New Rules for Cross-Border Bankruptcy Cases
Enacted as Part of New U.S. Bankruptcy Legislation

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Part of the new bankruptcy legislation recently approved by Congress and signed into law by President George W. Bush on April 20, 2005 is an entirely new chapter of the Bankruptcy Code — chapter 15 — governing cross-border bankruptcy and insolvency cases. Chapter 15 is patterned after the Model Law on Cross-Border Insolvency, 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.

Long-heralded chapter 15 replaces section 304 of the Bankruptcy Code. Section 304 allowed an accredited representative of a debtor in a foreign insolvency proceeding to commence a limited "ancillary" bankruptcy case in the U.S. for the purpose of protecting the foreign debtor's U.S. assets from creditor collection efforts, and in some cases, facilitating the repatriation of those assets abroad to be administered in the debtor's insolvency or bankruptcy case. Chapter 15 continues that practice, but establishes new rules and procedures applicable to transnational bankruptcy cases. In what follows, we briefly discuss the new legislative regime and how it is likely to affect cross-border bankruptcy cases.

The Purpose of Chapter 15

Chapter 15's stated purpose is "to provide effective mechanisms for dealing with cases of cross-border insolvency" consistent with the following objectives:
(i) cooperation between U.S. courts, court and administrative functionaries and debtors, on the one hand, and non-U.S. courts and other competent foreign authorities involved in cross-border insolvency cases, on the other;

(ii) greater legal certainty for trade and investment;

(iii) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested parties, including the debtor;

(iv) protection and maximization of the value of the debtor's assets; and

(iv) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

Procedure

An 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 whatever country contains the debtor's "center of main interest" -- and "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment" (conducts business or owns assets). The debtor's registered office, or habitual residence in the case of an individual, is presumed to be the center of the debtor's main interest. If the bankruptcy court is provided with sufficient evidence
(delineated in the statute) testifying to the legitimacy of a pending foreign bankruptcy proceeding (main, nonmain or both), it may enter an "order of recognition."

Pending its decision on recognition, the bankruptcy court is empowered to grant certain kinds of provisional relief. Thus, for example, section 1521 authorizes the court, "where relief is urgently needed to protect the assets of the debtor or the interests of the creditors," to stay any execution against the debtor's assets, entrust the administration of the debtor's assets to a foreign representative, or suspend the right to transfer, encumber or otherwise dispose of any of the debtor's assets. Any provisional relief granted pending approval terminates at such time that the bankruptcy court confers or withholds an order recognizing the foreign proceeding.

Upon recognition of a foreign proceeding, certain provisions of the Bankruptcy Code automatically come into force, and others may be deployed in the bankruptcy court's discretion by way of "additional assistance" to the foreign bankruptcy case. Among these are the automatic stay (or an equivalent injunction) preventing creditor collection efforts with respect to the debtor or its assets located in the U.S. (section 362, subject to certain enumerated exceptions), the right of any entity asserting an interest in the debtor's U.S. assets to "adequate protection" of that interest (section 361), and restrictions on the debtor's ability to use, sell or lease its U.S. property outside the ordinary course of its business (section 363). The bankruptcy court's decision to provide "additional assistance" must be designed to reasonably assure the following:

(1) just treatment of all creditors and shareholders;

(2) protection of U.S. creditors against prejudice and inconvenience in asserting their claims in the foreign proceeding;

(3) prevention of preferential or fraudulent dispositions of the debtor's assets;
distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by the U.S. Bankruptcy Code; and

(5) if appropriate, the provision of an opportunity for a fresh start for an individual foreign debtor.

Finally, the bankruptcy court may exercise its discretion to order any of the relief authorized by chapter 15 upon the commencement of a case or recognition of a foreign proceeding "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected."

The foreign representative in a recognized chapter 15 case is conferred with some of the powers given to a bankruptcy trustee under the Bankruptcy Code, although they do not include the ability to invalidate preferential or fraudulent asset transfers or obligations. The foreign representative may also intervene in any court proceedings in the U.S. in which the debtor is a party, and can sue and be sued in the U.S. on the debtor's behalf.

Upon recognition of a main proceeding, the foreign representative may also commence a full-fledged bankruptcy case under any other chapter of the Bankruptcy, so long as the foreign debtor is eligible to file for bankruptcy in the U.S. and the debtor has assets located in the U.S. In general, any "person" (defined to include a corporation) that "resides or has a domicile, a place of business, or property" in the U.S. can file for bankruptcy in the U.S. However, foreign banks and foreign insurance companies are prohibited from filing for bankruptcy here. Thus, under the new law, a foreign bank with a U.S. branch cannot file a chapter 15 petition or an ordinary ("plenary") bankruptcy case. A foreign insurance company, by contrast, can file for chapter 15 protection, but not under any other section of the Bankruptcy Code. If an order for relief is
granted with respect to a foreign debtor in a case under another chapter of the Bankruptcy Code, the foreign representative has standing to invoke most of the avoidance and strong-arm powers of a bankruptcy trustee. Only assets located in the U.S. are subject to administration in a case filed by a foreign representative under any other chapter of the Bankruptcy Code.

