# Second Circuit Rules That Foreign Debtor's Insolvency Proceeding May Not Be Recognized Under Chapter 15 Unless Debtor Has Place of Business or Property in the U.S.

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The U.S. Court of Appeals for the Second Circuit recently held in *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 2013 BL 341634 (2d Cir. Dec. 11, 2013), that section 109(a) of the Bankruptcy Code, which requires a debtor "under this title" to have a domicile, a place of business, or property in the U.S., applies in cases under chapter 15 of the Bankruptcy Code. In *Barnet*, the Second Circuit vacated a bankruptcy court order granting recognition under chapter 15 to a debtor's Australian liquidation, concluding that the court erred in ruling that section 109(a) does not apply in chapter 15 cases and that it improperly recognized the debtor's Australian liquidation in the absence of any evidence that the debtor had a domicile, a place of business, or property in the U.S.

## Recognition of Foreign Insolvency Proceedings by U.S. Bankruptcy Courts

Enacted in 2005, chapter 15 of the Bankruptcy Code is patterned on the 1997 UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"), which was designed to provide effective mechanisms for dealing with cross-border insolvency cases. The basic requirements for recognition of a "foreign proceeding" in the U.S. under chapter 15 are outlined in section 1517(a) of the Bankruptcy Code: (i) the proceeding must be "a foreign main proceeding or foreign nonmain proceeding" within the meaning of section 1502; (ii) the foreign representative applying for recognition must be "a person or body"; and (iii) the petition must be supported by the documentary evidence specified in section 1515.

"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 proceeding 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."

## Who May Be a Debtor Under Chapter 15?

Section 109(a) of the Bankruptcy Code provides that, "[n]otwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title." Section 103(a) provides that "this chapter"—i.e., chapter 1, including section 109(a)—"appl[ies] in a case under chapter 15."

Even so, chapter 15, unlike chapters 7, 9, 11, 12, and 13, contains its own definition of "debtor." Section 1502(1) of the Bankruptcy Code defines a "debtor," "[f]or the purposes of [chapter 15]," as "an entity that is the subject of a foreign proceeding." The Second Circuit addressed the apparent inconsistency between sections 109(a) and 1502(1) in *Barnet*.

### *Barnet*

In July 2009, Octaviar Administration Pty Ltd. ("OA"), a company incorporated in Queensland, Australia, had been ordered to liquidate by an Australian court. As part of an investigation into OA's affairs, various Australian affiliates of Drawbridge Special Opportunities Fund LP ("Drawbridge") were sued in Australia.

In August 2012, the OA liquidators, as foreign representatives, sought recognition of the Australian liquidation as a foreign main proceeding under chapter 15 in a New York bankruptcy court. Drawbridge objected on the basis that OA did not meet the requirements for a debtor set forth in section 109(a) of the Bankruptcy Code.

The bankruptcy court entered an order recognizing OA's Australian liquidation on September 6, 2012. It overruled Drawbridge's objection, ruling that the definition of "debtor" in section 1502(1) determines whether a foreign debtor can be granted relief under chapter 15 and that the debtor need not have a domicile, property, or a place of business in the U.S. *See* Transcript of Hearing at 30, l. 1–13, *In re Octaviar Admin. Pty Ltd.*, No. 12-13443 (Bankr. S.D.N.Y. Sept. 6, 2012) [Document No. 22]. In response to a joint request by Drawbridge and OA's foreign representatives, the bankruptcy court certified a direct appeal of the recognition order to the Second Circuit, which agreed to review the case.

**The Second Circuit's Ruling**

After determining that it had jurisdiction over Drawbridge's appeal of the recognition order, the Second Circuit considered whether section 109(a) applies in a chapter 15 case. The court ruled that it does, on the basis of a "straightforward" interpretation of the statute, because section 103(a) expressly provides that chapter 1—of which section 109(a) is a part— applies in a case under

chapter 15. "Section 109, of course," the Second Circuit wrote, "is within Chapter 1 of Title 11 and so, by the plain terms of the statute, it applies 'in a case under chapter 15.' "

The court emphasized that "[s]ection 109(a) . . . creates a requirement that must be met by any debtor." Because OA's foreign representatives had made no attempt to establish that OA had a domicile, a place of business, or property in the U.S., the Second Circuit explained, the bankruptcy court should not have granted recognition to OA's Australian liquidation.

The Second Circuit rejected the foreign representatives' argument that section 109(a) does not apply because OA is a "debtor" under the Australian Corporations Act (rather than under the Bankruptcy Code) and the foreign representatives (rather than the debtor) were seeking recognition of the foreign proceeding. According to the court:

> [T]he presence of a debtor is inextricably intertwined with the very nature of a Chapter 15 proceeding . . . [and] [i]t stretches credulity to argue that the ubiquitous references to a debtor in both Chapter 15 and the relevant definitions of Chapter 1 do not refer to a debtor under the title [title 11] that contains both chapters.

