Breaking New Ground (Again) in Chapter 15

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Two recent decisions from the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") have further contributed to the rapidly expanding volume of chapter 15 jurisprudence. In *In re Fairfield Sentry Ltd.*, 2011 WL 1998374 (Bankr. S.D.N.Y. May 23, 2011), and *In re Fairfield Sentry Ltd.*, 2011 WL 1998376 (Bankr. S.D.N.Y. May 23, 2011), bankruptcy judge Burton R. Lifland rendered two decisions involving offshore "feeder funds" that invested in the massive Ponzi scheme associated with Bernard L. Madoff Investment Securities LLC ("BLMIS"). Judge Lifland ruled, in matters of apparent first impression, that: (i) the court would not remand or abstain from hearing actions commenced by the foreign representatives of a foreign debtor seeking recovery or avoidance of transfers made in connection with the Madoff Ponzi scheme; and (ii) the tolling provisions of the Bankruptcy Code apply in chapter 15, such that the foreign representatives would receive an extension of deadlines in connection with both pending and potential lawsuits.

Removal of Litigation to the Bankruptcy Court

One of the benefits of filing for bankruptcy is that it suspends piecemeal litigation against the debtor and its assets in potentially hundreds of different courts and centralizes litigation in a single coordinated forum. To that end, the debtor and anyone who is involved in litigation with the debtor are permitted pursuant to 28 U.S.C. § 1452(a) to "remove" to the district court certain kinds of litigation pending in state or other federal courts. In most districts, such removed actions are then automatically referred to the bankruptcy court. In accordance with Rule 9027 of the

Federal Rules of Bankruptcy Procedure ("Bankruptcy Rule 9027"), removal requires only that the litigant file a notice of removal with the district court, or the bankruptcy court in districts in which such matters are automatically referred to the bankruptcy court, within a prescribed period that varies according to whether the litigation was commenced prior or subsequent to the bankruptcy petition date.

The notice must contain a statement indicating whether, once removed, the action would be within the bankruptcy court's "core" jurisdiction and, if not, whether the removing litigant consents to the entry of final orders or judgment by the bankruptcy court. Court approval is not necessary. Certain actions, however, may not be removed to the district or bankruptcy court. These include noncivil actions (*e.g.*, criminal, administrative, and arbitration proceedings), tax court proceedings, certain governmental proceedings, and claims or causes of action over which the district court does not have jurisdiction.

Remand and Abstention

Once litigation has been "removed" to the district or bankruptcy court, under certain circumstances, the court can "remand" such removed litigation to the court from which it came. Pursuant to 28 U.S.C. § 1452(b), the court may remand a removed "claim or cause of action on any equitable ground." Factors that courts consider in determining whether "equitable remand" is appropriate include: (1) the effect of the action on the administration of the bankruptcy estate; (2) the extent to which issues of state law predominate; (3) the complexity of applicable state law; (4) "comity," or the interest that a state has in developing its law and applying its law to its citizens; (5) the relatedness or remoteness of the action to the bankruptcy case; (6) the existence of a right

to jury trial; and (7) prejudice to the party involuntarily removed from state court. A court's decision on a remand request is not subject to appellate review above the district court level.

A related concept—"abstention"—involves the bankruptcy court's determination not to hear a case because another forum is more appropriate. "Permissive abstention" from adjudicating particular controversies in a bankruptcy case is authorized by 28 U.S.C. § 1334(c)(1), which provides (with emphasis added):

> *Except with respect to a case under chapter 15 of title 11*, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

Permissive abstention is allowed even in disputes involving the bankruptcy court's "core" jurisdiction, such as litigation to avoid preferential or fraudulent transfers, although bankruptcy courts seldom abstain from hearing these cases. The italicized reference to chapter 15 cases was added to section 1334(c)(1) when chapter 15 was enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

In determining whether permissive abstention is appropriate, courts consider many of the same factors applied in connection with a remand request. Additional factors include: (1) the feasibility of severing state-law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court; (2) the burden on the court's docket; (3) whether commencement of the proceeding in a bankruptcy court involves forum shopping by one of the parties; and (4) the presence in the proceeding of nondebtor parties.

