Global Distress Signal

Developments in International and Cross-Border Insolvency

Davis Polk

INTRODUCTION

by Donald S. Bernstein

Welcome to the latest issue of *Global Distress Signal* – Davis Polk's newsletter about developments in global insolvency law and practice.

During 2014, a number of important U.S. decisions affected cross-border insolvency practice. Some of these decisions confirm the willingness of U.S. courts to recognize foreign insolvency proceedings by broadly construing the requirements to commence proceedings under Chapter 15 in support of foreign main proceedings. The decisions in *Barnet* and *Suntech*, discussed below, provide useful guidance to foreign representatives regarding the requirements for Chapter 15 eligibility. Similarly, the decision in *Irish Bank Resolution Corp.* highlights the flexibility of U.S. courts in determining whether a bespoke foreign liquidation is a "proceeding" eligible for Chapter 15 relief.

This trend is a sensible response to the unfortunately limited view expressed in the Second Circuit's *Octaviar* decision, which reversed the initial *Barnet* eligibility ruling. The *Octaviar* decision, discussed in the last edition of this newsletter, held that a Chapter 15 debtor must meet the eligibility requirements that apply to Chapter 11 debtors, i.e., a domicile, place of business or property within the United States. *Octaviar* limited the relief available to foreign representatives where none of these eligibility requirements is met, even if the debtor has creditors and other stakeholders in the United States. The expansive reading of the "property within the United States" for purposes of determining eligibility for Chapter 15 relief expressed in the recent *Barnet* and *Suntech* decisions mitigates the impact of the *Octaviar* decision and reduces barriers to the use of Chapter 15, so the goal of efficient cross-border restructuring can be achieved.

The potential importance of Chapter 15 for foreign debtors was highlighted by several other decisions. In particular, the *Rede Energia* decision demonstrated the benefits of recognition of foreign debtors' restructuring plans by Chapter 15 courts. As noted by the court in *Rede Energia*, for example, in the absence of Chapter 15 recognition, the U.S. indenture trustee might have refused to implement the foreign restructuring plan. A Chapter 15 filing should be considered by the foreign debtor's authorized foreign representative whenever U.S. assets are implicated or U.S. stakeholders need to be bound.

Illustrative of the expansive approach to determining the existence of property within the territorial jurisdiction of the United States being taken by U.S. courts, in *Fairfield*, the Second Circuit determined that an intangible asset (a claim against the Madoff Securities estate) owned by a foreign debtor was situated in the United States and, therefore, that its sale was subject to the requirements of section 363 of the Bankruptcy Code. On the other hand, another decision in the *Madoff Securities* case illustrates that there are limits to the extraterritorial reach of U.S. insolvency jurisdiction. In

Winter 2015

2 *Fairfield Sentry* and "Within the Territorial Jurisdiction of the U.S."

3 The Resolution of Global Financial Institutions and Chapter 15

4 Extraterritorial Recovery of Avoidable Transfers and Comity

6 *Barnet*: Satisfying the Technical Jurisdictional Requirements for Chapter 15

7 *Rede Energia* and Recognition of Foreign Plans Under Chapter 15

9 Special Report by De Brauw, Blackstone Westbroek: The Netherlands Proposes Modern Restructuring Legislation

12 On Our Radar: Chapter 15 Cases to Monitor

EDITORS

Timothy Graulich
timothy.graulich@davispolk.com
212 450 4639

Darren S. Klein
darren.klein@davispolk.com
212 450 4725

the latter decision, distributions from a non-U.S. Madoff Securities "feeder fund" to its customers were shielded from the avoidance powers of the Madoff Securities SIPA trustee.

The articles in this issue discuss these 2014 rulings and their potential impact on cross-border insolvency practice in the United States. In addition, we are very pleased to include a special contribution from our friends at De Brauw Blackstone Westbroek N.V. discussing the proposed restructuring legislation in the Netherlands. The Netherlands' legislation is expected to be implemented at the beginning of 2016 and will entirely overhaul the insolvency regime in that country by providing a reorganization framework based on Chapter 11 in the U.S. and U.K. schemes of arrangement. Anyone doing business, investing or lending in the Netherlands needs to understand how the proposed law would affect the balance between debtors and creditors in that country.

Fairfield Sentry and "Within the Territorial Jurisdiction of the U.S."

