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A legal update from Dechert's Bankruptcy/Corporate Recovery and Insolvency Group

## Bankruptcy Reform Bill Adopts UN Model Law to More Effectively Deal with Cross-Border Insolvencies

*The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") amends Title 11 of the United States Code (the "Bankruptcy Code") in a number of ways. One significant amendment: the adoption of a model law on cross-border insolvencies, originally proposed in 1997 by the United Nations Commission on International Trade Law ("UNCITRAL").*

The UNCITRAL model law has been enacted as the new Chapter 15 of the Bankruptcy Code and replaces former section 304, which previously governed the procedure for cases filed ancillary to foreign proceedings. With the United States' passage of the law, many other countries may also pass the UNCITRAL model law, which should lead to greater global harmonization of cross-border insolvency proceedings.

### Objectives of the Model Cross-Border Insolvency Law

Chapter 15 seeks to balance the right of U.S. courts to administer assets of a debtor located within the United States with principles of comity and similar rights of foreign courts with respect to assets of the same debtor located within their purview. To this end, Chapter 15 sets forth the following objectives:

- "[C]ooperation between (A) courts of the United States, United States trustees, examiners, debtors, and debtors in possession; and (B) the courts and other competent authorities of foreign countries involved in cross-border insolvency cases;
- greater legal certainty for trade and investment;
- fair and efficient administration of cross-border insolvencies that protects the

interests of all creditors, and other interested entities, including the debtor;

- protection and maximization of the value of the debtor's assets; and
- facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment." 11 U.S.C. § 1501(a).

Chapter 15 provides that these principles should be carried out in accordance with international legal norms in an effort to harmonize the world-wide law on cross-border insolvencies (unless those principles conflict with a United States' treaty obligation or public policy).

### Procedure for Recognition of a Foreign Proceeding

Chapter 15 applies when a foreign court<sup>1</sup> or foreign representative<sup>2</sup> seeks assistance in the U.S. in connection with a foreign proceeding<sup>3</sup> or where such assistance is sought in a foreign country in a

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<sup>1</sup> A "foreign court" means "a judicial or other authority competent to control or supervise a foreign proceeding."

<sup>2</sup> A "foreign representative" means "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."

<sup>3</sup> A "foreign proceeding" means 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."

case pending under the Bankruptcy Code. *Id.* §1501(b)(1) & (b)(2). Chapter 15 will not apply to certain individuals, foreign insurance companies, or entities subject to a proceeding under the Securities Investor Protection Act of 1970. *Id.* § 1501(c).

Chapter 15 cases may only be filed in the district court where the debtor<sup>4</sup> has its principal place of business or assets in the U.S. or, if the debtor does not have a place of business or assets in the U.S., in the district in which there is pending against the debtor an action or proceeding in a federal or state court.

A case under Chapter 15 is commenced when a foreign representative files a petition for recognition of a foreign proceeding, which petition must be accompanied by official court documentation or other evidence of the foreign proceeding. If the petition contains adequate proof of a foreign proceeding, then the court enters an order recognizing the foreign proceeding.

After a petition is filed but prior to the entry of such an order recognizing, the court may grant certain provisional relief, including:

- Staying execution against the debtor’s assets
- Entrusting the administration or realization of all or part of the debtor’s assets located in the United States to the foreign representative or other authorized person
- Suspending the right of the debtor to transfer, encumber, or otherwise dispose of any assets
- Providing for examination of witness and the taking of evidence concerning the debtor’s assets, affairs, rights, obligations, or liabilities
- Granting any additional relief that may be available to a trustee, except for certain relief related to exempt property and certain causes of action arising under Chapter 5 of the Bankruptcy Code

If the court recognizes a foreign proceeding, it must recognize such proceeding as either a “foreign main proceeding,” if the proceeding is pending in the country where the debtor has its “center of main interests,” or as a “foreign nonmain proceeding,” if the debtor has an

<sup>4</sup> The term “debtor,” in this context, means “an entity that is the subject of a foreign proceeding.”

