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Foreign Representative Alert: Chapter 15 Gap Period Relief Subject to Preliminary Injunction Standard

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Unlike in cases filed under other chapters of the Bankruptcy Code, the filing of a petition for recognition of a foreign bankruptcy or insolvency case under Chapter 15 does not automatically trigger a stay of actions against a debtor or its U.S. assets. Courts disagree as to the standard that should govern the issuance of such relief during the gap period. The authors of this article discuss this issue and its implications.

Unlike in cases filed under other chapters of the Bankruptcy Code, the filing of a petition for recognition of a foreign bankruptcy or insolvency case under Chapter 15 does not automatically trigger a stay of actions against a debtor or its U.S. assets. Instead, the automatic stay generally applies only at such time that the U.S. bankruptcy court later enters an order recognizing the foreign bankruptcy as a "main" proceeding under Chapter 15 or, in the event of recognition as a foreign "nonmain" proceeding, the court exercises its discretion to grant equivalent provisional relief.

This can be problematic if creditor collection efforts continue during the "gap" period between the filing of the Chapter 15 petition and the entry of a recognition order. However, Section 1519 of that Chapter authorizes

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bankruptcy courts to grant provisional relief — including extension of the automatic stay to protect the foreign debtor's U.S. assets — during the gap period "where relief is urgently needed to protect the assets of the debtor or the interests of the creditors."

Courts disagree as to the standard that should govern the issuance of such relief during the gap period. A California bankruptcy court recently weighed in on this issue. In *In re Worldwide Educ. Services, Inc.*,[1] the court ruled that "the standard of proof for preliminary injunctive relief should apply" to a foreign representative's emergency motion during the gap period for implementation of a provisional stay under Sections 105, 362, and 1519 of the Bankruptcy Code. However, the court also noted that an adversary proceeding subject to the procedural rules set forth in Part VII of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") is not required to request provisional injunctive relief during the gap period.

PROCEDURES AND RELIEF UNDER CHAPTER 15

Under Chapter 15, the duly accredited representative of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign [insolvency] proceeding." "Foreign proceeding" is defined in 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.

More than one bankruptcy or insolvency proceeding may be pending with respect to the same foreign debtor in different countries. Chapter 15 therefore contemplates recognition in the U.S. of both a "main" proceeding — a case pending in the country where the debtor's "center of main interests" is located — and "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment," i.e., "any place of operations where the debtor carries out a nontransitory economic activity."

If a U.S. court recognizes a foreign main proceeding under Chapter 15, Section 1520(a)(1) of the Bankruptcy Code provides that actions against the foreign debtor or its property located in the U.S. are stayed under Section 362 — the Bankruptcy Code's "automatic stay." Following recognition of a main or nonmain proceeding, a bankruptcy court is authorized under Section 1521 to grant, among other things, injunctive relief, the authority to distribute the proceeds of the debtor's U.S. assets and, with certain exceptions, any additional relief available to a bankruptcy trustee "where necessary to effectuate the purpose of [Chapter 15] and to protect the assets of the debtor or the interests of the creditors." Section 1521(e) provides that such injunctive relief (authorized by Sections 1521(a)(1) and (2)), certain other forms of relief (e.g., suspending the right to transfer assets of the debtor (Section 1520(a)(3)), and any extension of provisional relief previously granted during the gap period (Section 1521(a)(6)) "shall" be governed by "[t]he standards, procedures, and limitations applicable to an injunction."

During the gap period, Section 1519(a) of the Bankruptcy Code authorizes a bankruptcy court to grant provisional injunctive relief and certain other forms of relief where "relief is urgently needed to protect the assets of the debtor or the interests of the creditors." In addition to an order staying execution against the debtor's U.S. assets, such relief can include, among other things, an order that entrusts the administration of assets to the foreign representative (Section 1519(a)(2)), provides for the examination of witnesses and the taking of evidence regarding the debtor's affairs (Sections 1519(a)(3) and 1521(a)(4)), or grants additional relief (other than avoidance of transfers) available to a bankruptcy trustee (Sections 1519(a)(3) and 1521(a)(7)).

Similar to Section 1521(e), Section 1519(e) provides that "[t]he standards, procedures, and limitations applicable to an injunction shall apply to [gap period] relief." Such relief terminates upon entry of an order of recognition, although it may be extended in the court's discretion under Section 1521(a)(6).