On September 26, 2014, the Second Circuit decided in *Fairfield Sentry*[1] that a Chapter 15 court must review the sale of an intangible asset owned by a foreign debtor even after the sale had been approved by the foreign bankruptcy court. The decision represents a significant expansion of the meaning of "within the territorial jurisdiction of the United States" under section 1502(8) of the Bankruptcy Code.[2]

Fairfield Sentry, a British Virgin Islands ("BVI") investment fund, was a feeder fund for Bernard L. Madoff Investment Securities LLC ("BLMIS"). When BLMIS was liquidated pursuant to the Securities Investor Protection Act ("SIPA"), Fairfield Sentry held a $230 million claim in the liquidation (the "SIPA Claim"). Soon afterwards, Fairfield Sentry itself faced liquidation in the BVI and consequently obtained Chapter 15 recognition of the BVI liquidation as a foreign main proceeding. In an auction to sell Fairfield Sentry's SIPA Claim, Farnum Place, LLC ("Farnum") was the winning bidder. The transaction between the parties was made subject to an agreement that the transaction be governed by New York law and approved by both the BVI court and the U.S. bankruptcy court. Three days after Fairfield Sentry and Farnum signed their agreement, the parties learned, based on developments in the BLMIS liquidation, that the SIPA Claim was worth approximately $40 million more than Farnum had bid at auction.

The BVI court approved the transaction but explicitly refrained from directing the U.S. bankruptcy court's decision regarding approval.[3] When it came time for the U.S. bankruptcy court to review the transaction, it declined to do so for two reasons: first, that section 363 review was not warranted under section 1520(a)(2) because the transaction did not fall within the meaning of "within the territorial jurisdiction of the United States" as it is defined in section 1502(8), and second, because comity principles instruct the U.S. bankruptcy court to defer to the BVI court's decision.[4] The district court affirmed on appeal.[5]

The Second Circuit determined that the bankruptcy court's analysis of section 1502 was "incomplete" because it applied substantive New York non-bankruptcy law to determine that the situs of the SIPA Claim was the BVI. Instead, under the Second Circuit's reading of section 1502(8), the court should apply substantive New York non-bankruptcy law to determine not only whether intangible property is located within the United States, but also whether certain intangible property is subject to garnishment or attachment and, if it is, where it is situated for attachment purposes. This more extensive application of substantive New York non-bankruptcy law placed the SIPA Claim in the United States and thereby subject to section 1520(a)(2) and section 363 review. In addition, the Second Circuit found that the U.S. bankruptcy court could not deny the need for section 363 review by relying on comity principles when the Bankruptcy Code required such review and when the foreign court explicitly deferred to the U.S. bankruptcy court on the issue. The Second Circuit vacated and remanded, instructing the bankruptcy court to perform section 363 review.

The *Fairfield Sentry* decision underscores the importance of potentially seeking approval from multiple courts when performing a sale of assets. Because of how extensively a Chapter 15 court may apply substantive non-bankruptcy law to determine the location of a debtor's intangible asset, almost any asset could be deemed subject to U.S. territorial jurisdiction. If there is any doubt as to whether an asset is "within the territorial jurisdiction" of the United States, counsel representing a foreign debtor should consider seeking U.S. bankruptcy court approval or otherwise proceed cautiously in the transfer of the asset.

At the same time, *Fairfield Sentry*'s impact remains to be seen because the case may be distinguished by its facts. Fairfield Sentry and Farnum stipulated to a condition precedent – that their transaction would be final only when both the BVI court and the U.S. bankruptcy court approved it. Other courts may reason that *Fairfield Sentry* sets a limited precedent because, unless parties have expressly required dual court approval, such approval may be unnecessary.

1 *Krys v. Farnum Place, LLC (In re Fairfield Sentry Ltd.)*, No. 13-3000, 2014 WL 4783370 (2d Cir. Sept. 26, 2014).

2 On November 21, 2014, the Second Circuit denied Farnum's petition for rehearing, and on January 13, 2015, the Second Circuit denied Farnum's petition for en banc review.

3 *See id.* at *2 (quoting BVI court: ("[I]t would be unwise for [us, the BVI court] to express views on the issues that will arise for determination by the U.S. Bankruptcy Court. . . . [Bringing the question of approval before the U.S. Bankruptcy Court] must be done in such a way that the U.S. Bankruptcy Court is presented with a choice whether or not to approve it.") (internal quotation marks omitted)).

