First Impressions: Defining the Limits of a Bankruptcy Court's Discretion in Chapter 15

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October 17, 2012, will mark the seven-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 19 nations or territories.

The jurisprudence of chapter 15 has evolved since 2005, as courts have transitioned 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 Florida federal district court in *SNP Boat Service S.A. v. Hotel Le St. James*, 2012 WL 1355550 (S.D. Fla. Apr. 18, 2012). Addressing an apparent matter of first impression concerning the ability of a U.S. bankruptcy court presiding over a chapter 15 case to examine foreign-court decisions to determine whether litigants received their due-process rights, the court upheld a bankruptcy court's ruling ordering discovery of a foreign debtor's principals notwithstanding a French "blocking statute" that would have prohibited discovery. However, the district court concluded

that the bankruptcy court abused its discretion in ordering discovery for the purpose of examining whether a creditor's interests were sufficiently protected in a specific French bankruptcy proceeding. The district court also reversed the bankruptcy court's dismissal of the debtor's chapter 15 case as a sanction for failing to comply with its discovery orders.

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, such as the automatic stay. Recognition of a foreign proceeding (main or nonmain) also empowers the U.S. bankruptcy court to grant other relief by way of "additional assistance" to the foreign representative. In addition, relief that may be granted upon recognition of a foreign proceeding (main or nonmain) includes, pursuant to section 1521(a)(5), "entrusting the administration or realization of all or part of the debtor's assets within the

territorial jurisdiction of the United States to the foreign representative or another person . . . authorized by the court." Pursuant to section 1521(b), such relief may also include "entrust[ing] the distribution of all or part of the debtor's assets located in the United States to the foreign representative or another person . . . authorized by the court, *provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected*." (Emphasis added.)

Thus, it would appear that section 1521(b) draws a distinction between U.S. ("local") and non-U.S. creditors. However, section 1522, which is entitled "Protection of creditors and other interested persons," does not expressly make any such distinction, providing in subsection (a) that "[t]he court may grant relief under section 1519 or 1521 . . . only if the interests of *the creditors* and other interested entities, including the debtor, are sufficiently protected." (Emphasis added.)

Section 1501(a) of the Bankruptcy Code provides that the express purpose of chapter 15 is to "incorporate the [Model Law] so as to provide effective mechanisms for dealing with cases of cross-border insolvency." The apparent inconsistency between sections 1521(b) and 1522(a) is addressed by the Guide to the Enactment of the UNCITRAL Model Law on Cross-Border Insolvency (the "Guide") (in which "article 21, paragraph 2" corresponds to section 1521(b), while section 1522(a) is referred to as "article 22, paragraph 1"):

> It should be noted that the Model Law contains several safeguards designed to ensure the protection of local interests before assets are turned over to the foreign representative. Those safeguards include the following: the general statement of the principle of protection of local interests in article 22, paragraph 1; the provision in article 21, paragraph 2, that the court should not authorize the turnover of assets until it is assured that the local creditors' interests are protected;

> and article 22, paragraph 2, according to which the court may subject the relief that it grants to conditions it considers appropriate.

However, the Guide tempers any perception that local interests are intended to be safeguarded to the exclusion of all others by providing that:

> The idea underlying article 22 is that there should be a balance between relief that may be granted to the foreign representative and the interests of the persons that may be affected by such relief . . . . In many cases the affected creditors will be "local" creditors. Nevertheless, in enacting article 22, it is not advisable to attempt to limit it to local creditors. Any express reference to local creditors in paragraph 1 would require a definition of those creditors. An attempt to draft such a definition (and to establish criteria according to which a particular category of creditors might receive special treatment) would not only show the difficulty of crafting such a definition but would also reveal that there is no justification for discriminating [against] creditors on the basis of criteria such as place of business or nationality.

The precise scope of a U.S. bankruptcy court's discretion to consider whether a nonlocal creditor's interests were sufficiently protected in connection with a motion to transfer custody of U.S.-based assets to the representative of a foreign debtor in a chapter 15 case was addressed by the court in *SNP Boat Service*.

SNP Boat Service

SNP Boat Service S.A. ("SNP") is a French corporation that designs luxury boats and provides brokerage, charter, and boat-management services. In May 2008, SNP executed a contract for the sale of a vessel. As part of the sale transaction, SNP agreed to accept the trade-in of a separate vessel—the *M/Y Saint James*—from a party other than the purchaser, Hotel Le St. James ("St. James"), a Canadian corporation, in exchange for which St. James would receive a €2.5 million credit to its account.

