief requested in order to protect U.S. assets was the attempt by debtors in *In re Zhejiang Topoint Photovoltaic Co., Ltd.* to include U.S. assets in the debtor's estate that were held by special purpose vehicles (SPVs) the debtors had formed under a joint venture. No. 14-24549, 2015 WL 2260647 at *1 (Bankr. D.N.J. Mar. 12, 2015). The SPVs built solar panels, which constituted the SPVs only assets. The SPVs had been sued by their project contractor for breach of contract in the U.S. Given the panels constituted the sole assets from which plaintiff might satisfy a future judgment, the contractor objected to their inclusion as property of the foreign debtor's estate. Normally, a creditor of a creditor does not have standing in bankruptcy court in the U.S. However, in *Zhejian Topoint*, the bankruptcy court concluded that the facts and circumstances were distinguishable from other cases where indirect creditors had been barred from such a challenge. The court reasoned that the contractor's standing was warranted because (i) the language of section 1522(a) grants the court "broad latitude to mold relief to meet specific circumstances with respect to "other interested entities," and (ii) the contractor in this case had no other means to represent its interests where the SPVs were controlled by the debtor and unwilling to oppose the characterization of the solar panels as property of the estate. Accordingly, debtor's attempt to bring the SPV's U.S. assets into the estate, while not denied per se, remained subject to a future judgment in the contractor's suit for breach.

Sometimes, rather than protecting assets or attempting to bring them into the estate, the disposal of U.S. assets forms an integral part of a foreign representative's reorganization plan. Advisors should bear in mind that the disposal of those assets, even upon recognition of the foreign proceeding, remains subject to mandatory review by the U.S. bankruptcy court under section 363 of the U.S. Bankruptcy Code. Upon remand from the Second Circuit, the bankruptcy court held that, "Notwithstanding a foreign representative's contrary intention, he can no more 'opt out' of § 363 than can a debtor in possession under chapter 11 or a trustee under chapter 7. The parties 'intent' is irrelevant because § 363 applies like it or not." *In re Fairfield Sentry Ltd.*, 539 B.R. 658, 673 (Bankr. S.D.N.Y. 2015).

As the concluding refrain in the theme of varying relief available to protect U.S. assets, insolvency professionals may so focus on chapter 15 relief that they lose sight of the fact that relief may be available outside of chapter 15. Without filing a petition for recognition of a foreign proceeding, a debtor—or its representative—may bring suit directly in U.S. courts. In a New York Supreme

Court case, defendants moved to dismiss on the basis that chapter 15 requires a foreign representative to seek recognition from a bankruptcy court pursuant to section 1517 of the Code before the representative may "apply directly to a court in the United States." (quoting 11 U.S.C. § 1509(b)). However, the court concluded that lack of recognition under chapter 15 did not negatively impact plaintiff's standing to bring the case. *Varga v. McGraw Hill Fin. Inc.*, No. 652410/2013, 2015 WL 4627748, at *13-14 (N.Y. Sup. Ct. 2015). Without recognition under chapter 15, foreign representatives cannot avail themselves of the protections and powers exclusive thereto, but the lack of recognition itself does not preclude bringing suit in the U.S.

The preceding examples of seeking relief with respect to U.S. property show the flexibility of the chapter 15 process in addressing the specific facts and circumstances of each debtor, and there appears to be an openness on the part of courts to form appropriate relief based on the facts and circumstances of each case—provided there is some modicum of property to protect. The same receptivity is striking absent when it comes to creative public policy arguments.

Will I Prevail on Public Policy Arguments in Chapter 15? Probably not.

Section 1506 of the Code creates a public policy exception that enables U.S. courts to refuse to take an action that would be "manifestly contrary to the public policy of the United States." 11 U.S.C. § 1506. While courts might rely on public policy to deny a broad range of relief related to foreign proceedings, U.S. courts continue to interpret the public policy exception extremely narrowly in keeping with international jurisprudence. In fact, an argument that lives or dies on the public policy exception has a very short life expectancy! Courts have demonstrated time and time again, even in the last twelve months, that they will be reluctant to create a public policy exception under section 1506 to proscribe an action a party merely finds inconvenient, unusual or even unjust in some way. *See, e.g., In re OAS S.A.*, 533 B.R. 83, 103 (Bankr. S.D.N.Y. 2015). To qualify for the public policy exception, the action proscribed must meet the high threshold indicated in the statute as violative of a fundamental policy important to the state—something "manifestly" contrary to the public policy of the United States.

Nonetheless, following the old adage "nothing ventured nothing gained," parties persist in asserting the public policy exception. In *Petroforte*, the trustee sought discovery to protect its assets as described above. Parties contesting the discovery claimed that such discovery was manifestly contrary to public policy under section 1506 because it was, in essence, un-American. Nonetheless, the court concluded without need for in-depth analysis that the investigation of individual fraud in this case was not of fundamental importance to the state. "The narrow public policy exception contained in § 1506 is intended to be invoked only under exceptional circumstances concerning matters of fundamental importance to the United States." *Petroforte* at 507 (quoting *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1069 (5th Cir. 2012)). In a subsequent decision in the same chapter 15 case, a similar public policy argument was likewise denied. In Brazil, third party fraudulent transferees were brought into the Petroforte estate by court action and subjected to subpoenas and additional investigation. Two of those parties sought to squash subpoenas in the United States, arguing that recognition of the Brazilian orders would be manifestly contrary to U.S. public policy because such relief would violate fundamental due process rights under the U.S. Constitution. The bankruptcy court denied the motion to dismiss, again, on the basis that the procedures used in Brazil to bring such parties into the case differed from those in the U.S. but did not thereby render such order manifestly contrary to U.S. public policy or justify terminating the foreign representative's right to continue conducting discovery upon recognition under chapter 15. *In re Petroforte Brasileiro de Petroleo Ltda.*, 542 B.R. 899 (S.D. Fla. 2015) (noting that the Brazilian proceedings still required due process to prove that such third parties did business with the debtor with the intent to defraud creditors and that such third parties belonged to the same economic group as the bankrupt debtor).