Pursuant to 28 U.S.C. § 1334(c)(2), a bankruptcy court is obligated to abstain from hearing certain types of cases that are "related to" a bankruptcy case, but not "arising under" the Bankruptcy Code or "arising in a case" under the Bankruptcy Code. "Mandatory abstention" is warranted "[u]pon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to" a bankruptcy case with respect to which there is no other basis for federal court jurisdiction and the action can be timely adjudicated in state court. Other than the denial of a request for mandatory abstention, a ruling on an abstention motion under section 1334(c) is not reviewable on appeal above the district court level.

Abstention from adjudicating proceedings under section 1334(c) is distinct from the bankruptcy court's "abstention" powers under section 305 of the Bankruptcy Code. That provision authorizes the court to dismiss a bankruptcy *case* or suspend all proceedings in a bankruptcy case, if the interests of creditors or the debtor would be better served by dismissal or suspension, or if the purposes of chapter 15 would be best served by dismissal or suspension.

Tolling Under Section 108

Section 108 of the Bankruptcy Code essentially establishes a two-year deadline from entry of the bankruptcy "order for relief" for a bankruptcy trustee (or a chapter 11 debtor in possession) to commence actions on behalf of the estate, provided that the applicable time period did not expire before the filing of the bankruptcy petition. Section 108(a) provides:

> If applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the debtor may commence an action, and such period has not expired before the date of the filing of the petition, the trustee may commence such action only before the later of—(1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or (2) two years after the order for relief.

Section 108(b) similarly provides a short extension of time for filing pleadings, curing defaults, and performing other acts on behalf of the debtor:

> Except as provided in subsection (a) of this section, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the debtor . . . may file any pleading, demand, notice, or proof of claim or loss, cure a default, or perform any other similar act, and such period has not expired before the date of the filing of the petition, the trustee may only file, cure, or perform, as the case may be, before the later of—(1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or (2) 60 days after the order for relief.

These provisions are made applicable to chapter 15 cases by section 103(a) of the Bankruptcy Code, which provides in relevant part that "chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title, *and this chapter*, sections 307, 362(n), 555 through 557, and 559 through 562 apply in a case under chapter 15" (emphasis added).

Fairfield Sentry

Fairfield Sentry Limited and two affiliates (collectively, "Fairfield") were organized under the laws of the British Virgin Islands ("BVI") as "feeder funds" for BLMIS. Shortly after it was revealed in December 2008 that disgraced former investment maven Bernard L. Madoff had orchestrated the largest Ponzi scheme in history, certain of Fairfield's shareholders and creditors commenced insolvency proceedings on behalf of Fairfield in the BVI.

The BVI court-appointed joint liquidators (the "liquidators") for Fairfield filed petitions on June 14, 2010, in the Bankruptcy Court seeking recognition of the BVI insolvency proceedings as foreign "main proceedings" under chapter 15 of the Bankruptcy Code. The Bankruptcy Court granted the petition and formally recognized the BVI insolvency proceedings on July 22, 2010.

Prior to filing for chapter 15 recognition, the liquidators, with the BVI court's approval, sued hundreds of Fairfield's subscribers in New York state courts, seeking the return of redemption payments allegedly made as part of the Ponzi scheme. Those actions asserted equitable and restitutionary common-law claims of unjust enrichment, "money had and received," mistaken payment, and constructive trust, as well as avoidance claims arising under the BVI Insolvency Act for "unfair preferences" and "undervalue transactions."

All of the state court actions were removed after entry of the recognition order to the Bankruptcy Court, where the liquidators commenced adversary proceedings against other subscribers seeking substantially the same relief. In all, more than 200 actions (the "redeemer actions") are currently pending in the Bankruptcy Court, seeking nearly $6 billion from the defendants.