Upon taking delivery of the *M/Y Saint James*, SNP claimed that the vessel "had not been delivered in good maintenance and operating condition" and was not accompanied by proper documentation. SNP accordingly refused to credit St. James' account. The breach-of-contract dispute between St. James and SNP soon escalated. In October 2008, SNP sued St. James in the commercial court in Cannes, France. The following month, St. James sued SNP in the court of Montreal. The Canadian court rejected SNP's argument that the court lacked both personal jurisdiction over SNP and subject-matter jurisdiction to consider St. James' breach-of-contract claim. Those rulings were upheld on appeal.

On April 7, 2009, the French commercial court approved a French *sauvegarde* proceeding for SNP. Similar to a case under chapter 11 of the U.S. Bankruptcy Code, a *sauvegarde* proceeding allows a debtor to negotiate a restructuring plan with its creditors, failing which the French commercial court can approve a nonconsensual repayment plan over a maximum period of 10 years. However, the court has no power to force creditors to write off debts or to accept a debt-equity swap, nor can it order debts to be generally discharged without creditor consent. If the debtor reaches an agreement with its creditors, the restructuring plan can include many different restructuring measures, including extending the maturity of debts beyond 10 years, creditor write-offs, and debt-equity swaps.

As in cases under the U.S. Bankruptcy Code, a *sauvegarde* proceeding imposes an automatic stay on any legal actions initiated by creditors. The French Supreme Court held in Cour de Cassation [Cass.] 1 e civ., Dec. 19, 1995, Bull. Civ., No. 93-20-424 (Fr.), that this automatic stay has extraterritorial effect.

On August 25, 2009, St. James filed an unsecured claim in the *sauvegarde* proceeding for the price of the *M/Y Saint James*, plus interest, damages, and other costs. Despite the pendency of the *sauvegarde* proceeding, the Canadian court entered a default judgment against SNP in the Canadian litigation on October 16, 2009, in the amount of CAD$4,047,500.

St. James later learned that SNP had assets in Florida, and on February 17, 2010, it domesticated its Canadian judgment in Florida for the purpose of levying on two SNP vessels harbored there. However, before the vessels could be sold to satisfy St. James' judgment, SNP's court-appointed administrator sought recognition from a Florida bankruptcy court of the *sauvegarde* proceeding under chapter 15 of the Bankruptcy Code.

The U.S. bankruptcy court entered an order recognizing the *sauvegarde* proceeding as a foreign main proceeding under chapter 15 on April 28, 2010. The recognition order stayed any further collection proceedings in the U.S. against SNP or its assets.

Shortly afterward, SNP's administrator filed a motion seeking an order of the bankruptcy court: (i) declaring that one of the seized vessels was subject to the jurisdiction of the French court overseeing SNP's *sauvegarde* proceeding; and (ii) entrusting the vessel to the administrator. Before the hearing on that motion was convened, however, the French court ruled that SNP was not liable to St. James for the €2.5 million price of the *M/Y Saint James*.

In anticipation of the hearing before the U.S. bankruptcy court, St. James sought discovery of various documents related to the *sauvegarde* proceeding. Among other things, SNP argued in response that a French "blocking statute," which makes discovery in France not pursuant to the Hague Convention a criminal act, precluded depositions of several SNP representatives. According to SNP, the scope of St. James' discovery requests indicated that St. James was attempting to re-litigate the French court's order approving the *sauvegarde* proceeding, which St. James had appealed and concerning which St. James already had ample opportunity to obtain discovery as a participant. St. James responded by asking the bankruptcy court to compel discovery or, in the alternative, to sanction SNP for its misconduct in refusing to comply by dismissing the chapter 15 case.

On June 30, 2011, the U.S. bankruptcy court ruled that the French blocking statute did not deprive the court of its power to order the parties to engage in discovery. Absent SNP's compliance with discovery requests, the court wrote, it would "conclude that the order granting recognition of the foreign main proceeding was improvidently entered . . . [,] revoke recognition of the foreign main proceeding, and . . . abstain from [the] matter under 11 U.S.C. § 305."

SNP refused to comply with St. James' discovery requests. On October 20, 2011, the bankruptcy court directed the U.S. Marshals Service to transfer the seized vessel to the county sheriff and dismissed SNP's chapter 15 case. SNP appealed the ruling to the Florida district court.

The District Court's Ruling

The district court affirmed the ruling in part and reversed in part. It did not fault the bankruptcy court for examining whether St. James' interests were sufficiently protected before directing that the seized vessel be turned over to SNP's administrator. According to the court, the Model Law indicates that:

> [A] bankruptcy court *must* be satisfied that *local creditors'* interests are "sufficiently protected" before allowing a foreign representative to distribute property in a foreign proceeding, and though not an express requirement, is *not precluded* from satisfying itself that *foreign creditors'* interests are "sufficiently protected" before allowing a foreign representative to distribute property in a foreign proceeding.

