Chapter 15 Debut in the Circuits

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April 17, 2010, marked the four-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 18 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. Until 2010, however, cases involving the interpretation of chapter 15's provisions had risen no higher in the appellate hierarchy than the federal district courts. That changed in March 2010, when the Fifth Circuit handed down its highly anticipated ruling in *Fogerty v. Petroquest Resources, Inc. (In re Condor Insurance Limited).* In that case, Mississippi bankruptcy and district courts held that unless the representative of a foreign debtor seeking to avoid prebankruptcy 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. The Fifth Circuit reversed on appeal, ruling that "[a]s Chapter 15 was intended to facilitate cooperation between U.S. courts and foreign

bankruptcy proceedings, we read section 1521(a)(7) in that light and hold that a court has authority to permit relief under foreign avoidance law under the section."

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 the country that 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 representative. 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 postrecognition 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 has been recognized by the bankruptcy court, the foreign representative is authorized to operate the debtor’s U.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 proceeding 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 most prebankruptcy 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 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 pending *under another chapter of this title* to initiate actions under sections 522, 544, 545, 547, 548, 550, 553, and 724(a)." The referenced provisions of the Bankruptcy Code pertain generally to a bankruptcy trustee's powers to avoid prebankruptcy transfers that are either preferential or fraudulent.

The legislative history of sections 1521 and 1523 provides 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 courts 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 St. 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 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. On the basis of 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.

The Fifth Circuit’s Ruling

The Fifth Circuit reversed on appeal. Addressing the interpretation of chapter 15 as a matter of first impression in the federal circuit courts of appeal, the Fifth Circuit examined the language of sections 1521 and 1523 as well as the legislative provenance of chapter 15 as a progeny of the Model Law. The avoidance-power exceptions to “any appropriate relief” delineated in section 1521(a)(7), the court of appeals explained, do not exist in the Model Law, and “[w]hile it is plain that relief under the listed sections is excluded, the statute is silent regarding proceedings that apply foreign law, including any rights of avoidance such law may offer.” In accordance with traditional rules of statutory construction, the Fifth Circuit wrote, exceptions beyond the U.S. avoidance powers expressly included in the provision “are not to be implied.” According to the court, “If Congress wished to bar all avoidance actions whatever their source, it could have stated so; it did not.”

Chapter 15’s stated purpose—“to incorporate the Model Law . . . so as to provide effective mechanisms for dealing with cases of cross-border insolvency”—and its overall structure, the

Fifth Circuit observed, “strongly suggest” that section 1521(a)(7) does not exclude avoidance actions under foreign law:

> The structure of Chapter 15 provides authority to the district court to assist foreign representatives once a foreign proceeding has been recognized by the district court. Neither text nor structure suggests additional exceptions to available relief. Though the language does not explicitly address the use of foreign avoidance law, it suggests a broad reading of the powers granted to the district court in order to advance the goals of comity to foreign jurisdictions. And this silence is loud given the history of the statute including the efforts of the United States to create processes for transnational businesses in extremis.

The court of appeals rejected the argument that permitting the application of foreign avoidance law in a chapter 15 case would allow foreign representatives to “section-shop” by commencing a chapter 15 case when they seek to use foreign law or by filing a chapter 7 or 11 case when they seek to use U.S. avoidance law. According to the Fifth Circuit, conflicts-of-law issues are inherent in cross-border bankruptcy cases and were considered carefully by the drafters of the Model Law and chapter 15:

> UNCITRAL’s Working Group on Insolvency Law examined three potential approaches to the question of which law a recognizing court should apply. The first approach would allow the recognizing court to apply its own law. This was favored by some countries concerned with the potential lack of familiarity with foreign law by recognizing courts. The second approach would apply the law of the main proceeding. This approach was favored by some as it “would lead to a more consistent, harmonized result, in view of divergences among national insolvency laws” and would help “avoid abetting debtors seeking to conceal assets behind another law that might provide a haven for those assets.” A third approach was to permit the recognizing court to apply either the law of the main proceeding or its own law—a solution which might “provide flexibility needed to limit insulation of assets from insolvency proceedings.” However this approach drew concern that it might raise the potential that a foreign representative “would be enabled to exercise more powers than those that would be available to the representative under the law of the appointing jurisdiction.”
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> The final provision did not accept any of these three approaches in full. Rather, the Model Law permitted the recognizing court to grant any appropriate relief and granted standing to the foreign representatives to bring avoidance actions under the law of the recognizing state. This purposefully left open the question of which

> law the court should apply—in deference to the choice of law concerns raised by the United States.
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> The drafters of Chapter 15, responsive to the concerns raised at the UNCITRAL debates, confined actions based on U.S. avoidance law to full Chapter 7 and 11 bankruptcy proceedings—where the court would also decide the law to be applied to the distribution of the estate. The application of foreign avoidance law in a Chapter 15 ancillary proceeding raises fewer choice of law concerns as the court is not required to create a separate bankruptcy estate. It accepts the helpful marriage of avoidance and distribution whether the proceeding is ancillary applying foreign law or a full proceeding applying domestic law—a marriage that avoids the more difficult depecage rules of conflict law presented by avoidance and distribution decisions governed by different sources of law.
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> It is no happenstance that this solution also addresses the concern that foreign representatives would bring an ancillary action simply to gain access to avoidance powers not provided by the law of the foreign proceeding. Access to foreign law offers no opportunity to gain the powers of avoidance provided by the U.S. Bankruptcy Code when there is no such power offered by the foreign state—at least not without filing a full bankruptcy case under the Code—and deference to comity does not invite forum shopping.