In addition to the statutory definitions of "foreign representative," "foreign main proceeding," "debtor," and "foreign proceeding," the court noted, the automatic and discretionary relief provisions that accompany recognition of a foreign main proceeding (*see* sections 1520 and 1521) are similarly "directed towards debtors."

The Second Circuit flatly rejected the foreign representatives' argument that, even if OA were required to qualify as a debtor under the Bankruptcy Code, it need satisfy only the chapter 15-specific definition of "debtor" in section 1502(1), and not the section 109 requirements. "This

argument also fails," the court wrote, "as we cannot see how such a preclusive reading of Section 1502 is reconcilable with the explicit instruction in Section 103(a) to apply Chapter 1 to Chapter 15."

According to the Second Circuit, not only a "plain meaning" analysis but also the context and purpose of chapter 15 support the application of section 109(a) to chapter 15. The court explained that Congress amended section 103 to state that chapter 1 applies in cases under chapter 15 at the same time it enacted chapter 15, which strongly supports the conclusion that lawmakers intended section 103(a) to mean what it says—namely, that chapter 1 applies in cases under chapter 15.

The court acknowledged that the strongest support for the foreign representatives' arguments lies in 28 U.S.C. § 1410, which provides a U.S. venue for chapter 15 cases even when "the debtor does not have a place of business or assets in the United States." However, the Second Circuit explained that this venue statute "is purely procedural" and that, "[g]iven the unambiguous nature of the substantive and restrictive language used in Sections 103 and 109 of Chapter 15, to allow the venue statute to control the outcome would be to allow the tail to wag the dog."

Finally, the Second Circuit found that the purpose of chapter 15 is not undermined by making section 109(a) applicable in chapter 15 cases. Section 1501(a) of the Bankruptcy Code provides that the purpose of chapter 15 "is to incorporate the Model Law . . . so as to provide effective mechanisms for dealing with cases of cross-border insolvency." Although section 109(a), or its equivalent, is not included in the Model Law, the Second Circuit emphasized, the Model Law

allows a country enacting it to "modify or leave out some of its provisions." In any case, the court concluded, the omission of a provision similar to section 109(a) from the Model Law does not suffice to outweigh the express language Congress used in adopting sections 103(a) and 109(a).

The Second Circuit accordingly vacated the recognition order and remanded the case to the bankruptcy court for further proceedings consistent with its ruling.

**Going Forward**

It remains to be seen what impact, if any, *Barnet* will have on the availability of chapter 15 to assist foreign companies in their cross-border restructurings. In many, if not most, complex cross-border restructurings, the foreign debtor maintains a presence, or owns property located, in the U.S. As such, the holding in *Barnet* would not be implicated. Similarly, the requirement for a U.S. presence or assets contained in section 109(a) has been broadly interpreted by courts in the U.S. to mean the presence of *any* property in the U.S., no matter how small. *See*, *e.g.*, *In re Global Ocean Carriers Ltd.*, 251 B.R. 31 (Bankr. D. Del. 2000). Therefore, foreign debtors should not meet any significant obstacle in satisfying this requirement.

It also remains to be seen whether courts in other circuits will follow the Second Circuit's lead. However, at least one bankruptcy court in another circuit has already disagreed with *Barnet*. Six days after the Second Circuit handed down its ruling, a Delaware bankruptcy court (which is in the Third Circuit) issued a bench ruling to the contrary in *In re Bemarmara Consulting A.S.*, Case No. 13-13037(KG) (Bankr. D. Del. Dec. 17, 2013). Bankruptcy judge Kevin Gross ruled that section 109(a) does not apply in chapter 15 because it is the foreign representative, and not

the debtor in the foreign proceeding, who petitions the court. Moreover, the judge wrote, "there is nothing in [the] definition [of "debtor"] in Section 1502 which reflects upon a requirement that [a] Debtor have assets." *See* Transcript of Hearing at 9, l. 11–18, *In re Bemarmara Consulting A.S.*, Case No. 13-13037(KG) (Bankr. D. Del. Dec. 17, 2013) [Document No. 39]. "A Debtor," he noted, "is an entity that is involved in a foreign proceeding."

It bears noting that chapter 15's predecessor—section 304 of the Bankruptcy Code (repealed in 2005), which gave U.S. bankruptcy courts discretion to grant a limited range of ancillary (principally injunctive) relief by way of assistance to the duly appointed representatives of foreign debtors with U.S. assets—did not require a foreign debtor to qualify as a "debtor" under section 109(a) as a condition to relief. *See*, *e.g.*, *Goerg v. Parungao (In re Goerg),* 844 F.2d 1562 (11th Cir. 1988); *Saleh v. Triton Container Intl., Ltd. (In re Saleh)*, 175 B.R. 422 (Bankr. S.D. Fla. 1994). *Barnet* suggests that chapter 15 departed from section 304 on this point, whereas *Bemarmara* adopts a contrary view.