Chapter 15 Petition Date "Anchors" COMI Analysis

May/June 2013

Pedro A. Jimenez
Mark G. Douglas

October 17, 2013, will mark the eighth anniversary of the enactment of chapter 15 of the U.S. Bankruptcy Code as part of the comprehensive U.S. bankruptcy-law reforms implemented in 2005. Chapter 15, which governs cross-border bankruptcy and insolvency cases, 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 ("UNCITRAL") 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 20 nations or territories.

The jurisprudence of chapter 15 has evolved since 2005, and one issue that has received considerable attention is the determination of a foreign debtor's "center of main interests" ("COMI"). In *Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*, No. 11-4376, 2013 BL 102426 (2d Cir. Apr. 16, 2013), the U.S. Court of Appeals for the Second Circuit recently ruled that COMI must be determined on the basis of the debtor's "activities at or around the time the Chapter 15 petition is filed," rather than on the commencement date of the foreign proceeding.

In making such an inquiry, the Second Circuit cautioned, "a court may consider the period between the commencement of the foreign insolvency proceeding and the filing of the Chapter 15 petition to ensure that a debtor has not manipulated its COMI in bad faith." Factors that may

be considered in determining COMI, the court explained, "are not limited and may include the debtor's liquidation activities."

Another important portion of the Second Circuit's decision was its analysis of the "public policy exception" to relief under chapter 15 contained in section 1506 of the Bankruptcy Code. The Second Circuit concluded that the exception is to be narrowly construed and that in the case of the foreign proceeding at issue in *Fairfield Sentry*, restricted access to documents in a British Virgin Islands liquidation proceeding "is no basis on which to hold that recognition of the BVI liquidation is manifestly contrary to U.S. public policy."

Recognition Under Chapter 15

Under chapter 15, the "foreign representative" of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding." "Foreign representative" is defined in section 101(24) of the Bankruptcy Code as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

"Foreign proceeding" is defined by section 101(23) of the Bankruptcy Code 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 COMI—and "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment."

Section 1517(b) of the Bankruptcy Code provides that a "foreign proceeding shall be recognized . . . as a foreign main proceeding if it is pending in the country where the debtor has the center of its main interests." The Bankruptcy Code does not define "COMI." However, section 1516(c) provides that, "[in] the absence of evidence to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be" the debtor's COMI. According to the statute's legislative history, this presumption was included "for speed and convenience of proof where there is no serious controversy." *See* H.R. Rep. No. 109-31, pt. 1, at 112−13 (2005), U.S. CODE CONG. & ADMIN. NEWS 2005, pp. 88, 175. An "establishment" is defined in section 1502(2) as "any place of operations where the debtor carries out a nontransitory economic activity."

The Bankruptcy Code does not specify what evidence is required to rebut the presumption that COMI is the debtor's place of registration or incorporation. Various factors have been deemed relevant by courts and commentators in examining COMI, including the location of the debtor's headquarters, managers, employees, investors, primary assets, or creditors, and which jurisdiction's law would apply to most disputes. Chapter 15 expressly directs courts to look for guidance on the determination of COMI to interpretations by foreign jurisdictions of similar statutes, such as the European Union Regulation on Insolvency Proceedings, Council Regulation (EC) No. 1346/2000 of 29 May 2000 (the "EU Regulation"), which applies to all insolvency

cases filed in the European Union (except for Denmark) on or after May 31, 2002, and the U.K. Cross-Border Insolvency Regulation of 2006, S.I. 2006/1030 (U.K.).

Additional guidance can be found in the Legislative Guide to Enactment of the Model Law adopted by UNCITRAL on June 25, 2004 (the "UNCITRAL Guide") and an extensive body of legal commentary developed during the 16 years since the Model Law was finalized in 1997 and in the wake of chapter 15's enactment in 2005. The UNCITRAL Guide explains that employing COMI as the basis for extending recognition of a main proceeding was modeled on the use of that concept in the EU Regulation. The EU Regulation provides that COMI "should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties." The concept is roughly equivalent to the "principal place of business" under U.S. law.