STANDARD APPLICABLE TO INJUNCTIVE RELIEF

Bankruptcy Rule 7065 provides that Rule 65 of the Federal Rules of Civil Procedure applies in adversary proceedings, except that a debtor, Chapter 11

debtor in possession, or trustee may apply for a temporary restraining order or preliminary injunction without posting a bond. Rule 65 sets forth the procedures governing a request for an injunction or restraining order. Bankruptcy courts also sometimes grant injunctive relief under Section 105(a) of the Bankruptcy Code, which provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[2]

Bankruptcy Rule 7001(7) provides that "a proceeding to obtain an injunction or other equitable relief, except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for the relief," is an "adversary proceeding" governed by the rules of Part VII, including the requirements in Bankruptcy Rules 7003 and 7004 that the proceeding be commenced by the filing and service of a summons and complaint. Thus, most courts require that a request for an injunction — even under Section 105(a) — must be made in an adversary proceeding.[3]

Before granting a preliminary injunction under Rule 65, Bankruptcy Rule 7065, or Section 105, most courts require the party seeking the provisional relief to demonstrate:

- a reasonable likelihood of success on the merits;
- a likelihood of irreparable harm in the absence of relief;
- that the balance of hardships tips in the applicant's favor; and
- that the public interest would not be disserved if injunctive relief were granted.[4]

In *Worldwide*, the court considered whether this standard should apply to a request by a foreign representative for the temporary imposition of the automatic stay during the Chapter 15 gap period.

WORLDWIDE

Worldwide Education Services, Inc. ("WWE") was originally established as a Wyoming limited-liability company that for many years successfully operated a business assisting customers to incorporate or form limited-liability

companies. Sometime prior to 2010, WWE was redomiciled in the British Virgin Islands ("BVI"). WWE ceased operating in 2010 after business dried up during the Great Recession.

On May 31, 2013, WWE's board of directors commenced a voluntary liquidation proceeding on behalf of the company under the BVI Companies Act of 2004. WWE's liquidator filed a petition in a California bankruptcy court on June 10, 2013, for recognition of the BVI liquidation as a foreign main (or, alternatively, nonmain) proceeding. According to the petition, although WWE had ceased operating and had no significant remaining assets, it was a defendant in various lawsuits pending in the U.S.

Shortly after the Chapter 15 filing, the liquidator filed a motion with the bankruptcy court seeking the implementation of a provisional stay under Sections 105, 362, and 1519 of the Bankruptcy Code of all litigation against WWE pending a ruling on the recognition petition. In the motion, the liquidator asserted, among other things, that WWE would "suffer irreparable harm by continuing to incur costs of litigation that it can no longer afford" and that "the continuation of litigation may result in certain creditors being treated more favorably than other similarly situated creditors." The plaintiffs in the litigation argued that the emergency motion was "nothing but a ploy" to prevent trials from proceeding later in June.

THE BANKRUPTCY COURT'S RULING

The *Worldwide* bankruptcy court denied the motion. As a preliminary matter, the court explained that the liquidator put misplaced reliance on *In re Pro-Fit Int'l, Ltd.*,[5] for the proposition that a motion for provisional relief requesting temporary application of the automatic stay under Section 1519(a) "does not even need to meet the requirements for injunctive relief, either procedural or substantive."

In *Pro-Fit*, the foreign representatives of affiliated debtors whose insolvency proceedings were pending in the U.K. sought provisional relief from the bankruptcy court during the gap period to stay execution by a judgment creditor against the debtors' U.S. assets.

That creditor objected to the request, contending that the foreign representatives' motion for provisional relief failed to comply with the "standards,

procedures, and limitations applicable to an injunction," as mandated by Section 1519(e). The *Pro-Fit* court rejected the creditor's reading of Section 1519(e), finding it to be inconsistent with bankruptcy jurisprudence generally and the legislative history of the provision:

> [S]uch a reading would impose procedural barriers that are unknown in the bankruptcy law to the availability of at least some § 1519 remedies. For example, § 1519(a)(3) authorizes "any relief referred to in paragraph (3), (4), or (7) of section 1521(a)." This relief includes the "examination of witnesses pursuant to Rule 2004 and the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities" (§ 1521(a)(4)). It is implausible to require an adversary proceeding for such actions in a chapter 15 case, where no adversary proceeding is required for such activity in a case under any other bankruptcy code chapter.

The court also explained that the legislative history of Section 1519(e) states that "[s]ubsection (e) makes clear that this section contemplates injunctive relief and that such relief is subject to specific rules and a body of jurisprudence." According to the court, this history suggests that "the rules and jurisprudence for an injunction apply…only where a foreign representative seeks an injunction under § 1519, and not where the relief sought is not an injunction."

The court in *Pro-Fit* ruled that the requested relief fell "outside of § 1519(e), because it is not an injunction or temporary restraining order," but was instead a request for "application of § 362 on a provisional basis, which does not require an adversary proceeding."