4 *See In re Fairfield Sentry Ltd.*, 484 B.R. 615, 618, 622, 628 (Bankr. S.D.N.Y. 2013) (Lifland, J.).

5 *See In re Fairfield Sentry Ltd.*, No. 13 Civ. 1524 (AKH) (S.D.N.Y. July 3, 2013) (Hellerstein, J).

The Resolution of Global Financial Institutions and Chapter 15

As we mentioned in a sidebar update in our inaugural issue of this newsletter, a recent bankruptcy court decision from Judge Sontchi of the District of Delaware in the Chapter 15 case of Irish Bank Resolution Corp. (IBRC) could have implications for the cross-border resolution of financial institutions. The decision affirms the view that the managed cross-border liquidation of a government-nationalized financial institution can qualify as a foreign proceeding under Chapter 15.

Background

As global financial markets seized up and Irish property prices tumbled in the 2008 crisis, two major Irish financial institutions, Anglo Irish Bank Corp. (Anglo Irish) and Irish Nationwide Building Society (INBS), suffered deteriorating balance sheets. To avoid a systemic panic and a run on Irish banks, the Irish government undertook a variety of stabilizing measures for Anglo Irish and INBS to guarantee, recapitalize, and backstop their financial positions. When these attempts to steady the Irish financial market failed, the Irish government nationalized Anglo Irish and INBS in 2009 and 2010, respectively.

After the panic of the crisis subsided, the Irish government merged the banks into a state-owned banking entity, IBRC, and determined to liquidate IBRC's assets under the newly enacted Irish Bank Resolution Corporation Act 2013 (IBRC Act). The IBRC Act authorized the Irish Minister for Finance to appoint Special Liquidators to wind up IBRC with little judicial oversight or creditor involvement. To protect the liquidation of certain U.S. loan portfolios, the Special Liquidators filed a Chapter 15 petition with the Delaware bankruptcy court for recognition of the Irish liquidation proceeding. Both creditors and borrowers involved in U.S. litigation with IBRC objected on various grounds to the Chapter 15 recognition of the Irish liquidation proceeding.

The Bankruptcy Court's Ruling

While calling the question a "close one," Judge Sontchi overruled the objections and recognized the Irish liquidation as a foreign main proceeding under Chapter 15. According to Judge Sontchi's written opinion, the objectors' principal arguments were those challenging whether the Irish proceeding could be recognized as a "foreign proceeding" as defined in 11 U.S.C. § 101(23).[1] The objecting creditors and borrowers argued, among other things, that the Irish proceeding was not (1) a "proceeding", (2) collective in nature; or (3) supervised by a foreign court.

In his decision, Judge Sontchi pointed to the *Betcorp* definition of "proceeding" as "acts and formalities" with rules for the resolution of a company that are set so that "creditors can know them in advance[.]"[2] Objectors had argued that they could not know the procedures in advance because the IBRC Act was newly created and granted the Minister for Finance broad powers.[3] Judge Sontchi held, however, that the law empowering the Minister for Finance provided a liquidation framework, and that the Minister's actions were subject to challenge under Irish law, thereby satisfying the requirements of a "proceeding" under Chapter 15.

The Court also rejected the argument that the Irish liquidation was not a collective proceeding. *Betcorp* instructed that a collective proceeding adjudicates the rights of the full range of creditors, in contrast to a "receivership remedy" for secured creditors.[4] The objectors argued that the proceeding, while on its face an orderly wind-down of IBRC for the benefit of all creditors, had the sole, impermissible purpose of resolving only the government's claims. The Court, however, reasoned that the IBRC Act provides for the resolution of claims of all classes of creditors by explicitly adopting the Irish priority scheme set forth in the Companies Act.

> A foreign court does not need to supervise a proceeding as actively as a U.S. court would in a U.S. bankruptcy case.

