

Client Alert

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New Chapter 15 of Bankruptcy Code Provides More Options for Non-US Debtors

Chapter 15 of the Bankruptcy Code ("Chapter 15") is part of the Bankruptcy Abuse Prevention and Consumer Protection Act (the "Act"), which President Bush signed into law on April 20, 2005.¹ Chapter 15 deals with the recognition of foreign bankruptcy or insolvency proceedings and replaces Section 304 of the Bankruptcy Code in cases commenced more than 180 days after the date of enactment (that is, October 17, 2005).

Chapter 15 is taken from the Model Law on Cross Border Insolvency prepared by the United Nations Commission on International Trade Law. Chapter 15 is principally intended to provide a coherent procedural framework for co-operating with foreign courts in the management of the United States assets of a debtor involved in insolvency proceedings overseas. An insolvency representative appointed by a foreign court may petition for recognition of the foreign proceeding in a United States bankruptcy court. Temporary remedies are available prior to the approval of the petition. After the foreign proceeding is recognized, the remedies available will depend on whether the United States court determines that the foreign proceeding is a main or a non-main proceeding. If a proceeding is determined to be a main proceeding, the foreign representative will have greater rights and remedies at his or her disposal. A proceeding is considered a main proceeding if brought where the debtor's

center of main interests lies - a location rebuttably presumed to exist in the country in which the debtor is incorporated or registered.

Filing of A Petition - Eligibility

New Section 1515 of Chapter 15 permits a foreign representative, such as a court-appointed administrator, to seek recognition of the foreign proceeding in the United States by filing a petition for recognition.² In order to obtain recognition of the foreign proceeding, it must merely be shown that a "foreign proceeding" has been commenced and that the petitioner is a "foreign representative."

Chapter 15 changes the definitions of "foreign proceeding" and "foreign representative" as previously interpreted by courts in proceedings under Section 304 of the Bankruptcy Code. Although the change to the definition of "foreign representative" is not particularly significant, the definition of "foreign proceeding" is expanded as described below. Under Section 304, three aspects of the definition of a foreign proceeding were required before ancillary proceedings were recognized: (1) the foreign proceeding must have been considered as a "proceeding;" (2) the proceeding must have been conducted for the purpose of liquidation, debt adjustment, discharge or reorganization; and (3) the proceeding must have been pending in a foreign country where the

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debtor's domicile, residence, principal place of business or assets were located. *Collier on Bankruptcy*, ¶ 304.02. Section 802 of the Act amends the definitions of foreign proceeding and foreign representative. Apart from the expansion of the definition of "foreign proceeding," these amendments largely serve the purpose of clarification and are unlikely to change the substantive outcome of a petition for recognition.

First, Section 802(b) of the Act amends Section 101(23) of the Code to define a foreign proceeding as a "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." The reference to the control or supervision of a foreign court seems narrower than the current definition, but in fact largely codifies case law. The prior definition had provided that a foreign proceeding means a "proceeding, whether judicial or administrative." Courts had interpreted this to mean that an insolvency or debt restructuring that was not supervised by a court did not qualify as a proceeding and was therefore not entitled to recognition under Section 304. See *In re Tam*, 170 B.R. 838, 842 (Bankr. S.D.N.Y. 1994). The *Tam* court held that a Cayman Islands liquidation that lacked judicial supervision was not a "foreign proceeding" within the meaning of Section 304 and therefore an English receivership would similarly fail to qualify to the extent that a receiver was appointed.

Second, Section 802(b) of the Act amends section 101(23) of the Bankruptcy Code to require that the foreign proceeding takes place "under a law relating to insolvency or the adjustment of debts." The reference to a relevant insolvency law did not appear in the prior definition, which instead required that the proceeding was for the purpose of "liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization." It would

appear that, by requiring only a relationship to insolvency laws, the new definition is broader than the earlier definition with its enumerated purposes.

Third, Section 802(b) of the Act amends Section 101(23) of the Code by removing the requirement that the foreign proceeding be commenced in a foreign country where "the debtor's domicile, residence, principal place of business, or principal assets are located." The amended definition merely requires that the proceeding be commenced in a foreign country. Even if a court were to find that the particular jurisdiction was neither the debtor's domicile nor the location of its principal assets, it would not preclude recognition of a foreign proceeding. Although, it would affect the determination as to whether the foreign proceeding should be considered a foreign main proceeding or a foreign non-main proceeding, as well as other rights and remedies, as discussed in greater detail below.

