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# CHAPTER 15 IN PRACTICE: BANKRUPTCY COURT LACKS JURISDICTION TO ADJUDICATE AVOIDANCE ACTIONS IN CHAPTER 15 UNDER U.S. OR FOREIGN LAW

April 17, 2009, will mark the three-and-one-half-year anniversary of the effective date of chapter 15 of the Bankruptcy Code, which was enacted as part of the comprehensive bankruptcy reforms implemented under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Governing cross-border bankruptcy and insolvency cases, chapter 15 is patterned after the Model Law on Cross-Border Insolvency (the "Model Law"), 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. The Model Law has now been adopted in one form or another by 15 nations or territories.

The jurisprudence of chapter 15 has evolved rapidly since 2005, as courts have transitioned in relatively short order from considering the theoretical implications of a new legislative regime governing cross-border bankruptcy and insolvency cases to confronting the new law's real-world applications. An important step in that evolution was the subject of a ruling recently handed down by a Mississippi district court. In *Fogerty v. Condor Guaranty, Inc. (In re Condor Insurance Limited (In Official Liquidation)*, 2009 WL 321627 (S.D. Miss. Feb. 9, 2009), the court held that, unless the representative of a foreign debtor seeking to avoid pre-bankruptcy asset transfers *under either U.S. or foreign law* first commences a case under chapter 7 or 11 of the U.S. Bankruptcy Code, a bankruptcy court lacks subject matter jurisdiction to adjudicate the avoidance action.

## PROCEDURES AND RELIEF UNDER CHAPTER 15

Under chapter 15, a duly 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 interests"—and "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment."

Upon recognition of a foreign "main" proceeding, certain provisions of the Bankruptcy Code automatically come into force, while 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); the power to avoid unauthorized post-recognition asset transfers (section 549); 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). In contrast, if the foreign proceeding is recognized as a "nonmain" proceeding, then the bankruptcy court may, but is not required to, grant a broad range of provisional and other relief designed to preserve the foreign debtor's assets or otherwise provide assistance to a main proceeding pending elsewhere.

Once a foreign main proceeding is recognized by the bankruptcy court, the foreign representative is authorized to operate the debtor's business in much the same way as a chapter 11 debtor-in-possession. He can 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 U.S. assets.

The foreign representative in a recognized chapter 15 case may intervene in any court proceedings in the U.S. in which the foreign debtor is a party, and it can sue and be sued in the U.S. on the foreign debtor's behalf. The representative is also conferred with some of the powers given to a bankruptcy trustee under the Bankruptcy Code, although those powers do not include the ability to invalidate pre-bankruptcy preferential or fraudulent asset transfers or obligations, unless a case is pending with respect to the foreign debtor under another chapter of the Bankruptcy Code.

This limitation is spelled out in sections 1521 and 1523 of the Bankruptcy Code. Section 1521(a)(7) provides that upon recognition of a foreign proceeding, the court may grant "any appropriate relief" including "additional relief that may be available to a trustee, *except for relief available under sections 522, 544, 545, 547, 548, 550 and 724(a).*" Section 1523(b) authorizes the bankruptcy court to order relief necessary to avoid acts that are "detrimental to creditors," providing that, upon recognition of a foreign proceeding, a foreign representative has "standing in a case concerning the debtor *under another chapter of this title* to initiate actions under sections 522, 544, 545, 547, 548, 550 and 724(a)." The referenced provisions of the Bankruptcy Code pertain generally to a bankruptcy trustee's powers to avoid pre-bankruptcy transfers that are either preferential or fraudulent.

The legislative history of sections 1521 and 1523 provide as follows:

> [Section 1521] follows article 21 of the Model Law, with detailed changes to conform to United States law. The exceptions in subsection (a)(7) relate to avoiding powers. The foreign representative's status as to such powers is governed by section 1523 below.
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> [Section 1523] follows article 23 of the Model Law, with wording to fit it within procedure under this title. It confers standing on a recognized foreign representative to assert an avoidance action but only in a pending case under another chapter of this title. The Model Law is not clear about whether it would grant standing in a recognized foreign proceeding if no full case were pending. This limitation reflects concerns raised by the United States delegation during the UNCITRAL debates that a simple grant of standing to bring avoidance actions neglects to address very difficult choice of law and forum issues. This limited grant of standing in

> section 1523 does not create or establish any legal right of avoidance nor does it create or imply any legal rules with respect to the choice of applicable law as to the avoidance of any transfer of obligation. The courts will determine the nature and extent of any such action and what national law may be applicable to such action.

H.R. Rep. 109-31(I), at 178–79 (2005) (footnotes omitted). In *Condor Insurance*, the court considered whether sections 1521 and 1523 preclude a foreign representative in a chapter 15 proceeding from seeking to avoid transfers *under non-U.S. law* without first commencing a chapter 7 or 11 case with respect to the debtor.