Finally, Judge Sontchi rejected the argument that the Irish proceeding had no foreign court supervision. The objectors pointed out that the IBRC Act provides for materially less court supervision compared to what creditors "would normally be afforded" under Irish law.[5] Judge Sontchi relied on the *ABC Learning Centers* decision in explaining that a foreign court does not need to supervise a proceeding as actively as a U.S. court would in a U.S. bankruptcy case; rather, the creditors' ability to appeal to a court to "determine any question arising in the winding-up of IBRC" constituted sufficient court supervision.[6]

1 *See* Findings of Fact and Conclusions of Law, *In re Irish Bank Resolution Corp. Ltd.*, Case No. 13-12159 (Bankr. D. Del. Apr. 30, 2014), ECF No. 307 at 1–2 [hereinafter "Findings of Fact"]. There were two other main objector arguments that were dealt with expeditiously by Judge Sontchi. First, the objectors argued that IBRC was either a Foreign Bank or an instrumentality of the government, both of which are excluded from the definitions of "person" or "debtor" eligible for Chapter 15 status. To be excluded, a Foreign Bank must have a branch in the United States. Because IBRC had no U.S. branch or operations during the relevant time periods, it was not a Foreign Bank. Moreover, IBRC's situation was on all fours with *Nortel*, which stated that the instrumentality must be "carrying out some governmental function" to be excluded and that a government entity for guaranteeing pensions could still meet these definitions. *In re Nortel Networks, Inc*., 669 F.3d 128, 138 (3d Cir. 2011). Second, the objectors argued that recognizing the Irish proceeding would conflict with U.S. public policy by discriminating against U.S. creditors and denying due process rights. Judge Sontchi countered that the Irish process was not "repugnant" to fundamental U.S. principles, but rather "established a different way to achieve similar goals." (citing *In re ABC Learning Centres Ltd,* 728 F.3d 301, 310 (3d Cir. 2013), *cert. denied* (Feb. 24, 2014)).

2 *In re Betcorp Ltd.*, 400 B.R. 266, 278 (Bankr. D. Nev. 2009).

3 Preliminary Objection to Verified Petition Under Chapter 15 for Recognition of a Foreign Main Proceeding, *In re Irish Bank Resolution Corp. Ltd.*, Case No. 13-12159 (Bankr. D. Del. Sept. 16, 2013), ECF No. 41 at 11.

4 *Betcorp Ltd.*, 400 B.R. at 281.

5 *Supra* note 4 at 10.

6 Findings of Fact at 34.

Takeaways

The resolution of complex global financial institutions requires flexible cross-border insolvency regimes that are recognized outside the home jurisdiction. Judge Sontchi's decision recognizes that foreign governments may utilize broad discretion to resolve financial institutions, including outside that country's traditional insolvency regime. This decision follows a line of cases establishing a high standard for challenging Chapter 15 recognition under the "foreign proceeding" definition.[7] Moreover, in recognizing the custom-built Irish proceeding, including its sweeping authority for the Minister for Finance and the Special Liquidators, Judge Sontchi's ruling stands for the proposition that Chapter 15 does not require procedural safeguards strictly equivalent to those applicable in plenary cases under the Bankruptcy Code, at least in the case of the resolution of financial firms, which typically allow more discretion to regulators even under U.S. law.

7 *See* David E. Kronenberg, *A Bark Louder Than Its Bite: Recognition Challenges Based on Chapter 15's "Foreign Proceeding" Definition*, 23 Norton J. of Bankr. L. & Prac. 314, 324 (arguing that to successfully challenge recognition under the "foreign proceeding" definition, a challenger must show that the proceedings are for the benefit of a single class of creditor or that some creditors have been barred from participation).

Extraterritorial Recovery of Avoidable Transfers and Comity

Consistent with the long-standing approach dating back to the seminal *Maxwell* case,[1] U.S. courts continue to show restraint in extending the extraterritorial reach of U.S. insolvency law. The courts use comity as their guiding principle, and hesitate to reach over international borders on matters where local insolvency laws should govern. The recent *Madoff Securities* decision from the U.S. District Court for the Southern District of New York (SDNY) highlights this continuing deference to foreign law, shielding "foreign-to-foreign" transfers from the reach of a U.S. SIPA trustee despite the ostensibly extraterritorial reach of U.S. law.