According to the court in *Worldwide*, the ruling in *Pro-Fit* "is flatly inconsistent with the plain and unambiguous language of section 1519(e)," which, as noted, provides that "[t]he standards, procedures, and limitations applicable to an injunction shall apply to relief under this section." The court rejected the *Pro-Fit* court's conclusion that Section 1519(e) is limited to motions that request *injunctive* relief (as distinguished from a motion seeking an extension of the automatic stay or any other form of relief delineated in the provision). The *Worldwide* court wrote that "the express language of the statute does not contain such a limitation and generally applies to all re-

lief sought pursuant to Section 1519, including imposition of the automatic stay." Moreover, the court explained, the *Pro-Fit* court did not articulate "a significant reason why purportedly non-injunctive relief would have been treated differently than the express standard set out in Section 1519(e)." The *Worldwide* court accordingly concluded that "the standard of proof for preliminary injunctive relief should apply here."

The *Worldwide* bankruptcy court then ruled that the WWE's liquidator had not satisfied that standard. According to the court, the only evidence supporting a likelihood of success on the merits consisted of "bald and conclusory statements" that the debtor had no choice other than to commence the BVI liquidation, rather than any specific information concerning the current resources of the bankruptcy estate and how much WWE had expended and could anticipate expending in defending the litigation. As such, the court wrote, the liquidator failed to establish that the requested provisional "relief is urgently needed to protect the assets of the debtor or the interests of creditors," as required by Section 1519(a).

The court also concluded that the liquidator failed to establish irreparable harm in the absence of injunctive relief. There was no evidence, the court noted, that the plaintiffs in the litigation would gain any advantage over other creditors because they were seeking merely to determine liability rather than to collect on their claims.

Addressing the balance of equities, the court remarked that "granting the motion for stay of litigation proceedings on the eve of trial in a case that has been pending for about two years would unduly prejudice creditors because they are ready to go to trial after extensive pretrial litigation and discovery." This prejudice, the court explained, outweighs any burden on WWE because liability would have to be determined in any event and the plaintiffs were not seeking to collect on their claims.

Finally, the court ruled that the public-interest factor of the standard for injunctive relief was "at most neutral since the reach of the requested injunction [is merely] to restrain pending litigation among certain parties and affects only them with no impact on nonparties."

The bankruptcy court did agree with one aspect of the court's ruling in *Pro-Fit* –namely, that an adversary proceeding is not required to obtain provisional relief under Section 1519. The court acknowledged that a request for

an injunction is normally designated an adversary proceeding under Bankruptcy Rule 7001. However, the court wrote that "a request for provisional relief under Section 1519 is ancillary to a petition for recognition of a foreign proceeding under Section 1515, which does not apparently require an adversary proceeding." As such, the court reasoned, a petition for recognition and any related requests for provisional relief under Section 1519 should be treated as "contested matters" under Bankruptcy Rule 9014.

OUTLOOK

Although arguably consistent with the "plain meaning" rule of statutory construction, *Worldwide*'s application of Section 1519(a) to require that any form of gap period relief comply with the standards governing an injunction places a heavy burden on foreign representatives seeking provisional relief during the Chapter 15 gap period. The court gave short shrift to *Pro-Fit*'s more nuanced approach, characterizing the distinction articulated in *Pro-Fit* between injunctive and other forms of relief as lacking any "significant reason." Whether either approach more nearly expresses lawmakers' intentions in enacting Section 1519 is an open question. Until that question is resolved, however, parties seeking gap period relief in Chapter 15 cases should be prepared to comply with the standards, procedures, and limitations — including the evidentiary burden — associated with an injunction.

NOTES

[1] 494 B.R. 494 (Bankr. C.D. Cal. 2013).

[2] *See PJC Tech., Inc. v. C3 Capital Partners, LP*, 2010 BL 17008 (W.D.N.Y. Jan. 27, 2010) (considering and denying injunctive relief under Section 105).

[3] *See*, *e.g.*, *In re Residential Capital, LLC*, 480 B.R. 529 (Bankr. S.D.N.Y. 2012); *In re Viney*, 369 B.R. 392 (Bankr. N.D. Ind. 2007).

[4] *See*, *e.g.*, *Broadstripe, LLC v. Natl. Cable Television Coop., Inc. (In re Broadstripe, LLC)*, 402 B.R. 646 (Bankr. D. Del. 2009); *Lyondell Chem. Co. v. CenterPoint Energy Gas Servs. Inc. (In re Lyondell Chem. Co.)*, 402 B.R. 571 (Bankr. S.D.N.Y. 2009).

[5] 391 B.R. 850 (Bankr. C.D. Cal. 2008).