

ALERTS

Finance, Insolvency & Restructuring Alert - Chapter 15: An Effective Aid To Foreign Administrators And Creditors For Collecting And Liquidating Assets In The U.S.

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In these days of continued integration of the world economy, it is not unusual for a foreign-based business enterprise to own assets of substantial value in the United States either directly or through an affiliate. If the foreign enterprise commences an insolvency proceeding in its home country, there is substantial risk that local American creditors of the insolvent company may seek to attach these assets to satisfy their own claims to the prejudice of non-U.S. creditors. In these circumstances, foreign creditors are well-advised to approach the insolvency administrator or other representative of the foreign debtor and urge him or her to commence a case in the United States under Chapter 15 of the United States Bankruptcy Code to shield these assets from local creditor collection and foreclosure actions and preserve the value of these assets for all creditors of the foreign debtor.

It is not unusual for an administrator or trustee appointed in a foreign insolvency proceeding to be charged by the supervising foreign court with the responsibility of collecting and administering assets located in the United States. Prior to 2005, a foreign administrator could petition a United States bankruptcy court to commence a “case ancillary to a foreign proceeding” under former section 304 of the United States Bankruptcy Code (the “Code”). This provision was enacted by Congress in 1978 as part of the Bankruptcy Reform Act of that year when economic globalization was in its infancy. This provision also granted American bankruptcy courts significant discretion to either accept a foreign administrator’s petition to commence an ancillary case or to deny it altogether and many of these petitions were dismissed on various grounds. Dismissal of these petitions not only hamstrung foreign administrators in performing their duties to creditors but also injured those creditors, especially those holding liens in the American assets, by inhibiting (and sometimes prohibiting) them from sharing in these potential sources of recoveries.

Cooperation and Legal Certainty

In 2005, the United States Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act which, among other things, adopted with certain language changes the Model Law on Cross Border Insolvency approved by the United Nations General Assembly in 1997 (the “Model Law”). The Model Law has been incorporated into Chapter 15 of the Code and its statutory purpose is to provide “effective mechanisms for dealing with cases of cross-border insolvency.” The goals of Chapter 15 are expressed in sections 1501(a)(1)—(5) of the Code as follows:

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- to encourage cooperation between (i) the courts of the United States and its court officers (e.g., trustees and debtors in possession); and (ii) the courts and those officers of foreign countries involved in cross-border insolvency cases;
- to insure “greater legal certainty for trade and investment;”
- to provide for the “fair and efficient administration” of cross-border insolvency cases which will, in turn, protect the interests of all creditors and the debtor;
- to protect and maximize the value of the debtor’s assets; and
- to facilitate the rescue of financially troubled businesses, which will protect investments and preserve employment.

Chapter 15 of the Code permits a “foreign representative” appointed in a foreign insolvency proceeding to file a petition for the opening of a Chapter 15 case with a United States bankruptcy court that has proper venue for that proceeding as determined under 28 U.S.C. § 1410. In order for a foreign representative to prevail on his or her petition to open a Chapter 15 case, the bankruptcy court must make the following determinations:

- the foreign proceeding in which the foreign representative was appointed must be either a “foreign main proceeding” or a “foreign nonmain proceeding” as described in section 1502 of the Code.
- the foreign proceeding must be a “collective judicial or administrative proceeding” pending in a foreign country under laws relating to the insolvency or debt adjustment and in which proceeding the debtor’s assets and affairs “are subject to the control or supervision of a foreign court, for the purpose of reorganization or liquidation.” 11 U.S.C. § 101(23). A critical requirement here is that the foreign proceeding must be “collective,” meaning that the proceeding must consider the rights and obligations of all of the foreign debtor’s creditors and not just one or a small group of creditors. American courts have held, however, that the foreign proceeding need not be one that is identical to a regular bankruptcy case commenced under the Code. See, e.g., *In re Schimmelpenninck*, 183 F.3d 347, 353 (5th Cir. 1990).

These provisions of Chapter 15 of the Code were crafted to replace the discretionary test under now-repealed section 304 of the Code with an objective and mechanical test. According to one bankruptcy court applying these new principles of recognition, “the ability to provide relief to foreign petitioners [under former section 304] was largely discretionary, based on subjective factors and comity. However, with the advent of Chapter 15, courts have been divested of much of this discretion and are now directed by objective statutory guidelines.” *Lavine v. Ran*, 406 B.R. 277, 282 (S.D. Tex. 2009), *aff’d*, 2010 U.S. App. LEXIS 10882 (5th Cir. May 27, 2010). One statutory exception to granting recognition under Chapter 15 is when that action “would be manifestly contrary to the public policy of the United States.” 11 U.S.C. § 1506. However, American bankruptcy courts have generally construed this public policy exception narrowly, applying it only when the proposed action sought to be

prohibited would violate the “most fundamental policies of the United States.” See, e.g., *In re SPhinX, Ltd.*, 351 B.R. 103, 115 n. 15 (Bankr. S.D.N.Y. 2006).

Broad Scope of Relief

Once an American bankruptcy court recognizes a foreign main proceeding, the foreign representative is immediately granted a broad scope of relief under Chapter 15, including the application of the automatic stay to prohibit creditors from levying, executing upon, or otherwise enforcing claims against or rights in the debtor’s assets. Other relief includes authorizing the foreign representative to operate the debtor’s business in the United States. 11 U.S.C. § 1520. If the court recognizes the foreign proceeding as a nonmain proceeding, the bankruptcy court may enter an order staying identified creditors from seeking to realize upon the debtor’s assets in the United States and an order entrusting the administration of the debtor’s U.S. assets to the foreign representative. 11 U.S.C. § 1521. The court may also grant certain interim relief for the benefit of the foreign representative upon filing a Chapter 15 petition for recognition, which relief may include staying execution against the debtor’s assets and entrusting the administration of those assets to the foreign representative to preserve and protect those assets pending a ruling on the petition. 11 U.S.C. § 1519.

Once a petition for recognition of a foreign main proceeding is granted, the foreign representative may commence a voluntary bankruptcy proceeding in the United States for a subsidiary or other affiliate of the foreign debtor. 11 U.S.C. § 1511(a)(2). If the petition for recognition is granted with respect to a foreign nonmain proceeding, then the foreign representative may file an involuntary bankruptcy petition in the United States against a subsidiary or other affiliate of the foreign debtor. 11 U.S.C. § 1511(a)(1). If such voluntary or involuntary bankruptcy petition is filed by the foreign representative, the automatic stay of section 362 of the Code will immediately apply to enjoin creditors from taking any collection or foreclosure actions against these debtors or their property.

In summary, Chapter 15 is designed to accomplish an overriding purpose: to preserve and protect assets of a foreign debtor located in the United States so that all creditors of that debtor may share in their value – and not just local American creditors who move quickly against those assets to satisfy their parochial claims. Foreign creditors should be vigilant and proactive by persuading foreign representatives to file Chapter 15 petitions in the United States promptly to increase the creditors’ ultimate recoveries.

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