## CONDOR INSURANCE

Condor Insurance, Limited ("Condor"), is a corporation organized under the laws of the Federation of Saint Kitts and Nevis that formerly operated an insurance and surety bond business. Condor became the subject of a winding-up petition under Nevis law in 2007. The company's court-appointed liquidators filed a petition the following year in the U.S. for recognition of the Nevis winding-up proceeding under chapter 15. After the Mississippi bankruptcy court entered an order recognizing the winding-up as a foreign main proceeding under chapter 15, the liquidators commenced an adversary proceeding in the bankruptcy court seeking to avoid as fraudulent transfers aggregating more than $313 million to Condor affiliates and principals. The defendants moved to dismiss, claiming that the bankruptcy court lacked jurisdiction to grant the relief requested. The bankruptcy court agreed.

On appeal to the district court, the liquidators argued that the language of sections 1521 and 1523 clearly indicates that foreign representatives are prohibited from utilizing certain sections of the U.S. Bankruptcy Code to avoid transfers but are not precluded from relying on foreign law to do so. The district court concluded that "the plain language of the statutes does not specifically address the use of avoidance powers under foreign law." Even so, the court emphasized, "the choice of law that is to be applied to a lawsuit is determined by a court having jurisdiction over the case, and the parties are not permitted to choose whatever law they wish when filing a lawsuit."

According to the district court, section 1521 speaks to the "types of powers and relief" that are available to a foreign representative, and lawmakers arguably referred to specific provisions of the Bankruptcy Code merely "to specify the types of powers that foreign representatives do not have." Given its conclusion that the express language of the provisions is ambiguous, the district court examined their legislative history. Based on that inquiry, the court concluded that sections 1521(a)(7) and 1523 "are intended to exclude all of the avoidance powers specified, under either United States or foreign law, unless a Chapter 7 or 11 bankruptcy proceeding is instituted." A contrary determination, the court explained, "would conflict with Congress' expressed desire that courts make the choice of law determination in a full bankruptcy proceeding." It accordingly affirmed the ruling below.

## OUTLOOK

*Condor Insurance* is indicative of the kinds of challenges faced by U.S. courts in fleshing out the details of a relatively new and untested legislative framework. The ruling may also illustrate that, despite the many years devoted by lawmakers, restructuring professionals, and international law experts to the arduous task of devising a workable framework of rules applying to cross-border bankruptcy cases, questions linger regarding how the rules are supposed to work. For example, notwithstanding the district court's reasoning in *Condor Insurance*, it is not clear, based upon the express language of chapter 15 and its brief legislative history, whether lawmakers intended to preclude actions to avoid pre-bankruptcy transfers under *foreign law* in the absence of a chapter 7 or 11 filing by the debtor.

The bankruptcy or insolvency laws of several other nations (*e.g.*, Germany, the U.K., and Japan) provide that transfers that either are fraudulent or unfairly prefer creditors may be voided by the functional equivalent of a bankruptcy trustee. In ancillary proceedings commenced under former section 304 of the Bankruptcy Code, some courts disagreed as to whether the representative of a foreign debtor could, simply by filing a section 304 petition in the U.S., legitimately assert avoidance powers arising under non-U.S. law to recover assets located in the U.S. The prevailing view on that question was that avoidance powers were not available in an ancillary proceeding but could be used in a plenary

case under chapter 7 or 11. According to the court in *Condor Insurance*, chapter 15 continues that practice—sections 1521 and 1523 preclude the assertion of avoidance actions arising under domestic or foreign law in the absence of a filing under another chapter of the Bankruptcy Code. However, with the exception of section 544 (discussed below), sections 1521(a)(7) and 1523(b) expressly reference only transfers that can be avoided under other provisions of the U.S. Bankruptcy Code. The legislative history certainly suggests that lawmakers intended the limitation to encompass avoidance causes of action under non-U.S. law due to difficult choice-of-law and -forum questions, but the provisions do not on their face express this intention.

Finally, one avenue of inquiry on this issue apparently overlooked by the court in *Condor Insurance* is the impact of section 544 (which is among the provisions referenced in sections 1521 and 1523). Section 544(b) provides that a bankruptcy trustee may avoid any transfer "that is voidable under applicable law" by an unsecured creditor of the debtor. If "applicable law" were interpreted to include foreign law, the bar to asserting avoidance powers under non-U.S. law in stand-alone chapter 15 cases would be less equivocal.

*Condor Insurance* does not represent the first instance that a U.S. bankruptcy court has been asked to decide whether a foreign representative in a chapter 15 proceeding can seek to avoid transfers under non-U.S. law. In *In re Loy*, 2008 WL 906503 (Bankr. E.D. Va. Apr. 3, 2008), the court ruled that a foreign representative could not sell the debtor's real property free and clear of a lien that was purportedly void or voidable under English law and section 549 of the Bankruptcy Code because the lien was recorded after the property became part of the debtor's bankruptcy estate. The court acknowledged that relief under the Bankruptcy Code's pre-bankruptcy transfer avoidance and recovery provisions can be granted only if the debtor is the subject of a case under another chapter of the Bankruptcy Code, while relief under section 549 regarding post-bankruptcy transfers can be granted in a chapter 15 proceeding. Even so, the *Loy* court ruled that avoidance under section 549 (regardless of the underlying substantive law) cannot be granted in the context of a motion under section 363(f) to sell property free and clear because the Bankruptcy Code requires that such relief be sought in an adversary proceeding.

## LAWYER CONTACTS

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