

Global Focus: Foreign Proceedings Recognized Under New Chapter 15

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Part of the sweeping bankruptcy reforms that became effective on October 17, 2005 is an entirely new chapter of the Bankruptcy Code — chapter 15 — governing cross-border bankruptcy and insolvency cases. Chapter 15 is patterned after the Model Law on Cross-Border Insolvency, a framework of legal principles formulated by the United Nations Commission on International Trade Law in 1997 to deal with the rapidly expanding volume of international insolvency cases.

Long-heralded chapter 15 replaces section 304 of the Bankruptcy Code. Section 304 allowed an accredited representative of a debtor in a foreign insolvency proceeding to commence a limited "ancillary" bankruptcy case in the U.S. for the purpose of protecting the foreign debtor's U.S. assets from creditor collection efforts, and in some cases, facilitating the repatriation of those assets abroad to be administered in the debtor's insolvency or bankruptcy case. Chapter 15 continues that practice, but establishes new rules and procedures applicable to transnational bankruptcy cases.

The new legislative regime governing cross-border bankruptcies having become effective on October 17, 2005, it has been left to the courts to iron out the details. Judging by rulings recently handed down by bankruptcy courts in New York and California, the transition from section 304 to chapter 15 appears to be proceeding smoothly. These

courts are the first to recognize the "main proceedings" of foreign business debtors under chapter 15.

The Purpose of Chapter 15

Chapter 15's purpose is "to provide effective mechanisms for dealing with cases of cross-border insolvency" consistent with the following objectives:

- cooperation between U.S. and non-U.S. courts and related functionaries;
- greater legal certainty for trade and investment;
- fair and efficient administration of cross-border cases in a way that protects the interests of all interested parties;
- protection and maximization of the value of the debtor's assets; and
- facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

Procedure

An accredited representative of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding." "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."

Because more than one bankruptcy or insolvency proceeding may be pending against the same foreign debtor in different countries, chapter 15 contemplates "recognition" in the

U.S. of both a "main" proceeding — a case pending in whatever country contains the debtor's "center of main interest" — and "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment" (conducts business or owns assets). The debtor's registered office is presumed to be the center of the debtor's main interest.

If the U.S. bankruptcy court is provided with sufficient evidence (delineated in the statute) testifying to the legitimacy of a pending foreign bankruptcy proceeding (main, nonmain or both), it may enter an "order of recognition."

Interim Relief

Pending its decision on recognition, the court is empowered to grant certain kinds of provisional relief. Section 1521 authorizes the court, "where relief is urgently needed to protect the assets of the debtor or the interests of the creditors," to stay any execution against the debtor's assets, entrust the administration of the debtor's assets to a foreign representative, or suspend the right to transfer, encumber or otherwise dispose of any of the debtor's assets.

Broad Powers Upon Recognition

Upon recognition of a foreign proceeding, certain provisions of the Bankruptcy Code automatically come into force, and others may be deployed in the bankruptcy court's discretion by way of "additional assistance" to the foreign bankruptcy case. Among these are the automatic stay (or an equivalent injunction) preventing creditor collection efforts with respect to the debtor or its assets located in the U.S. (section 362, subject to certain

enumerated exceptions), the right of any entity asserting an interest in the debtor's U.S. assets to "adequate protection" of that interest (section 361), and restrictions on the debtor's ability to use, sell or lease its U.S. property outside the ordinary course of its business (section 363).

Once a foreign main proceeding is recognized by the bankruptcy court, the foreign representative may also commence a full-fledged bankruptcy case under any other chapter of the Bankruptcy Code, so long as the foreign debtor is eligible to file for bankruptcy in the U.S. and the debtor has assets located in the U.S.

Chapter 15 expressly gives foreign creditors a significant degree of access and protection. For example, foreign creditors are entitled to notification of the commencement of a case under chapter 15. Among other things, the notice must specify the deadline for submitting documentation of unsecured and secured claims against the debtor. Foreign creditors have the same rights as domestic creditors regarding the commencement of, and participation in, a case under the Bankruptcy Code.

The law, however, is non-committal as to whether foreign unsecured creditor claims are entitled to the same priority of distribution specified in sections 507 and 726 of the Bankruptcy Code. Instead, it provides that "the claim of a foreign creditor under those sections shall not be given a lower priority than that of general unsecured claims without priority solely because the holder of such claim is a foreign creditor."

Cooperation and Coordination

Chapter 15 was designed to promote cooperation and coordination between courts in two or more countries presiding over bankruptcy or insolvency proceedings involving the same debtor. To that end, the U.S. bankruptcy court, and with court supervision, any bankruptcy trustee or examiner, are authorized to communicate directly with a foreign court or a foreign representative.