Some of Bernie Madoff's largest customers were offshore "feeder funds" that pooled capital from various investors around the world principally in order to "feed" investments into Madoff Securities. In many cases the vast majority, or all, of the capital in the feeder funds was channeled directly to, and as investments in, Madoff Securities. When feeder funds received distributions from Madoff Securities, they would often in turn distribute assets to their foreign customers. In the consolidated case captioned *Securities Investor Corp. v. Bernard L. Madoff Investment Securities LLC*,[2] Judge Jed S. Rakoff of the SDNY dismissed recovery claims asserted by the Madoff Securities trustee against foreign subsequent transferees that had received distributions from foreign Madoff feeder funds on the basis that section 550(a)(2) of the Bankruptcy Code does not apply extraterritorially under the circumstances and, alternatively, international comity considerations prohibit recovery from these foreign entities.

Using section 550(a)(2) of the Bankruptcy Code, which allows a trustee to recover property that is the subject of an avoided transfer from "any immediate or mediate transferee" of an initial transferee, the Madoff Securities trustee appointed under the Securities Investor Protection Act brought avoidance and recovery actions against the foreign customers of certain offshore Madoff feeder funds that had received subsequent distributions.

Extraterritoriality Still Matters

The district court began its decision by reciting the long-standing presumption that Congressional legislation is meant to apply only within the United States in the absence of contrary intent.[3] Under the recent Supreme Court decision *Morrison v. Nat'l Australia Bank Ltd.*,[4] the court must first determine whether the factual circumstances of the case require extraterritorial (as opposed to domestic) application of the relevant statute. In answering "yes" to this inquiry, the court evaluated the "focus" of the transactions that section 550(a) seeks to regulate. The statute focuses on the nature of the transactions at issue (transfers between foreign parties abroad), rather than the U.S. debtor more generally, leading the court to conclude that the Trustee's attempted recovery of the "predominantly foreign" transactions would require an extraterritorial application of section 550(a).

> Congressional legislation is meant to apply only within the United States in the absence of contrary intent.

The second step of the *Morrison* analysis is whether Congress intended the statute to apply extraterritorially. The Trustee and Securities Investor Protection Corporation

1 *In re Maxwell Communications Corp.*, 186 B.R. 807 (S.D.N.Y. 1995), *aff'd* 93 F.3d 1036 (2d Cir. 1996).

2 *Securities Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 12-mc-115 (JSR), 2014 WL 2998557 (S.D.N.Y. July 6, 2014).

3 *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991).

4 130 S. Ct. 2869 (2010).

("SIPC") had argued that, although extraterritorial intent is not present in the plain language of section 550(a), the court should look to section 541(a) for statutory context, which provides that "property of the estate" is estate property "wherever located and by whomever held." Rejecting this argument as "clever [but] neither logical nor persuasive," the court ultimately held that the Trustee had not adequately rebutted the presumption against extraterritoriality and was therefore prohibited from utilizing section 550(a) to recover transfers to the foreign investors of the offshore feeder funds.

Comity Still Matters

In an alternative ruling, the court determined that even if the Trustee's attempted recovery from the foreign subsequent transferees did not require an extraterritorial application of section 550(a), such action would be precluded by principles of comity. The court recognized that many of the other Madoff feeder funds are subject to liquidation proceedings in their home countries where their own clawback statutes govern. As the defendants noted in their briefing, the British Virgin Islands trial court and appellate court had already addressed, and rejected, one feeder fund liquidator's attempt to recover these same transfers pursuant to local common law.

The defendants criticized the Trustee's approach as seeking a type of unfair double recovery, arguing that the Trustee should not be permitted to first recover initial transfers to the feeder funds and then recover subsequent transfers to the feeder fund's customers, but rather should be required to stand in line alongside the feeder fund customers and share as a creditor of the feeder fund's estate. On the other hand, SIPC focused on U.S. interests in stating that comity is not implicated where the Trustee attempts to recover property stolen from investors in a U.S. broker-dealer as part of a Ponzi scheme with its "center of gravity" in the United States.[5] Judge Rakoff agreed with the defendants, describing the proceedings before him as an attempt by the Trustee to "reach around" the foreign proceedings and pull in foreign investors with no direct relationship to the U.S. estate and no reason to expect that U.S. law would apply to distributions received from foreign investment funds.