Finally, Section 802(b) of the Act amends Section 101(24) of the Bankruptcy Code to elaborate on the definition of a foreign representative, without significantly changing the substance of the definition. Therefore, it is now made clear that a foreign representative is an individual "authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or to act as a representative of such foreign proceeding." The leading commentator has noted that the prior statute defining a foreign representative should be given a broad interpretation. *Collier on Bankruptcy*, ¶ 101.24, citing *In re Kingscroft Ins. Co. Ltd.*, 138 B.R. 121, 125-26 (Bankr. S.D. Fla. 1992) (noting that the definition of foreign representative was broad and holding that directors of United Kingdom company could be recognized as foreign representatives because they occupied position analogous to that of debtors in possession). The proposed definition is somewhat more precise than its predecessor, which defined a foreign

representative as a “duly selected trustee, administrator, or other representative of an estate in a foreign proceeding.” However, it does not appear that this change will significantly alter the courts’ interpretation of who may function as a foreign representative.

Finally, the Act simplifies the evidentiary requirements for recognition of foreign proceedings. New Section 1516 provides that a certified copy of the decision commencing the foreign proceeding indicating on its face that such proceeding is a foreign proceeding and that the representative is a foreign representative allows the court to presume that such assertions are true.

Effects of Filing - Temporary Remedies Available

A representative of a foreign proceeding will be able to obtain remedies more immediately under Chapter 15 than under Section 304. Under Section 304(b), the remedies described below may be granted if “a party in interest does not timely controvert the petition.” However, under new Section 1519(a), temporary remedies are available upon application by the foreign representative until the petition for recognition of the foreign proceeding has been decided by the court, so long as such remedies are “urgently needed to protect the assets of the debtor or the interests of the creditors...” Under Section 1519(a)(1), these provisional remedies can include: (1) staying of execution against the debtors assets; (2) entrusting the debtor’s United States assets to the foreign representative; (3) suspension of the right to transfer assets of the debtor; (4) provision for examination of witnesses and collection of information concerning assets and liabilities; and (5) the granting of additional relief excluding relief related to avoidance actions. All of these remedies were available under former Section 304, either directly in the statute or as a result of case law. See *In re Culmer*, 25 B.R. 621, 624 (Bankr. S.D.N.Y. 1982) (holding that under Section 304

courts could create relief in “near black check” fashion); *Angelo v. Kedzep*, 29 B.R. 417 (S.D. Tex. 1983) (requiring submission to discovery by the foreign representative). However, Section 1519 makes these remedies available upon request before the petition is approved, apparently whether or not the underlying application for recognition is controverted. Thus, Chapter 15 provides for provisional remedies that the representative of a foreign proceeding can request based simply upon the filing of a petition for recognition.

Furthermore, a representative of a foreign proceeding need not meet the multi-factor test required by former Section 304 in order to obtain the remedies outlined in Chapter 15. In determining whether to grant relief, Section 304(c) had required a court to look to a list of factors including: (1) just treatment of the claim holders; (2) protection against prejudice and inconvenience to claim holders in the United States in processing claims in the foreign proceeding; (3) prevention of preferential or fraudulent transfers; (4) distribution of proceeds in appropriate order under the Bankruptcy Code; (5) comity; and (6) the provision of opportunity for a fresh start for the subject of the foreign proceeding. In granting remedies (whether provisional remedies under Section 1519 or the broader remedies available upon recognition under sections 1520 and 1521, discussed *infra*), the court need not look to the factors described in Section 304(c) and listed above. Nonetheless, Section 1506 does permit the court to deny relief if it would be “manifestly contrary to the public policy of the United States.” The ability of the court to grant or terminate relief is also modified by Section 1522(a), which requires that the court ensure that “the interests of the creditors and other interested entities, including the debtor, are sufficiently protected.” Section 304’s factor test is found in Section 1507, but that provision is limited to determinations as to whether to grant “additional assistance.” Thus, although the court must look to the interests of all the parties, Chapter 15 seems to grant courts

less discretion in determining whether to recognize a foreign proceeding, but greater discretion in fashioning appropriate measures upon such recognition than under Section 304.

Effects of Recognition - Remedies Available in any Proceeding

If a foreign proceeding is recognized by the US bankruptcy court, any temporary remedy granted pursuant to proposed Section 1519 is automatically extended under new Section 1521. In addition, the court may stay the commencement or continuation of any action concerning the debtor's assets, rights, obligations or liabilities. As with temporary relief available under Section 1519, the court is empowered to grant "additional relief," which can be presumed to be as extensive as that allowed in the case law relating to Section 304 (see *supra*). These powers are not without limits, however. Section 1521 provides for specific limitations on available relief. For example, under Section 1521(d), the regulatory or police actions of a governmental unit may not be stayed and Section 1521(f) provides that the set-off of specified financial transactions cannot be stayed. The remedies available to the foreign representative would also exclude the avoidance of transfers at the time of commencement in general and the avoidance of preferential and fraudulent transfers in particular. In order to obtain a remedy on such grounds, the foreign representative would be required to commence a full title 11 case, which he would be empowered to do pursuant to proposed Section 1511, as more fully discussed below.