If more than one bankruptcy case is commenced with respect to a foreign debtor in the U.S., chapter 15 creates a mechanism to coordinate the proceedings. Thus, for example, if a foreign debtor is already concurrently the subject of a foreign proceeding and a chapter 7 or 11 case in the U.S. when its foreign representative commences a chapter 15 case, the U.S. bankruptcy court, if it recognizes the foreign proceeding, is obligated to harmonize any relief it decides to grant in the chapter 15 case so that it is consistent with the relief granted in the chapter 11 case. Similarly, if the representative files a chapter 7 or 11 case in the U.S. after the bankruptcy court recognizes a pending foreign proceeding under chapter 15, the bankruptcy court must review the relief it has already granted under chapter 15 to ensure that it is consistent with the relief granted in the chapter 7 or 11 case. The bankruptcy court is also entrusted with coordinating nonmain foreign proceedings.

In addition, chapter 15 establishes rules to account for the possibility that creditors of a foreign debtor may have received full or partial satisfaction of their claims from sources outside of the U.S. Chapter 15 provides that "[w]ithout prejudice to secured claims or rights in rem, a creditor who has received payment with respect to its claim in a foreign proceeding pursuant to a law relating to insolvency may not receive a payment for the

same claim in a case under any other chapter of [the U.S. Bankruptcy Code] regarding the debtor, so long as the payment to other creditors of the same class is proportionately less than the payment the creditor has already received."

Protection of Foreign Creditors

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Chapter 15 in Practice: Recent Recognition Rulings

Bankruptcy courts in New York and California were the first to apply the new legislative framework to foreign commercial debtors. On December 7, 2005, Judge Burton R. Lifland of the U.S. Bankruptcy Court for the Southern District of New York issued an order recognizing the U.K insolvency proceedings of Les Mutuelle du Mans Assurances IARD ("MMA"), the U.K. branch of French insurer La Mutuelle du Mans Assurances

IARD, as a "foreign main proceeding" under chapter 15. Judge Lifland also permanently enjoined creditors from moving against MMA's assets.

MMA was the subject of an insolvency proceeding under the U.K. Companies Act of 1985. The High Court of Justice of England and Wales approved a "scheme of arrangement" for the insurer on October 28, 2005. MMA filed its chapter 15 petition on November 11, 2005 to gain time to make payouts under the scheme and to prevent creditors from suing it or attaching its assets in the U.S. Judge Lifland found that the "center of main interest" in the foreign proceeding is in the U.K., and not France, despite the fact that MMA is the U.K. branch of a French company. Among other things, the order recognizing MMA's proceeding provides that "[t]he scheme of arrangement sanctioned by the U.K. High Court in the foreign proceeding shall be given full force and be binding on all persons and entities in the United States." MMA's chapter 15 petition was the first filed in New York.

The U.S. Bankruptcy Court for the Central District of California also recognized a foreign main proceeding under chapter 15 on December 7, 2005. The debtor is TriGem Computer Inc. of South Korea, which filed its chapter 15 petition on November 3, 2005 seeking recognition of a corporate reorganization proceeding filed by its corporate parent in the Bankruptcy Division of the Suwon District Court. Bankruptcy Judge Thomas Donovan enjoined creditors from proceeding against TriGem's U.S. assets and forced creditors to file their claims overseas.

Individual Ian Thou officially filed the first chapter 15 petition in the U.S. He filed his petition on November 2, 2005 with the U.S. Bankruptcy Court for the Western District of Washington seeking recognition of a foreign main proceeding pending in Vancouver, British Columbia.

Outlook

To date, the U.S., Japan, Eritrea, Mexico, Poland, South Africa, and within Yugoslavia, Montenegro have adopted bankruptcy laws patterned after the Model Law. Canada, Australia, New Zealand and the U.K. are actively considering whether to do so. Before chapter 15 was enacted, progress on implementing the principles contained in the Model Law was all but stalled as many countries waited to see whether the U.S. would sign on to the project. It remains to be seen whether the enactment of chapter 15 will jump-start the process.

The importance of meaningful progress in this area cannot be overstated — the EU's enactment in 2002 of the European Union Regulation on Insolvency Proceedings gave Europe an advantage in the global commerce arena by creating a unified system of rules applying to insolvency proceedings in member countries. To a considerable degree, transnational trade players outside of the EU are still forced to cope with the vagaries of a hodgepodge of different laws governing such proceedings in the rest of the world. With chapter 15 finally in place, the U.S. has taken a big step toward leveling the playing field.

Recent decisions granting recognition to foreign insolvency proceedings indicate that the framework established by chapter 15 is functioning as it was intended. Still, not all

recent developments are unequivocally positive. For example, a New York district court recently held that chapter 15 is the only recourse for an accredited representative of a foreign debtor seeking to enjoin U.S. litigation against the debtor. Although injunctive relief is clearly authorized by chapter 15, there is no indication that the statute was intended to preclude such a remedy outside of chapter 15 in accordance with traditional principles of comity that have been applied by federal courts for hundreds of years.

In re Petition of Lloyd, Case No. 05-60100 (BRL) (Bankr. S.D.N.Y. Dec. 7, 2005) (unpublished order).

In re TriGem Computer, Inc., Case No. 2:05-bk-50052-TD (Bankr. C.D. Cal. Dec. 7 2005) (unpublished order).

U.S. v. J.A. Jones Construction Group, LLC, 2005 WL 3177053 (E.D.N.Y. Nov. 29, 2005).