This interpretation, the court explained, is consistent with the "exceedingly broad" authority provided to the bankruptcy court to grant "any appropriate relief."

The district court also concluded that the bankruptcy court acted within its discretion when it refused to enforce the French "blocking" statute to preclude discovery of SNP's principals. It is well settled, the court explained, that such a statute does " 'not deprive an American court of the power to order a party subject to its jurisdiction to produce evidence even though the act of production may violate that statute.' " (Quoting *Société Nationale Industrielle Aérospatiale v. U.S. Dist. Court for the S. Dist. of Iowa*, 482 U.S. 522, 544 n.29 (1987).) Deferring to a "blocking" statute, the district court emphasized, would, among other things, provide foreign nationals with preferred status in U.S. courts.

SNP argued that, even if the bankruptcy court properly examined whether St. James' interests were sufficiently protected before ordering that the seized vessel be entrusted to the administrator, the court exceeded its authority by ordering discovery to determine whether those

interests were sufficiently protected in the French *sauvegarde* proceeding. The bankruptcy court's actions, SNP claimed, constituted "nothing less than appellate oversight of a specific French bankruptcy proceeding" and were therefore beyond the scope of the court's authority under chapter 15 in keeping with the chapter's underlying purpose (i.e., providing assistance to foreign bankruptcy proceedings consistent with principles of "comity").

The district court agreed. Explaining that chapter 15 incorporates many of the principles that informed jurisprudence under its predecessor, section 304 of the Bankruptcy Code, the court looked for guidance on this issue to decisions applying section 304, including the Second Circuit's ruling in *Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B.*, 825 F.2d 709 (2d Cir. 1987). On the basis of *Victrix*, the district court in *SNP Boat Service* concluded that:

> To inquire into a specific foreign proceeding is not only inefficient and a waste of judicial resources, but more importantly, necessarily undermines the equitable and orderly distribution of a debtor's property by transforming a domestic court into a foreign appellate court where creditors are always afforded the proverbial "second bite at the apple." Chapter 15's directive that courts be guided by principles of comity was intended to avoid such a result. St. James is no more entitled to SNP's assets than any other creditor of SNP outside the determinations of the foreign insolvency proceeding. Thus, it was an abuse of the bankruptcy court's discretion to order discovery for the purposes of determining whether St. James' interests were sufficiently protected in the specific French *sauvegarde* proceeding. St. James has not advanced the argument that creditors' interests are not sufficiently protected under French *sauvegarde* law and this Court has no reason to determine otherwise. In concluding that jurisdiction is limited to a determination that French *sauvegarde* proceedings generally are sufficient to protect creditors' interests, it follows that a bankruptcy court is without jurisdiction to inquire whether a particular creditor's interests are sufficiently protected in any specific foreign proceeding.

Finally, the district court held that dismissal of SNP's chapter 15 case as a sanction for failing to comply with discovery was unwarranted. According to the court, the "severe sanction" of dismissal is appropriate "only as a last resort." Because the bankruptcy court failed to explore

whether a lesser sanction would be adequate to compel compliance, and inasmuch as the court improperly inquired into the *sauvegarde* proceeding, the district court ruled that dismissal was an abuse of discretion.

Outlook

Above and beyond the ruling's practical ramifications in the context of discovery in chapter 15 cases, *SNP Boat Service* serves as a reminder that chapter 15, albeit of relatively recent vintage, is the product of a long history of jurisprudence regarding cross-border bankruptcy cases. That history, which is expressly imprinted on chapter 15, is premised on the principle of comity, or the recognition that one sovereign nation extends within its territory to the legislative, executive, or judicial acts of another sovereign, with due regard for the rights of its own citizens.

Implicit in a U.S. bankruptcy court's order recognizing a foreign main or nonmain proceeding under chapter 15 is a determination that the foreign proceeding warrants the assistance of U.S. courts (i.e., is deserving of comity). This is because, among other things, the foreign proceeding, although not identical to a U.S. bankruptcy case, is governed by a similar regime of legal principles, including basic substantive and procedural safeguards for all parties involved. In *SNP Boat Service*, the district court clarified that, once a U.S. bankruptcy court determines that a foreign proceeding is worthy of recognition, it no longer has discretion to examine whether those safeguards are adequate. According to the court, although a U.S. bankruptcy court may pass on the propriety of a foreign *insolvency regime* in connection with its determination to grant or withhold recognition, it is not permitted to delve into the details of (including specific rulings issued in) any particular foreign *insolvency case*. From a different perspective, this also means

that creditors, whether local or foreign, will not be permitted a “second bite at the apple” once a recognition order has been entered by a U.S. court.