If a U.S. court recognizes a foreign main proceeding under chapter 15, actions against the foreign debtor or its property located in the U.S. are stayed under section 362 of the Bankruptcy Code. Following recognition of a main or nonmain proceeding, a bankruptcy court may also provide "additional assistance" to a foreign representative. This can include injunctive relief or authority to distribute the proceeds of all or part of the debtor's U.S. assets, provided, however, that the court concludes, "consistent with the principles of comity," that such assistance will reasonably ensure, among other things, the just treatment of creditors and other stakeholders, the protection of U.S. creditors against prejudice and inconvenience in pursuing their claims in the foreign proceeding, and the prevention of fraudulent or preferential disposition of property.

Moreover, any relief under chapter 15, including recognition itself, is subject to the caveat contained in section 1506, which states that "[n]othing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."

In *Fairfield Sentry*, the Second Circuit considered as matters of first impression: (i) whether the commencement date of a foreign insolvency proceeding or the date of the chapter 15 petition should be used to determine COMI in ruling on a petition for recognition of a foreign main proceeding under chapter 15; and (ii) whether the public policy exception warranted denial of chapter 15 recognition due to the confidential nature of a foreign bankruptcy proceeding.

Fairfield Sentry

Fairfield Sentry Limited and two affiliates (collectively, "Fairfield") were organized under the laws of the British Virgin Islands ("BVI") in 1990 as "feeder funds" for Bernard L. Madoff Investment Securities LLC ("BLMIS"). Pursuant to its organizational documents, Fairfield administered its business interests from the BVI, where its registered office, registered agent, registered secretary, and corporate documents were located. Fairfield's day-to-day operations were handled by an investment manager based in New York, where the company's three directors also resided.

On July 21, 2009, the High Court of Justice of the Eastern Caribbean Supreme Court (the "BVI Court") entered an order commencing liquidation proceedings for Fairfield under the Virgin Islands Insolvency Act of 2003. The BVI Court-appointed joint liquidators (the "liquidators") for Fairfield filed a petition on June 14, 2010, in the U.S. bankruptcy court seeking recognition of

the BVI liquidation as a foreign "main proceeding" under chapter 15. As of that date, Fairfield's liquid assets consisted of approximately $73 million in Ireland, $22 million in the U.K., and $17 million in the BVI. Its remaining assets consisted of claims and causes of action, including a claim for approximately $6 billion in customer funds in BLMIS's U.S. liquidation proceeding under the Securities Investor Protection Act, $3 billion in claims against former BLMIS customers who profited from redemptions in New York, and $150 million in similar redemption claims in the BVI. These claims were being litigated in New York, the Netherlands, Ireland, and the BVI.

A New York bankruptcy court granted the liquidators' chapter 15 petition and formally recognized the BVI liquidation on July 22, 2010, as a foreign main proceeding. In determining Fairfield's COMI, the bankruptcy court examined the period between December 2008, when Fairfield stopped doing business, and June 2010, the chapter 15 petition date. The court concluded that Fairfield's "COMI for the purpose of recognition as a main proceeding is in the BVI, and not elsewhere."

The bankruptcy court's recognition order stayed a derivative action commenced in May 2009 in New York state court by Morning Mist Holdings Ltd. ("Morning Mist"), a Fairfield shareholder, alleging that Fairfield's directors, management, and service providers breached fiduciary duties.

Morning Mist appealed the recognition order to the district court, which affirmed, ruling that the bankruptcy court properly considered Fairfield's administrative activities in its COMI analysis and correctly considered Fairfield's COMI as of the chapter 15 petition date, as distinguished

from other dates or periods throughout the course of its 18-year operational history. The district court rejected Morning Mist's argument that recognition would be manifestly contrary to U.S. public policy because the BVI liquidation was not an open proceeding, reasoning that the right of public access in the U.S. to court records is not absolute. Morning Mist appealed to the Second Circuit.

The Second Circuit's Ruling

A three-judge panel of the Second Circuit affirmed. Writing for the court, chief judge Dennis Jacobs first looked to the language of section 1517(b), which provides that a "foreign proceeding shall be recognized . . . as a foreign main proceeding if it *is pending* in the country where the debtor *has* the center of its main interests." (emphasis added). According to Judge Jacobs, the use of the present tense suggests that a court should examine a debtor's COMI at the time the chapter 15 petition is filed. In light of this plain language, the judge rejected Morning Mist's argument that a court should consider the debtor's entire operational history or base the COMI determination on the commencement date of the foreign proceeding. "Under the text of the statute," he wrote, "the filing date of the Chapter 15 petition should serve to anchor the COMI analysis."

