CROSS-BORDER INSOLVENCY ISSUES UNDER THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

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Grand Hyatt Atlanta Hotel
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April 6-8, 2006
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January 2006

I. Introduction

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “Act”) effected important changes to the relief available to foreign debtors in the United States. Former Bankruptcy Code §304 has been repealed and replaced with Chapter 15, Ancillary and Other Cross Border Cases (“Chapter 15”), which adopts, in large measure, the Model Law on Cross-Border Insolvency and which expressly directs U.S. bankruptcy courts interpreting Chapter 15 to “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” and to “cooperate to the maximum extent possible” with foreign courts and foreign representatives. 11 U.S.C. §§1501(a), 1508 and 1525(a). Given that former Code §304 was designed and generally interpreted to invoke the protections and provisions of the Bankruptcy Code in a limited way and with an emphasis on comity, these explicit directions may not result in any sweeping change in the adjudication of ancillary proceedings in the U.S. As with many of the changes to the Code promulgated by the Act, it is still too early for a complete assessment.

II. Recognition of Foreign Insolvency Proceedings

Commencement of a Case Under Chapter 15:

As was the case under former Bankruptcy Code §304, the prerequisites for the commencement of an ancillary proceeding under Chapter 15 are minimal and provisional relief may be sought at the outset. A case under Chapter 15 is commenced by the filing by a foreign representative of a petition for “recognition” of a foreign proceeding, together with a statement identifying the pending foreign proceeding(s), evidence of its commencement and the evidence of the appointment of the foreign representative. 11 U.S.C. §101(24).


“Foreign representative” is now defined 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.” 11 U.S.C. §101(24). In addition, Bankruptcy Code §1502 contains the following new definitions: (i) “recognition” is defined as “the entry of an order granting recognition of a foreign main proceeding or foreign nonmain proceeding under this chapter;” (ii) “foreign main proceeding” is defined to mean “a foreign proceeding pending in the country where the debtor has the center of its main interests;” (iii) “foreign nonmain proceeding” is defined as “a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment;” and (iv) “establishment” is defined to mean “any place of operations where the debtor carries out a nontransitory economic activity.” The “center of

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Relief Available Between Filing and Recognition of Foreign Proceeding:

Unlike the provisional relief typically available under former Bankruptcy Code §304, relief granted in conjunction with the filing of the recognition petition is limited to that which is “urgently needed,” such as: (i) a stay of execution against the debtor’s assets; (ii) turnover to the foreign representative or other person authorized by the court of the responsibility for administering or realizing on debtor’s assets for the purpose of protecting and preserving depreciating assets; (iii) freezing the debtor’s assets; (iv) discovery and (v) certain other relief available to a trustee. 11 U.S.C. §1519(a). The standard for a grant of relief under §1519 is an injunction standard. 11 U.S.C. §1519(e). In addition, such relief must be denied where it would interfere with a foreign main proceeding and terminates when the recognition petition is granted. 11 U.S.C. §§1519(b) and (c). In addition, such relief terminates once the recognition petition is granted unless the foreign representative seeks and obtains post-recognition relief. 11 U.S.C. §1507.

III. Applicability of Bankruptcy Code Protections and Additional Relief Available

Effect of Recognition:

If a petition for recognition is granted, the foreign representative (i) is entitled to comity or cooperation by the United States court; (ii) may, in the case of a foreign main proceeding, commence a voluntary case if the foreign proceeding is a foreign main proceeding or an involuntary case under Bankruptcy Code §§301, 302 or 303; (iii) is deemed a party in interest in any case pending against the debtor under Title 11; (iv) may sue and be sued in the United States; (v) may apply directly to a U.S. court for appropriate relief and (vi) may intervene in any state or federal court proceeding where the debtor is a party. 11 U.S.C. §§1509, 1511, 1512, 1524.

In a significant change from pre-Act law, upon the recognition of a foreign main proceeding, (i) Bankruptcy Code §§361 (adequate protection) and 362 (automatic stay) apply to any property of the debtor located in the U.S.; (ii) Code §§363 (sale or use of property), 549 (post-petition transfers) and 552 (liens on after-acquired property) apply to transfers of property of the debtor in the U.S.; and (iii) the foreign representative is the debtor’s main interests” of a foreign debtor is presumed to be its registered office pursuant to Code §1516(c). Finally, the definition of the term “foreign proceeding” has been revised to mean “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.” 11 U.S.C. §101(23).

Bankruptcy Code §1104(d) (appointment of disinterested person as trustee or examiner) applies in Chapter 15. 11 U.S.C. §1522(d).
empowered to operate the debtor and take action under Code §§363 and 552. 11 U.S.C. §1520.

