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Editorial Offices
630 Central Ave., New Providence, NJ 07974 (908) 464-6800
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

MATTHEW BENDER

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U.S. Causes of Action and Attorney Retainer Fund Are Sufficient Assets for Chapter 15 Recognition

Pedro A. Jimenez and Mark G. Douglas*

The U.S. Court of Appeals for the Second Circuit held as a matter of first impression in Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet) *that Section 109(a) of the Bankruptcy Code, which requires a debtor to have a domicile, a place of business or property in the U.S., applies in cases under Chapter 15. However, the Second Circuit did not provide any guidance as to how extensive a foreign debtor's property holdings in the U.S. must be to qualify for Chapter 15 relief. In* In re Octaviar Administration Pty Ltd., *the bankruptcy court found that the requirement of property in the U.S. should be interpreted broadly. By holding that relatively minimal U.S. assets are required to qualify for Chapter 15 recognition of a foreign bankruptcy or insolvency proceeding,* Octaviar *sets a low bar for recognition. The authors of this article discuss these decisions and their implications.*

In December 2013, the U.S. Court of Appeals for the Second Circuit held as a matter of first impression in *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*[1] 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. The Second Circuit accordingly vacated a bankruptcy court order granting recognition under Chapter 15 to a debtor's Australian liquidation proceeding, concluding that the bankruptcy 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 proceeding in the absence of any evidence that the debtor had a domicile, a place of business or property in the U.S.

However, the Second Circuit did not provide any guidance as to how extensive a foreign debtor's property holdings in the U.S. must be to qualify for Chapter 15 relief. The bankruptcy court recently answered that question on

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* Pedro Jimenez, the partner-in-charge of Jones Day's Miami office, is a restructuring lawyer whose practice focuses primarily on U.S. and cross-border transactions. Mark G. Douglas, a member of the Board of Editors of *Pratt's Journal of Bankruptcy Law*, is the Restructuring Practice Communications Coordinator at Jones Day. The authors may be contacted at pjimenez@jonesday.com and mgdouglas@jonesday.com, respectively.

[1] 737 F.3d 238 (2d Cir. 2013).

remand from the Second Circuit's ruling in *Barnet*. In *In re Octaviar Administration Pty Ltd.*,[2] the bankruptcy court found that, consistent with case law analyzing the scope of Section 109 for purposes of determining who is eligible to commence a case under Chapter 11, the requirement of property in the U.S. should be interpreted broadly. In this case, the fact that the Australian debtor had causes of action governed under U.S. law against parties in the U.S. and also had an undrawn retainer maintained in the U.S. satisfied the requirement that the debtor have property located 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 foreign "main" proceeding—a proceeding pending in the country where the debtor's "center of main interests" is located—and foreign "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."

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[2] 511 B.R. 361 (Bankr. S.D.N.Y. 2014).

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, was 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. Drawbridge itself refused to consent to the jurisdiction of the Australian courts.

In August 2012, the OA liquidators, as foreign representatives, sought recognition of the Australian liquidation proceeding 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 to be a debtor under Section 109(a) of the Bankruptcy Code.

The bankruptcy court entered an order recognizing OA's Australian liquidation proceeding on September 6, 2012. It overruled Drawbridge's objection, holding 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, a place of business or property in the U.S. 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

The Second Circuit ruled as a matter of first impression that Section 109(a) applies in a Chapter 15 case, on the basis of a "straightforward" interpretation of the statute. According to the court, 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 held that the bankruptcy court should not have granted recognition to OA's Australian liquidation proceeding.

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.

The Second Circuit also 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 [sic], 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.

ON REMAND: *OCTAVIAR*

Shortly after the Second Circuit handed down its ruling in *Barnet*, OA's foreign representatives, having determined not to pursue their initial petition, filed a second Chapter 15 petition alleging that OA satisfies the requirements of Section 109(a) in accordance with the Second Circuit's ruling. According to the new Chapter 15 petition, OA has property in the U.S. consisting of: (i) claims or causes of action against Drawbridge and other U.S. entities; and (ii) an undrawn retainer in the possession of the foreign representatives' U.S. counsel.

Drawbridge objected to the second Chapter 15 petition, arguing that:

1) Octaviar failed to satisfy the requirements of Section 109(a) as of the filing of the initial Chapter 15 petition;

2) the second petition should be dismissed as an abuse of process; and

3) even if recognition of the second petition is granted, the court should immediately dismiss the case pursuant to Section 305(a)(2) of the Bankruptcy Code (authorizing the court to dismiss or suspend all proceedings in a Chapter 15 case if "the purposes of chapter 15 . . . would be best served by such dismissal or suspension") to further the objectives of Chapter 15.