Chapter 15 expressly gives foreign creditors a significant degree of access and protection. For example, foreign creditors are entitled to notification of the commencement of a case under chapter 15. Among other things, the notice must specify the deadline for submitting documentation of unsecured and secured claims against the debtor. Foreign creditors have the same rights as domestic creditors regarding the commencement of, and participation in, a case under the Bankruptcy Code. However, the law is non-committal as to whether foreign unsecured creditor claims are entitled to the same priority of distribution specified in sections 507 and 726 of the Bankruptcy Code. Instead, it provides that "the claim of a foreign creditor under those sections shall not be given a lower priority than that of general unsecured claims without priority solely because the holder of such claim is a foreign creditor."

**Cooperation and Coordination of Proceedings**

Chapter 15 was designed to promote cooperation and coordination between courts in two or more countries presiding over bankruptcy or insolvency proceedings involving the same debtor. To that end, the U.S. bankruptcy court, and with court supervision, any bankruptcy trustee or examiner, are authorized to communicate directly with a foreign court or a foreign representative. Chapter 15 contains a non-exclusive list of appropriate means of implementing "cooperation," including:
(i) the appointment of a functionary (e.g., an examiner) to act at the court's direction;

(ii) communication of information by any means considered appropriate by the court;

(iii) coordination of the administration and supervision of the debtor's assets and affairs;

(iv) approval or implementation of agreements concerning the coordination of proceedings; and

(v) coordination of concurrent proceedings regarding the same debtor.

If more than one bankruptcy case is commenced with respect to a foreign debtor in the U.S., chapter 15 creates a mechanism to coordinate the proceedings. Thus, for example, if a foreign debtor is already concurrently the subject of a foreign proceeding and a chapter 7 or 11 case in the U.S. when its foreign representative commences a chapter 15 case, the U.S. bankruptcy court, if it recognizes the foreign proceeding, is obligated to harmonize any relief it decides to grant in the chapter 15 case so that it is consistent with the relief granted in the chapter 11 case. Similarly, if the representative files a chapter 7 or 11 case in the U.S. after the bankruptcy court recognizes a pending foreign proceeding under chapter 15, the bankruptcy court must review the relief it has already granted under chapter 15 to ensure that it is consistent with the relief granted in the chapter 7 or 11 case. The bankruptcy court is also entrusted with coordinating nonmain foreign proceedings.

Chapter 15 also establishes rules to account for the possibility that creditors of a foreign debtor may have received full or partial satisfaction of their claims from sources outside of the U.S. Section 15 provides that "[w]ithout prejudice to secured claims or rights in rem, a creditor who has received payment with respect to its claim in a foreign proceeding pursuant to a law relating
to insolvency may not receive a payment for the same claim in a case under any other chapter of
[the U.S. Bankruptcy Code] regarding the debtor, so long as the payment to other creditors of the
same class is proportionately less than the payment the creditor has already received."

**Outlook**

To date, the U.S., Japan, Eritrea, Mexico, South Africa, and within Yugoslavia, Montenegro
have adopted bankruptcy laws patterned after the Model Law. Canada and Australia are actively
considering whether to do so. Before chapter 15 was enacted, progress on implementing the
principles contained in the Model Law was all but stalled as many countries waited to see
whether the U.S. would sign on to the project. It remains to be seen whether the enactment of
chapter 15 will jump-start the process. The importance of meaningful progress in this area
cannot be overstated -- the EU's enactment in 2002 of the European Union Regulation on
Insolvency Proceedings gave Europe an advantage in the global commerce arena by creating a
unified system of rules applying to insolvency proceedings in member countries. To a
considerable degree, transnational trade players outside of the EU are still forced to cope with the
vagaries of a hodgepodge of different laws governing such proceedings in the rest of the world.

Many of the concepts embodied in chapter 15 are not new. A bankruptcy court's discretion to
grant relief under section 304 by way of assistance to a pending bankruptcy or insolvency
proceeding involving a foreign debtor with U.S. assets was considerable. Still, cooperation
between foreign and U.S. courts designed to harmonize cases pending against the same debtor in
more than one country was undertaken very much on an ad hoc basis. In many cases, many of
the rules and procedures now contained in chapter 15 were implemented in protocols that sometimes took months or even years to negotiate and obtain court approval.

The effective date of chapter 15 is 180 days after its enactment. This means that the new procedures apply only to bankruptcy cases filed on or after October 17, 2005. Thus, it will be some time before we can assess the impact of chapter 15 on cross-border bankruptcy cases.