Additional Relief Available Post-Recognition:

If recognition is granted, the foreign representative may seek “additional assistance” from the bankruptcy court, including (i) a stay of any action or proceeding; (ii) a stay of execution against the debtor’s assets; (iii) suspension of the right to transfer, encumber or dispose of any assets; (iv) discovery; (v) turnover of the administration or realization of the debtor’s assets to the foreign representative or other authorized person; (vi) extension of any relief previously granted under Bankruptcy Code §1519; (vii) certain other relief available to a trustee and (viii) authorization to distribute the debtor’s assets, provided that the interests of creditors in the United States are sufficiently protected. 11 U.S.C. §§1507, 1521(a) and (b). In granting relief under §1521 with respect to a foreign nonmain proceeding, “the court must be satisfied that the relief relates to assets that, under the law of the United States, should be administered in the foreign nonmain proceeding or concerns information required in that proceeding.” 11 U.S.C. §1521(c).

In determining whether to provide such assistance, the court must “consider whether such additional assistance, consistent with principles of comity,” is also consistent with the principles listed in former Bankruptcy Code §304, including just treatment of holders of claims, protection of U.S. creditors from prejudice and the inconvenience of prosecuting claims in a foreign proceeding, prevention of fraudulent and preferential transfers, distributions substantially in accordance with the priorities prescribed by the Bankruptcy Code, and the debtor’s opportunity for a fresh start. 11 U.S.C. § 1507(b).

IV. Voluntary Petitions in the U.S. By Foreign Debtors and Forum Shopping:

Who May Be a Debtor Under Chapter 15:

Previously, courts held the debtor-eligibility requirements of Bankruptcy Code §109 inapplicable to ancillary cases involving foreign debtors. In a change from pre-Act law, Chapter 15 specifically applies to (i) a foreign court or representative seeking assistance in the United States in connection with a foreign proceeding, (ii) an entity seeking assistance in a foreign country with respect to a case under Title 11, (iii) concurrently pending foreign and Title 11 cases and (iv) creditors or “other interested persons” in a foreign country who wish to commence or participate in a case under the Bankruptcy Code. 11 U.S.C. §1501(b). Chapter 15 expressly does not apply to entities prohibited from being debtors under amended Code §109(b). This includes foreign banks, savings banks, cooperative banks, savings and loan associations, building and loan associations, credit unions which have a branch or agency (as defined in §1(b) of the International Banking Act of 1978) and foreign insurance companies engaged in such business in the U.S.


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Venue:

Under the pre-Act version of 28 U.S.C. §1410, venue was based on the relief sought and was proper in the district where, for example, an action which the foreign representative sought to enjoin was pending. Under Chapter 15, however, venue is proper (i) in the district where the foreign debtor’s principal assets or principal place of business in the United States are located; or (ii) if none, in the district where an action in state or federal court is pending against the foreign debtor; or (iii) in the absence of such an action, in a district “consistent with the interests of justice and the convenience of the parties, having regard to the relief sought by the foreign representative.” 28 U.S.C. §1410.

Having dispensed with the specific references to the relief sought by the foreign representative in favor of references to the foreign debtor’s presence in the U.S., the revised venue provisions appear to permit forum shopping for foreign debtors who have no or limited assets in the United States and who are able to create a basis for filing in a particular district by depositing assets in that district pre-filing. It is, however, too soon to be able to determine with certainty whether these changes will result in increased forum-shopping.

V. Availability of Involuntary Relief in the U.S. Against Foreign Debtors:

As was the case under the pre-Act Code, “a foreign representative of the estate in a foreign proceeding” may commence an involuntary case pursuant to Bankruptcy Code §303(b)(4). Recognition of a foreign main proceeding under Chapter 15 constitutes proof that the foreign debtor is insolvent for purposes of Bankruptcy Code § 303. 11 U.S.C. § 1531. Section 303 was not amended by the Act in any way that would prevent the commencement of an involuntary case against a foreign debtor in the U.S. so long as the other requirements of the Code are met. 11 U.S.C. §1511.

VI. Extraterritorial Reach of Bankruptcy Code:

So long as a foreign debtor meets the eligibility requirements of Bankruptcy Code §109, it may commence a plenary case in the United States pursuant to Bankruptcy Code §301. In such a case, and in the absence of a pending foreign proceeding, the automatic stay and all of the other rights and protections available under the Bankruptcy Code will apply to the foreign debtor and property of the estate “wherever located” and U.S. bankruptcy courts may issue orders with respect to such property. 11 U.S.C. §541(a); In re Simon, 153 F.3d 991 (9th Cir. 1998), cert. denied 525 U.S. 1141 (1999); In re Yukos Oil Co., 320 B.R. 130 (Bankr. S.D. Tex. 2004).6