The nature of the further remedies available to the representative of a foreign proceeding will vary depending on whether the court finds the foreign proceeding to be a main or non-main foreign proceeding. Although remedies under Section 1521 are generally available in the case of any recognized

foreign proceeding, in granting permanent relief, Chapter 15 draws a distinction between "main" and "non-main" proceedings.

Section 1502(4) defines a foreign main proceeding as a proceeding in country where "the debtor has the center of its main interests," and Section 1516 states that, "in the absence of evidence to the contrary," the location of the debtor's registered office is the center of its main interests. It is not clear how this presumption will be applied in the context of an organization with multiple registered offices, but courts may be persuaded to rely on interpretations of the same phrase found in the European Union's Regulation on Cross-Border Insolvencies (the "EU Reg."). In the end, the determination may come down to a factual inquiry which leaves some potential for conflicting results. For example, in the 2003 *Daisytek* case, a United Kingdom judge ruled that the debtor's center of main interests was in the United Kingdom despite the fact that the company's German subsidiaries had their registered offices in Germany.

A foreign non-main proceeding is defined in Section 1502(5) as a proceeding "pending in a country where the debtor has an establishment." Section 1502(2) goes on to define an establishment as "any place of operations where the debtor carries out a non-transitory economic activity," similar to the definition of the term "establishment" used in the EU Reg.

To the extent that the US bankruptcy court determines that a foreign proceeding is non-main, the relief granted under Section 1521 would be subject to the requirement that the court is satisfied "that the relief relates to assets that, under the law of the United States, should be administered in the foreign non-main proceeding or concerns information required in that proceeding." Furthermore, the determination that the foreign proceeding is main or non-main is also relevant to the extent that the foreign representative seeks to commence a full Title 11 case in order to avoid preferential or fraudulent transfers. The

foreign representative of a foreign proceeding would have standing to commence a full Title 11 case pursuant to Section 1511, but is entitled to commence a voluntary case only if the foreign proceeding is main. If the foreign proceeding is non-main, the representative would only be able to commence an involuntary case.

Effects of Recognition - Automatic Remedies in Main Proceedings

The representative of a foreign proceeding will be afforded more remedies under new Chapter 15 than current law provides. Whereas the remedies available under Section 304 were available only when sought by the foreign representative, under new Section 1520, recognition of a foreign main proceeding triggers certain automatic remedies. In particular, recognition of a foreign proceeding will trigger the automatic stay of Section 362. This would mean that no judicial proceeding against the foreign debtor can be commenced or continued in the United States to the extent that the cause of action arose before the commencement of the ancillary case under Chapter 15. Section 362 would also prevent enforcement of judgments, liens and set-offs obtained before the commencement of the case, as well as other acts to obtain control of the property of the debtor's estate. It should be noted that Section 1520(4)(b) explicitly permits the commencement of "an individual action or proceeding in a foreign country to the extent necessary to preserve a claim against the debtor." Thus, creditors of a foreign debtor would retain a limited right to proceed against the company in the jurisdiction where the foreign proceeding is pending and elsewhere. The date of effectiveness of the automatic

stay is likely to be the date of recognition of the foreign proceeding (excluding any period of interim relief). Therefore, actions that were or could have been commenced prior to the filing of the petition for recognition of the foreign proceeding will be stayed, and the date of commencement of the foreign proceeding itself will not be pertinent to the application of the automatic stay.

Section 1520 also provides certain other automatic remedies and protections. First, the foreign representative in a foreign proceeding would have the ability to use, sell or lease the cash collateral (including cash equivalents) of the foreign debtor upon notice and hearing or upon consent of the secured party pursuant to Section 363 of the Code. Second, pursuant to Section 549, a foreign representative would also be able to avoid transfers of property of the estate occurring "post-recognition." Third, pursuant to Section 552, any property acquired by the foreign debtor (that is within the territorial jurisdiction of the United States) would be free from any security interests that existed before the commencement of the ancillary case. Finally, pursuant to Section 361, the remedies available to the foreign representative in sections 362 and 363 would be subject to the requirement that the foreign debtor's creditors receive adequate protection of their interest in its assets.

Endnotes

¹ Pub. L. No. 109-8 (2005)

² Section 109 of the Bankruptcy Code contains eligibility requirements concerning who may be a debtor in a bankruptcy proceeding. However, these requirements have been held to be inapplicable to recognition of foreign proceedings under Section 304 of the Code. In re Brierley, 145 B.R. 151, 159 (Bankr. S.D.N.Y. 1992). There is no basis to believe that any additional eligibility requirements have been imposed in Chapter 15.

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