Further Application

The *Madoff* ruling should give a measure of comfort to foreign customers of foreign investment funds regarding constraints on the ability of a U.S. debtor to utilize U.S. bankruptcy law to claw back their distributions. In fact, more than 100 foreign defendants in clawback adversary proceedings brought by the Madoff Securities trustee just days ago supplemented their motions to dismiss based on this ruling. It will be interesting to see whether the *Madoff* ruling is broadly applied, or if the courts limit the ruling in any way.[6] The defendants will assert that their arguments are even stronger to the extent the foreign funds were not "feeders" into Madoff Securities, but instead invested only a small portion of their assets with Madoff Securities. Under such facts, it will be argued that foreign investors have a more tenuous connection to U.S. bankruptcy law and the U.S. courts. They would likely assert that, in such a case, in terms of due process, it is even less appropriate to bring the foreign subsequent transferees into the U.S. Madoff Securities bankruptcy.

Despite this, it is important to note that principles of comity require a comparison of jurisdictional interests that does not always result in deference. In a recent chapter 15 case, *In re Elpida Memory Inc.*,[7] the bankruptcy court conducted a *de novo* review of a sale transaction that had been previously approved by the Japanese bankruptcy court in the main proceeding, stating that comity "is not the end all be all of the [chapter 15] statute." In *Madoff*, the court found persuasive the fact that many of the feeder funds were undergoing liquidation proceedings in their respective home countries. The Trustee could seek recovery from subsequent transferees pursuant to the laws of the feeder funds' home countries. Without those facts, or if the feeder funds' home jurisdictions had been these with undeveloped insolvency laws such that the U.S. retained a stronger interest in seeing the subsequent transfers recovered from the feeder funds' customers, the result might have been different.

5 *See* SIPA § 78fff-2(c)(3).

6 Consolidated Supplemental Memorandum of law in Support of the Transferee Defendants' Motion to Dismiss Based on Extraterritoriality. *Securities Investor Protection Corp. v. Bernard L. Madoff Investment* Securities LLC (Case No. 08-01789) (Jan. 3, 2015).

7 Case No. 12-10947 (CSS), 2012 Bankr. LEXIS 5367 (Bankr. D. Del. Nov. 16, 2012).

Barnet: Satisfying the Technical Jurisdictional Requirements for Chapter 15

In the Spring 2014 edition of *Global Distress Signal*, we discussed the Second Circuit's decision in *In re Barnet*. As a brief refresher, the *Barnet* case involved the Octaviar Group,[1] an Australian-incorporated conglomerate, which filed a Chapter 15 petition seeking recognition of its Australian insolvency proceeding in order to investigate "potential claims or causes of actions" against "entities located in the United States." Drawbridge Special Opportunities Fund LP, one of the entities against which Octaviar was investigating claims, objected to the petition on the grounds that Octaviar had neither assets nor a place of business in the United States and was therefore ineligible to be a Chapter 15 debtor.[2] The Bankruptcy Court overruled the objection;[3] however, the Second Circuit reversed and held that a foreign debtor must have property or a place of business in the United States in order for such debtor's foreign insolvency proceeding to be recognized under Chapter 15.[4]

We also pointed out a largely overlooked aspect of the decision in which the Second Circuit noted that the foreign debtor (Octaviar Group) had commenced discovery under 28 U.S.C. § 1782(a), which provides for discovery in aid of a foreign proceeding and contains no jurisdictional requirement. Interestingly, following the Second Circuit's decision, the foreign representatives of Octaviar continued discovery against Drawbridge under Section 1782(a). Following this discovery, Octaviar identified and filed causes of action against Drawbridge in both federal and state court in New York. In addition, Octaviar provided its U.S. counsel with a $10,000 retainer. Thereafter, and more than 18 months after Octaviar's first Chapter 15 petition was filed, the foreign representatives refiled Octaviar's Chapter 15 case (creating perhaps the first "Chapter 30" in U.S. history).

Drawbridge objected to the foreign representatives' request for recognition of the newly filed petition, but the bankruptcy court concluded that the particular claims and causes of action against Drawbridge (now reduced to complaints) were property in the United States within the meaning of section 109(a) of the Bankruptcy Code.[5]

> Chapter 15 eligibility simply requires property in the United States without an inquiry into the circumstances surrounding the debtor's acquisition of the property.