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6 Although there are no statutory restrictions, practical limitations may exist. See In re Yukos Oil Co., 321 B.R. 396, 410-11 (Bankr. S.D. Tex. 2005) (dismissing case based on inability to grant relief due to

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In the event that a foreign proceeding is pending, the foreign representative has the ability to commence a plenary case in the United States, but the “effects of such case shall be restricted to the assets of the debtor that are within the territorial jurisdiction of the United States and, to the extent necessary to implement cooperation and coordination . . . to other assets of the debtor that are within the jurisdiction of the court under Sections 541(a) of this title, and 1334(e) of title 28, to the extent that such other assets are not subject to the jurisdiction and control of a foreign proceeding that has been recognized under this chapter.”7 11 U.S.C. §1528. Similarly, the automatic stay and other provisions applicable in foreign main proceedings are limited to assets located in the U.S. 11 U.S.C § 1520(a). Thus, rather than leave it to the U.S. and foreign courts presiding over concurrent plenary proceedings to determine which laws to apply to particular assets, the drafters of Chapter 15 have expressly limited the reach of the U.S. Bankruptcy Code in such situations.

VII. Recognition and Enforcement in the U.S. of Orders and Judgment of Foreign Courts:

As set forth above, additional relief is available to a foreign representative pursuant to Bankruptcy Code §§1519 and 1521 so long as such relief is consistent with the principles enunciated under former Code §304, including the doctrine of comity, pursuant to which courts in different jurisdictions seek to avoid interfering with one another. The principles of coordination and cooperation upon which Chapter 15 is founded make clear that the emphasis on cooperation is key to the interpretation of all of its provisions and should be considered in connection with all issues arising in ancillary proceedings. See 11 U.S.C. §§ 1501, 1508, 1525, 1526 and 1529.

Cooperation is not, however, synonymous with comity, which suggests generally that U.S. courts should recognize and enforce orders and judgments of foreign courts provided that such foreign courts acted with a minimum of due process. See Hilton v. Guyot, 159 U.S. 113, 141 (1895); Cunard Steamship Co. v. Salen Reefer Servs. AB, 773 F.2d 452, 457 (2d Cir. 1985).

In this regard, Chapter 15 does contain limits, including §1503, which provides that in the event of a conflict between Chapter 15 and a treaty or agreement with another country, the treaty or agreement will control. In addition, relief under §§1519 and 1521 cannot be used to enjoin a police or regulatory act of a governmental unit or to stay rights not subject to the automatic stay under Bankruptcy Code §§362(b)(6), (7), (17) or (27) or 362(n), courts may refuse to act under Chapter 15 if to do so would “be manifestly

lack of participation of Russian government, questionable exercise of U.S. jurisdiction and proceedings pending in other countries).

7 The term “within the territorial jurisdiction of the United States” is defined as follows: “when used with reference to property of a debtor, refers to tangible property located within the territory of the United States and intangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may properly be seized or garnished by an action in a Federal or State court in the United States.” 11 U.S.C. §1502(8).
contrary to the public policy of the United States.” 11 U.S.C. §1506. Further, under certain pre-Act case law, limits were placed on comity in cases where the rules of the foreign proceeding were inconsistent with the Bankruptcy Code in a manner deemed prejudicial to U.S. creditors. See e.g., In re Treco, 240 F.3d 148 (2d Cir. 2001).

Since these rules, though now codified, are note new, and since case law under the former Code §304 is likely to continue to be relevant in Chapter 15 cases, it is unclear whether Chapter 15 has significantly expanded the likelihood of the enforceability of orders and judgments of foreign courts.

VIII. **Rights of Foreign Creditors in U.S. Cases:**

The rights of foreign creditors are now recognized under §§1513 and 1514 and include: (i) “the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors;” (ii) protection against the reclassification of foreign creditor priority claims under Code §§507 or 726 to a priority lower than general unsecured claims solely because the holder of such claim is a foreign creditor; (iii) notices that must be given to creditors generally; (iv) individual notice unless the court otherwise directs; (v) information regarding the mechanism and timing for filing proofs of claim and (vi) reasonable additional time to file proofs of claim.

IX. **Conclusion**

Although it is, in many respects, a codification of existing law as it has developed under former Bankruptcy Code §304, Chapter 15 does contain new provisions which may effect further significant changes in the practice with respect to ancillary proceedings. The two-step process for obtaining recognition and pre- and post-recognition relief could arguably give creditors two opportunities to examine and challenge such relief in ancillary proceedings. In addition, the applicability of the automatic stay and other provisions with respect to asset sales and transfers in connection with foreign main proceedings represents a significant change in practice. It is still too soon, however, to fully assess the impact of these changes.