Its conclusion that Congress did not intend to preclude application of foreign avoidance law in chapter 15 cases, the Fifth Circuit emphasized, is supported by the practice in "ancillary proceedings" commenced under chapter 15's predecessor—section 304 of the Bankruptcy Code. For example, a New York bankruptcy court in 1987 in *In re Metzler* rejected earlier authority suggesting that bankruptcy courts had discretion to authorize the utilization of U.S.-law avoidance powers in a section 304 proceeding. However, the court ruled that only avoidance actions relying upon foreign law were permitted under section 304, in keeping with the limited role of U.S. courts in providing assistance to the administration of foreign bankruptcy proceedings. In *Condor Insurance*, the Fifth Circuit determined that, in enacting chapter 15, "Congress essentially made explicit *In re Metzler*'s articulation of the bar on access to avoidance powers created by the U.S. [Bankruptcy] Code by foreign representatives in ancillary proceedings."

Finally, the Fifth Circuit concluded that access to foreign avoidance laws in a chapter 15 case does not offend important policy considerations affecting domestic and global commerce:

> [T]he application of foreign law under Chapter 15 of the Bankruptcy Code implicates none of the salient concerns driving reliance by United States Courts upon the law of foreign nations in defining domestic norms. Providing access to domestic federal courts to proceedings ancillary to foreign main proceedings springs from distinct impulses of providing protection to domestic business and its creditors as they develop foreign markets. Settled expectations of the rules that will govern their efforts on distant shores is an important ingredient to the risk calculations of lenders and corporate management. In short, Chapter 15 is a congressional implementation of efforts to achieve the cooperative relationships with other countries essential to this objective. The hubris attending growth of the country's share of international commerce rests on a nourishing of its exceptionalism not its diminishment.

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. As noted, *Condor Insurance* represents the debut of chapter 15 in the circuit courts of appeal. Other decisions at the circuit level are likely in the near future as disputed issues regarding application and interpretation of the chapter's provisions percolate upward through the appellate process.

Condor Insurance does not represent the first instance that a U.S. 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*, a Virginia bankruptcy court ruled in 2008 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 prebankruptcy 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 postbankruptcy 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.

Finally, *Condor Insurance* is not alone among the recent significant developments in the evolving chapter 15 jurisprudence. Another breaking development was the subject of a ruling handed down in March 2010 by a Pennsylvania bankruptcy court. In *In re RHTC Liquidating Co.*, an involuntary chapter 7 petition was filed in the U.S. against a U.S.-incorporated company that, together with its Canadian parent corporation, was a debtor in a Canadian bankruptcy proceeding. The involuntary case was filed by U.S. creditors shortly after the Canadian proceeding had been recognized under chapter 15 by a U.S. bankruptcy court.

The bankruptcy court denied the foreign representative's motion to dismiss the chapter 7 case under section 305(a)(2) of the Bankruptcy Code, which provides that the court may dismiss or suspend all proceedings in a chapter 15 case if "the purposes of chapter 15 . . . would be best served by such dismissal or suspension." The court concluded that the representative failed to

satisfy its burden of showing that dismissal of the parallel involuntary chapter 7 petition, which had been filed by creditors holding roughly 85 percent of the U.S. subsidiary's unsecured debt, would best serve the purposes of chapter 15. Dismissal, the court explained, was not necessarily warranted on grounds of comity because: (i) it was unclear what interest Canada had in applying Canadian insolvency law to a U.S. company, given that funds to be distributed to creditors were derived primarily from the sale of assets located in the U.S.; (ii) dismissal did not appear to further the purpose of providing legal certainty, as creditors or investors dealing with the company in the U.S., where most of the company's assets and operations were located even though its headquarters were in Canada, would presumably anticipate that any liquidation of the company would also occur in the U.S.; and (iii) the petitioning U.S. creditors raised concerns about whether their interests were being adequately protected in the Canadian proceedings. *RHTC Liquidating* is one of the first rulings to address "abstention" under section 305(a)(2), which was enacted as part of the 2005 U.S. bankruptcy reforms specifically to govern chapter 15 cases.

Fogerty v. Petroquest Resources, Inc. (In re Condor Insurance Limited), 601 F.3d 319 (5th Cir. 2010), *reversing Fogerty v. Condor Guaranty, Inc. (In re Condor Insurance Limited (In Official Liquidation))*, 411 B.R. 314 (S.D. Miss. 2009).

In re Metzler, 78 B.R. 674 (Bankr. S.D.N.Y. 1987).

In re Loy, 2008 WL 906503 (Bankr. E.D. Va. Apr. 3, 2008).

In re RHTC Liquidating Co., 424 B.R. 714 (Bankr. W.D. Pa. 2010).