This approach, Judge Jacobs explained, has been adopted by nearly every federal court that has addressed the question, including the Fifth Circuit Court of Appeals in *In re Ran*, 607 F.3d 1017 (5th Cir. 2010). In *Ran*, the Fifth Circuit rejected the argument that the COMI determination should be made with regard to the debtor's operational history. According to the court, "If Congress had, in fact, intended bankruptcy courts to view the COMI determination through a look-back period, it could have easily said so," and in fact it did so in another provision of the

Bankruptcy Code—section 522(b)(3)(A), which contains a look-back period for the purpose of establishing domicile in connection with a debtor's claim of exemptions. The Fifth Circuit also emphasized that third parties (primarily creditors) should be able to ascertain a debtor's COMI. However, the Fifth Circuit, albeit in dicta, left open the possibility of looking at a broader time frame to frustrate possible bad-faith COMI manipulation.

Among the few dissenting courts, Judge Jacobs noted in *Fairfield Sentry*, are the bankruptcy and district courts in *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011), *aff'd*, 474 B.R. 88 (S.D.N.Y. 2012). In *Millennium*, the bankruptcy court suggested substituting principal place of business for COMI, writing that "it is obvious that the date for determining an entity's place of business refers to the business of the entity before it was placed into liquidation." Judge Jacobs rejected this approach in *Fairfield Sentry*, noting that, according to the writings of one of chapter 15's drafters, "center of main interests" as it appears in the Model Law could have been supplanted by "principal place of business," as a phrase more familiar to U.S. judges and lawyers, but the drafters elected to retain COMI, believing that "such a crucial jurisdictional test should be uniform around the world."

Judge Jacobs also found that the *Millennium* court's reliance on chapter 15's predecessor—section 304 of the Bankruptcy Code (repealed in 2005)—was misplaced. Although the definition of "foreign proceeding" for purposes of section 304 was determined by reference to the location of the debtor's domicile, residence, "principal place of business," or principal assets as of the "commencement" of the foreign insolvency case, he wrote, "Congress abandoned that provision in enacting Chapter 15."

Judge Jacobs noted section 1508 of the Bankruptcy Code's instruction that "[i]n interpreting [chapter 15], the court shall consider its international origin and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions." Accordingly, he examined international sources bearing on the issue of COMI. Overall, the judge concluded, "international sources are of limited use in resolving whether U.S. courts should determine COMI at the time of the Chapter 15 petition or in some other way."

Judge Jacobs first consulted the UNCITRAL Guide, which does not define "COMI" but states that the concept was drawn from the EU Regulation. Like chapter 15, he explained, the EU Regulation employs the present tense, but its reference to the debtor's administration "on a regular basis" in defining "COMI" could suggest a potentially broader time frame. However, the judge determined that "the EU Regulation does not operate as an analog to chapter 15" because, under the regulation, a main insolvency proceeding filed in one EU member state is automatically recognized by all other EU member states, making a recognition petition, such as the petition required under chapter 15, unnecessary.

Next, Judge Jacobs examined relevant European case law interpreting COMI, which generally focuses on whether a debtor's COMI is "regular and ascertainable" and therefore not easily subject to tactical removal. *See*, *e.g.*, *In re Eurofood IFSC Ltd.*, Case No. C-341/04, 2006 E.C.R. I-3813, 2006 WL 1142304 (E.C.J. 2006); *In re Stanford International Bank Ltd.*, Case Nos. A3/2009/1565 & 1643, 2010 EWCA Civ. 137, 2010 WL 605796 (Ct. of Appeal 2010).

On the basis of these considerations, Judge Jacobs adopted a hybrid approach:

> We therefore hold that a debtor's COMI should be determined based on its activities at or around the time the Chapter 15 petition is filed, as the statutory text suggests. But given the EU Regulation and other international interpretations, which focus on the regularity and ascertainability of a debtor's COMI, a court may consider the period between the commencement of the foreign insolvency proceeding and the filing of the Chapter 15 petition to ensure that a debtor has not manipulated its COMI in bad faith.