“establishment”<sup>5</sup> in the country where the foreign recognition proceeding. Upon recognition, the foreign representative has the capacity to sue and be sued in the United States, and may apply for relief directly to a court in the U.S. *Id.* § 1509(c).

If the court denies the request for recognition of the foreign proceeding, then it may issue any appropriate order necessary to prevent the foreign representative from obtaining comity or cooperation from courts in the U.S. *Id.* § 1509(d). Section 305 of the Bankruptcy Code has also been amended to provide that recognition of a foreign proceeding can serve as a ground for dismissing or staying a pending case under the Bankruptcy Code.

If the court recognizes the proceeding as a foreign main proceeding, then certain provisions of the Bankruptcy Code apply with respect to the debtor’s property within the territorial jurisdiction of the United States. These include: the adequate protection, the automatic stay, and the sale, use or lease provisions of the Bankruptcy Code.

Irrespective of whether the court recognizes a foreign proceeding as a foreign main proceeding or a foreign nonmain proceeding, upon recognition, the court, subject to Section 1521 of the Bankruptcy Code, may enter broad relief, such as staying execution, preventing the debtor’s transfer of assets, or entrusting the realization or administration of the assets to a trustee or examiner.

Foreign creditors, however, have the same rights regarding the commencement of, and participation in, a case under Chapter 15 as a domestic creditor would have. Section 1514 provides for special notice provisions for these foreign creditors, which includes a provision requiring additional time for foreign creditors to file proofs of claim.

If the proceeding is a foreign main proceeding, then a case under Chapter 7 or Chapter 11 “may be commenced only if the debtor has assets in the United States,” which case shall be limited to those assets in the U.S. *Id.* § 1528. Additionally, the foreign representative has standing under Chapter 15 to institute preference actions, fraudulent transfer actions, and other similar actions.

<sup>5</sup> “Establishment” means “any place of operations where the debtor carries out a nontransitory economic activity.”

The foreign representative is also granted a direct right to intervene in any proceedings in a state or federal court in the U.S. in which the debtor is a party. *Id.* § 1509. However, the fact that a foreign representative files a petition for recognition does not subject that foreign representative to the jurisdiction of any court in the U.S. for any other purpose. *Id.* §1510.

### **Cooperation with Foreign Courts and Concurrent Proceedings**

Chapter 15 also applies to concurrent insolvency proceedings pending under the Bankruptcy Code and a foreign proceeding or where interested parties in a foreign country request the commencement of, or participation in, a case or proceeding under the Bankruptcy Code. *Id.* §1501(b)(3) & (b)(4).

Subchapters IV and V of Chapter 15 set forth principles by which the U.S. court should cooperate with a foreign court and the foreign representative. This cooperation may either be direct or through the trustee. The bankruptcy court is also authorized to communicate directly with a foreign court or request information or assistance from such court, subject to the rights of a party in interest to notice and participation. The trustee or other person, including but not limited to, an examiner, authorized by the court, may also communicate directly with a foreign court or foreign representative.

Chapter 15 grants the bankruptcy court broad discretion to determine what information is communicated to a foreign court or the foreign representative and how that information is communicated, including, but not limited to, coordination of the administration of the debtor's assets and coordination of concurrent proceedings.

Chapter 15 further provides that if more than one foreign proceeding is pending regarding the debtor, the court should harmonize its orders and the relief entered with respect to the foreign nonmain proceeding and foreign main proceeding. Thus, the bankruptcy courts have been given broad discretion to coordinate an efficient administration of global, cross-border insolvencies with foreign courts.

### **Conclusion**

The Act has received tremendous attention for its changes to consumer bankruptcy law; however, the enactment of the UNCITRAL Model Law on Cross-Border Insolvency is a significant change to the Bankruptcy Code that may greatly impact the global economy. If successful, this new experiment in globalization may save jobs and create greater certainty in the international financial market. If unsuccessful, the law could create confusion and chaos as courts worldwide compete with one another across international boundaries for large multinational bankruptcy cases.

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## Practice group contacts

If you have questions regarding the information in this legal update, please contact the authors or the Dechert attorney with whom you regularly work. Visit us at [www.dechert.com/insolvency](http://www.dechert.com/insolvency).

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