The liquidators also sued Fairfield's former investment advisors in state court in May 2009, seeking in excess of $919 million in investment management and performance fees from Fairfield's BLMIS accounts. In addition, certain of Fairfield's shareholders commenced a derivative action on Fairfield's behalf in state court. Both actions were removed to the bankruptcy court following entry of the recognition order. Finally, the bankruptcy court is also presiding over litigation commenced against Fairfield by the trustee appointed under the Securities Investor Protection Act ("SIPA") to liquidate BLMIS (in addition to the SIPA liquidation proceeding commenced with respect to BLMIS). That adversary proceeding seeks recovery of more than $3 billion in fraudulent transfers and preferences.

Certain of the defendants in the redeemer actions petitioned for an order pursuant to 28 U.S.C. § 1452(b) remanding their actions to the courts in which they were originally filed or, in the alternative, for an order abstaining from hearing the actions under 28 U.S.C. § 1334(c). In addition, the liquidators sought an order from the Bankruptcy Court under, among other provisions, section 108 of the Bankruptcy Code, giving the liquidators extensions of time to assert causes of action and meet applicable deadlines on Fairfield's behalf with respect to currently pending and potential litigation.

The Bankruptcy Court's Rulings

Remand and Abstention

Having first found that the Bankruptcy Court had jurisdiction over the redeemer actions, Judge Lifland denied the defendants' requests for equitable remand and abstention. At the outset, he noted that discretionary abstention is not permitted in a chapter 15 case by operation of 28 U.S.C. § 1334(c)(1). He concluded that, even if it were, neither equitable remand nor discretionary abstention was warranted under the circumstances, given, among other things, the parties' acknowledgment that the actions should proceed as a whole, the Bankruptcy Court's familiarity with the legal issues involved, the risk of duplicative efforts and duplicative rulings, and the absence of prejudice to the defendants in having the actions adjudicated in the Bankruptcy Court. Because the actions fell within the court's core jurisdiction, Judge Lifland also held that mandatory abstention "is inapplicable on the face of the statute itself." Even if the actions were noncore, the judge noted, mandatory abstention would not be appropriate because, among other things, the actions as a whole are not "based upon a State law claim," but rather, "implicate foreign and U.S. insolvency law . . . and require adjudication of issues arising under the [Bankruptcy] Code."

Finally, Judge Lifland rejected the defendants' argument that the redeemer actions should be remanded because the liquidators' removal notices were not timely filed. The judge joined the majority of other courts in ruling that the 90-day deadline set forth in Bankruptcy Rule 9027(a)(2) applies in a chapter 15 case, rather than the 30-day deadline specified in 28 U.S.C. § 1446, which, together with 28 U.S.C. § 1441, governs removal in most other federal litigation. In a chapter 15 context, Judge Lifland held, the "order for relief" referred to in Bankruptcy Rule 9027(a)(2) refers to the recognition order in a chapter 15 case.

Tolling

In addition to section 108, the liquidators based their request for an extension of deadlines in connection with pending or prospective litigation on sections 103(a), 105(a), 1507(a), and 1521(a)(7) of the Bankruptcy Code. As noted, section 103(a) makes the entirety of chapter 1 of the Bankruptcy Code ("this chapter")—including section 108—applicable in a chapter 15 case. Section 105(a) gives a bankruptcy court broad equitable powers to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code.

Section 1507(a) authorizes the court, upon recognition of a foreign proceeding and subject to the specific limitations elsewhere in chapter 15, to "provide additional assistance to a foreign representative under this title or under other laws of the United States." Finally, section 1521(a)(7) provides that the relief which may be granted by the court upon recognition of a foreign proceeding under chapter 15 may include "granting any additional relief that may be available to a trustee, except for relief available under" sections 522 (delineating "exempt" property), 544 (granting the trustee "strong arm" powers), 545 (avoidance of statutory liens), 547

(avoidance of preferential transfers), 548 (avoidance of fraudulent transfers), 550 (liability of avoidance-action transferees), and 724(a) (avoidance of certain punitive-damage-based liens).

Judge Lifland acknowledged that "there is no dispositive case law addressing whether Section 108 is automatically applicable in these chapter 15 cases." Even so, he concluded that the question is "squarely addressed" by section 103(a), which "unambiguously" states that " 'this chapter'—chapter one—applies in its entirety." Moreover, he wrote, section 108 is a "general provision, which is not restricted to, or excluded from, cases under any specific chapter of the Code."