The judge found no fault with the bankruptcy court's conclusion that Fairfield's COMI was located in the BVI during the relevant time period. He also ruled that the evidence did not support a finding that Fairfield manipulated its COMI in bad faith between the initiation of the BVI liquidation and the chapter 15 petition date. Among other things, Judge Jacobs wrote that "any relevant activities, including liquidation activities and administrative functions, may be considered in the COMI analysis."

Finally, Judge Jacobs rejected Morning Mist's argument that the public policy exception should have been invoked to preclude recognition because the BVI liquidation was "cloaked in secrecy." He emphasized that section 1506 must be narrowly construed in keeping with its limited scope to preclude chapter 15 relief only in cases where such relief is "manifestly contrary" to U.S. public policy—as opposed to merely *conflicting* with public policy. According to the judge, the "confidentiality of BVI bankruptcy proceedings does not offend U.S. public policy" because, even in the U.S., the right of access to judicial records, although important, is not absolute and "can easily give way to 'privacy interests' or other considerations."

Outlook

The Second Circuit's ruling resolves a split among lower courts in the circuit on the issue and aligns itself generally with the approach taken by the Fifth Circuit in *Ran*. Under this hybrid

approach, COMI is to be determined as of the chapter 15 petition date, but the court can examine the debtor's activities during the period preceding that date to prevent bad-faith COMI manipulation.

Although this approach comports with the express language of chapter 15, its focus on the chapter 15 petition date has been criticized as an invitation to forum shopping by corporate debtors seeking to liquidate in countries that have favorable laws but have little or no connection to the debtors' prefiling activities. According to some commentators, *Millennium*'s "principal place of business" interpretation is more consistent with the intent of UNCITRAL and U.S. lawmakers that a foreign proceeding be recognized under chapter 15 as a foreign main proceeding only if there is a sufficient nexus between the debtor and the venue of the proceeding.

In fact, an UNCITRAL working group considering various proposed changes to the Model Law adopted a proposal in 2012 to amend the Model Law to clarify, among other things, that the date of commencement of a foreign insolvency proceeding should be used to determine both COMI and the related concept "establishment." *See* UNCITRAL, Report of Working Group V (Insolvency Law) on the work of its 41st session, U.N. Pub. Sales No. A/CN.9/742 at ¶ 4; UNCITRAL, Report of Working Group V (Insolvency Law) on the work of its 42nd session, U.N. Pub. Sales No. A/CN.9/763 at ¶¶ 50−52. If this approach were adopted, it would mean that liquidation activities and administrative functions following the filing of a foreign insolvency proceeding—factors that were clearly relevant to the Second Circuit's analysis in *Fairfield Sentry*—would not be relevant to the COMI determination. It remains to be seen whether these

proposals will be adopted and, if so, what bearing the change would have on rulings under chapter 15.

Even nearly eight years on, chapter 15 continues to be fertile ground for first impressions and new departures in U.S. bankruptcy and appellate courts. In addition to the Second Circuit in *Fairfield Sentry*, the court in *In re Kemsley*, 2013 BL 77005 (Bankr. S.D.N.Y. Mar. 22, 2013), recently ruled on "the first contested matter involving recognition of an individual's foreign insolvency case to be decided in the Southern District of New York." In *Kemsley*, the foreign representative of debtor Paul Kemsley sought recognition under chapter 15 of Kemsley's U.K. bankruptcy case. The petition was filed after the principal creditor in Kemsley's U.K. case sued Kemsley in two U.S. state courts to recover £5 million.

Kemsley, however, had lived in the U.S. for several years at the time the chapter 15 petition was filed on August 21, 2012, although he maintained ties to the U.K., where his children were then living with their mother in London. Interestingly, the court decided that Kemsley's COMI should be determined as of the date of commencement of his U.K. bankruptcy proceeding (January 13, 2012), rather than the chapter 15 petition date, because it was a fixed, verifiable date.

The court ruled that, because Kemsley was living in the U.S. with his children at the time he commenced the U.K. proceeding, his COMI was in the U.S. at that time. The court acknowledged that the result may well have been otherwise if COMI had been tested as of the chapter 15 petition date. It accordingly refused to recognize Kemsley's U.K. bankruptcy case as a foreign main proceeding under chapter 15. In addition, on the basis of its conclusion that

Kemsley did not even have a "place of operations" in the U.K. for carrying out nontransitory economic activity, the court denied the petition for recognition of the U.K. bankruptcy case as a foreign nonmain proceeding.