The bankruptcy court rejected each of these arguments. The court acknowledged that OA's claims against Drawbridge and the other U.S. entities may have been merely "potential causes of action" at the time of the filing of the first

Chapter 15 petition. However, it explained, such causes of action predated the first filing, and OA's foreign representatives, after being granted discovery, commenced litigation in New York state and federal courts on the causes of action prior to the second Chapter 15 filing. The court wrote that Drawbridge's arguments, including its abuse of process claim:

> amount to a procedural "Catch-22" in which the Foreign Representatives do not deserve to be caught, to wit: since the Foreign Representatives did not identify existing causes of action or other property in the First Chapter 15 Petition, now that the Foreign Representatives have properly obtained discovery and alleged the existence of causes of action in the Second Chapter 15 Petition, this Court should refuse to grant recognition.

The court rejected Drawbridge's assertion, relying on *In re Fairfield Sentry Ltd.*,[3] that OA's causes of action should be deemed located in Australia, rather than the U.S., because causes of action, as intangible assets, are located where the plaintiff, rather than the defendant, is domiciled. In *Fairfield Sentry*, the court wrote, the bankruptcy court emphasized that the situs of intangibles depends on a "common sense appraisal of the requirements of justice and convenience" in the particular circumstance at issue. Unlike in *Fairfield*, the court explained, the foreign representatives in *Octaviar* "have asserted claims under U.S. law that involve defendants located in the United States and include allegations that certain funds were wrongfully transferred by Drawbridge and other U.S. entities to the United States." According to the court, although these claims may be related to transactions and issues that are the subject of the Australian litigation, they do not involve the same parties, and "[a]s a general matter, where a court has both subject matter and personal jurisdiction, the claim subject to the litigation is present in that court."

In dicta, the bankruptcy court found that OA also has property in the U.S. in the form of an undrawn retainer in the possession of the foreign representatives' U.S. counsel. Because the funds were deposited after the first, but prior to the second Chapter 15 filing, Drawbridge argued that the creation of the account was an improper or bad faith attempt to "manufacture eligibility" for Chapter 15 recognition and to evade the consequences of *Barnet*. The *Octaviar* court rejected this argument, finding that the foreign representatives acted in good faith in transferring the funds to the retainer account. Section 109(a), the court wrote, "says nothing about the amount of . . . [U.S.] property nor does it direct that there be an inquiry into the circumstances

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[3] 484 B.R. 615 (Bankr. S.D.N.Y. 2013).

surrounding the debtor's acquisition of the property." It is "thus consistent with other provisions of the Code that reject lengthy and contentious examination of the grounds for a bankruptcy filing."

Finally, the bankruptcy court concluded that the policy and purposes of Chapter 15 would be undermined if the foreign representatives were deprived of an opportunity to prosecute causes of action in the U.S. on behalf of Octaviar for the benefit of its creditors. Recognition of the Australian liquidation proceeding, the court wrote, "will not prejudice Drawbridge or abridge its rights to assert all available defenses it has" in the state and federal court litigation, including a defense on the basis of forum non conveniens. Moreover, it noted, "[c]ourts have frequently expressed concern that the recognition provisions of chapter 15 not be used by a defendant who is attempting to evade its legitimate foreign creditors." According to the court, where, as here, Drawbridge refused to consent to the jurisdiction of the Australian courts, granting recognition of OA's Australian liquidation proceeding promotes cooperation between U.S. and Australian courts and will foster the fair, efficient and timely adjudication of the Australian liquidation as well as assist in protecting both the interests of OA and its creditors.

OUTLOOK

By holding that relatively minimal U.S. assets are required to qualify for Chapter 15 recognition of a foreign bankruptcy or insolvency proceeding, *Octaviar* sets a low bar for recognition. However, this low threshold is arguably consistent with the goals of Chapter 15 in, among other things, providing an effective vehicle for foreign debtors to collect assets outside of the jurisdiction where their primary bankruptcy or insolvency proceedings are pending.

Barnet does not represent the only view on whether U.S. assets are required before a foreign proceeding can be recognized under Chapter 15. A Delaware bankruptcy court (which is in the Third Circuit) issued a bench ruling to the contrary in *In re Bemarmara Consulting A.S.*[4] The court 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 court wrote, "there is nothing in [the] definition [of "debtor"] in Section 1502 which reflects upon a requirement that [a] Debtor have assets."[5] "A Debtor," the court noted, "is an entity that is involved in a foreign proceeding."

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[4] Case No. 13-13037(KG) (Bankr. D. Del. Dec. 17, 2013).

[5] *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].

Given *Octaviar's* pronouncement that minimal U.S. property is adequate to satisfy the requirements of Chapter 15, however, the distinction between the two courts' approaches may be of little consequence in the vast majority of cases.