Judge Lifland also rejected the defendants' argument that section 1520(a)(3) of the Bankruptcy Code "provides the exclusive relief that can be transferred from 'trustees' to foreign representatives, without including Section 108." Section 1520(a)(3) gives a foreign representative in a recognized chapter 15 case the power to operate the debtor's business and to exercise the rights and powers of a bankruptcy trustee *under sections 363* (governing the use, sale, or lease of estate property) *and 552* (governing the enforceability of prepetition liens on property acquired by the estate or the debtor postpetition). "Simply put," Judge Lifland wrote, "inclusion of Section 108 relief in section 1520 would have been superfluous in light of the plain language of section 103(a) of the Code."

Judge Lifland similarly rejected the defendants' argument that the term "trustee" in a chapter 15 case does not include a foreign representative. Section 1502(6) of the Bankruptcy Code provides that "trustee" for the purposes of chapter 15 "includes a trustee, a debtor in possession in a case

under any chapter of this title, or a debtor under chapter 9 of this title." The word "includes," the judge explained, indicates that the definition is not meant to be exclusive, and foreign representatives "are indistinguishable from trustees with respect to the purpose of Section 108 to provide the entity stepping into the shoes of the debtor additional time to evaluate and preserve a debtor's rights."

According to Judge Lifland, his conclusion is supported by: (i) the legislative history of section 1520, which confirms lawmakers' "awareness of the application of Section 108 in a chapter 15 proceeding"; (ii) *In re Condor Insurance Ltd.*, No. 07-51045, Dkt. No. 44 (Bankr. S.D. Miss. Oct. 10, 2007), where the court directed that "the application of section 108 of the Bankruptcy Code is relief available to a trustee and therefore can be granted to the Foreign Representatives under section 1521(a)(7)," without indicating any objection to the automatic availability of such relief or considering section 103(a); (iii) a comprehensive law journal article examining chapter 15 jurisprudence issued by the National Conference of Bankruptcy Judges in 2008; and (iv) the only other court ruling touching on the issue, *In re Bancredit Cayman Ltd.*, 2007 WL 3254369 (Bankr. S.D.N.Y. Nov. 2, 2007), *aff'd*, 2008 WL 919533 (S.D.N.Y. Mar. 31, 2008), where the bankruptcy court expressly declined to address the issue, stating that "[n]othing in this decision should be read to decide the ultimate issue: whether § 108 is available to foreign representatives."

As in his ruling concerning the defendants' remand and abstention requests, Judge Lifland held that the chapter 15 recognition date is the date of the "order of relief" for purposes of section 108 and other provisions in or made applicable to chapter 15. Finally, the judge ruled that, even if

section 108 were not "a self-executing statute" with respect to chapter 15 cases, a bankruptcy court has the power to grant such relief under sections 1507(a) and 1521(a)(7).

Outlook

Chapter 15 of the Bankruptcy Code will mark the sixth anniversary of its effectiveness on October 17, 2011. Judge Lifland's groundbreaking rulings in *Fairfield Sentry* indicate that many of the nuances of this relatively new legislation are as yet unexplored and of uncertain application. The rulings also highlight the fundamental purpose of chapter 15 as a vehicle for harmonizing and coordinating cross-border insolvency proceedings. In addition, they bring into sharp focus the important role played by U.S. bankruptcy courts in centralizing disputes in the U.S. against a foreign debtor as a means of providing assistance to foreign insolvency proceedings and the duly appointed representatives entrusted with administering a foreign debtor's assets. The *Fairfield Sentry* rulings and the Fifth Circuit's "pioneer decision" in *Fogerty v. Petroquest Res., Inc. (In re Condor Ins. Ltd.)*, 601 F.3d 319 (5th Cir. 2010), in which the court recognized the power of a U.S. bankruptcy court to permit relief under foreign avoidance laws in chapter 15, along with other similar cases, illustrate the wide array of tools available to a foreign representative in a chapter 15 case