As indicated in several decisions over the past twelve months, U.S. courts continue to apply a narrow reading of the section 1506 public policy exception as adopted in *In re Vitro* and *Fairfield Sentry*. But the narrow interpretation is not merely a U.S. construct; its roots are planted in the interpretation of article 6 of the UNCITRAL Model Law of Cross-Border Insolvency, which is likewise "only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting State." *In re OAS S.A.*, 533 B.R. at 103 (quoting *Fairfield Sentry*, 174 F.3d at 139). Such narrow construction contrasts with the broad spectrum of available relief to protect property in the U.S. described above—but the common thread is the ongoing

attempt by debtors to seek relief on both—and any available—bases. From that common thread of seeking relief by any colorable means, emerges a third trend: debtors unsuccessfully relying on their locus of corporate registration to shift COMI to a more favorable jurisdiction.

COMI and the Recognition of a Foreign Proceeding: But We're Registered There!

Although the place of registration of a debtor creates a rebuttable presumption of its center of main interest (COMI), courts over the course of the past year have repeatedly rejected hollow efforts to gain advantage by relying on such presumption. The bankruptcy court looked to the nerve center of the debtors and the expectations of its financial creditors in determining that COMI for the debtors was in Brazil and not in Austria, which was merely a place of registration and was immaterial to the creditors' decision to invest. *In re OAS S.A.*, 533 B.R. at 101-03 (finding the directors lived and met in Brazil and the debtor's business was in Brazil). The court also looked to the offering memorandum associated with the issuance of the notes whose holders were opposing recognition. The court noted that the risk factors therein warned of various Brazilian-related issues, including the fact that the debtor subsidiaries might become subject to Brazilian bankruptcy proceedings, under which the creditors might receive less favorable treatment than in the U.S. or other jurisdictions. *Id.*

While not related to determining COMI per se, a similar issue arose with respect to a debtor registered in Luxembourg attempting to bring a fraudulent transfer action in the U.S. under section 213 Insolvency Act 1986 in connection with a U.K. proceeding. The choice of law was challenged, a conflict of laws existed, and the court looked to New York law to determine which jurisdiction had the greatest interest in the alleged tort. New York law does not require strict adherence to the *lex loci* rule (*i.e.*, where the tort occurred), and the court looked to various factors, including where the harm occurred and where funds were ultimately transferred in determining that U.K. had the greatest interest in the transaction. *Hosking v. TPG Capital Mgmt., L.P. (In re Hellas Telecommc'ns (Lux.) II SCA*, 535 B.R. 543 (Bankr. S.D.N.Y. 2015). Defendant's argument that Luxembourg law should apply was unavailing, despite the fact that the debtor was registered in Luxembourg and had its COMI in Luxembourg at the time of the transfers.

Again, in *In re Creative Finance Ltd.*, the place of registration was not only insufficient for COMI purposes but figured into the "most blatant effort to hinder, delay and defraud a creditor" the court had ever seen. 543 B.R. 498, 502 (Bankr. S.D.N.Y. 2016). Despite conducting their business in the U.K., Spain and Dubai, the debtors commenced liquidation proceedings in the British Virgin Islands—a "letterbox jurisdiction" where the debtors were organized but conducted no business. Finding debtors acted in bad faith and that the appointed liquidator's efforts, given a shoestring budget from the debtors, "were so minimal that the Debtors' COMI never shifted . . . to the BVI." Indeed, the liquidator "failed to do enough to support a finding that the Debtors had an establishment in the BVI." Accordingly, the court denied the recognition of the sham BVI liquidation as either a foreign main or non-main proceeding under chapter 15.

Examples from decisions from the past twelve months demonstrate that the presumption of COMI based on registration is not only eminently rebuttable, but more common than one might think—and all parties in interest in cross-border cases would be wise to carefully consider assumptions about jurisdiction in their strategic analyses—not only with respect to place, but also to time. *See Flynn v. Wallance (In re The Irish Bank Resolution Corp. Ltd. (In Special Liquidation))*, 538 B.R. 692 (D. Del. 2015) (concluding that a debtor must qualify for chapter 15 recognition as of the filing of a petition and that a court won't examine a debtor's entire operational history in the U.S. to determine a debtor's eligibility at some time prior to filing).

Each of the three themes present in U.S. cross-border insolvency cases over the past year has its own application and context. Foreign debtors—and their creditors—need not be shy in asserting creative strategies for obtaining relief with respect to any U.S. property interests. In the spirit of cooperation, deference and comity that underscores chapter 15, courts continue to prove flexible in crafting appropriate relief. Indeed, although chapter 15 permits such flexibility to be constrained where requested relief would violate fundamental public policy of the United States, such constraints are reserved for the narrowest and truly fundamental concerns of the state. Finally, while such flexibility does not provide a *tabula rasa* on which foreign debtors and their

representatives may inscribe relief at will in the name of comity and deference. Where chapter 15 relief is based on hollow presumptions—like a place of corporate registration—U.S. courts have been careful to conscribe rights to those justified on the underlying realities of each case.