This holding is consistent with the Second Circuit's decision in *In re Fairfield Sentry Ltd*.[6] In *Fairfield Sentry*, the debtor, a Madoff feeder fund that was situated in the British Virgin Islands, held a claim against the estate of Bernard L. Madoff. The bankruptcy court found that, under New York law, the claim held by the debtor was a general intangible asset of the debtor and was located in the situs of the debtor, the BVI.[7] The Second Circuit reversed, holding that a more thorough application of New York law actually located the claim within the United States. The *Barnet* court found that the flexible test employed by the court in *Fairfield Sentry*, which depended on "a common sense appraisal of the requirements of justice and convenience," allowed for a different conclusion with respect to the foreign representatives' claims.[8] In *Barnet*, the claims were asserted under U.S. law, involved defendants located in the United States and included allegations that funds were wrongfully transferred in the United States. In addition, the actions in the United States involved different parties than did related actions in Australia, and the U.S. courts had both personal and subject matter jurisdiction.[9] The *Barnet* decision is aligned with the Second Circuit's view as to the analysis required in the determination of the "location" of a claim.

The *Barnet* court further found that Octaviar had property in the United States within the meaning of section 109 of the Bankruptcy Code in the form of an undrawn retainer, deposited with the foreign representatives' counsel prior to the filing of the second Chapter 15 petition.[10] Drawbridge argued that the retainer was insubstantial and depositing the retainer constituted a "bad faith attempt to manufacture eligibility" to file for Chapter 15.[11] The court found that Octaviar had acted in good faith and that, "[i]n any event, as the Second Circuit emphasized in *Barnet*, the Court must abide by the plain meaning of the words in the statute. Section 109(a) says, simply, that the debtor must have property; it says nothing about the amount of such property . . .."[12] Furthermore, the imposition of a requirement that the property be "substantial" would "subvert the intent of Congress and the plain meaning of the statute."[13]

When the *Barnet* court applied section 109(a) to the question of Octaviar's eligibility to file for chapter 15 relief, it

1 The case is styled *In re Barnet* because "Barnet" was the name of the foreign representative of Octaviar.

2 11 U.S.C. § 109(a).

3 *In re Barnet*, Case No. 12-13443 (Bankr. S.D.N.Y. Sept. 6, 2012) (Chapman, J.).

4 *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013).

5 *In re Octaviar Admin. Pty. Ltd.*, 511 B.R. 361, 371 (Bankr. S.D.N.Y. 2014).

6 *Krys v. Farnum Place, LLC (In re Fairfield Sentry Ltd.)*, No. 13-300 (2d Cir. Sept. 26, 2014).

7 *Id*. at 623.

8 *In re Octaviar*, 511 B.R. at 371.

9 *Id*. at 372.

10 *Id*.

11 *Id*.

12 *Id*. at 373.

13 *Id*.

surprised many bankruptcy commentators and practitioners who had not previously interpreted that section of the Bankruptcy Code to apply to chapter 15 debtors. Since the Second Circuit entered the decision, *Barnet* has already impacted bankruptcy jurisprudence on chapter 15 eligibility. Recently, in *In re Suntech Power Holdings Co., Ltd.*, another bankruptcy judge in the Southern District of New York followed *Barnet*, applying section 109(a) to determine chapter 15 eligibility of a Cayman Islands company.[14] The *Suntech* court found that the company was eligible to be a chapter 15 debtor by virtue of a bank account opened in the United States specifically for the purpose of establishing U.S. jurisdiction. Quoting the *Octaviar* decision, the *Suntech* court held that chapter 15 eligibility simply requires property in the United States without "an inquiry into the circumstances surrounding the debtor's acquisition of property."[15] Together, *Barnet* and *Suntech* suggest that debtors that are otherwise ineligible for chapter 15 would have the ability to locate a relatively small amount of assets in the United States, overcoming the technical jurisdictional requirements of chapter 15.

14 *In re Suntech Power Holdings Co., Ltd.*, No. 14-10383, at *14-15 (SMB) (Bankr. S.D.N.Y. Nov. 17, 2014).

15 *Id*. at *18 (quoting *Octaviar*, 511 B.R. at 373).

Rede Energia and Recognition of Foreign Plans Under Chapter 15

One important function of Chapter 15, although until recently underutilized by Chapter 15 debtors, is the ability of the U.S. bankruptcy courts to recognize and enforce a foreign plan of reorganization. A recent decision in the bankruptcy court for the SDNY, *In re Rede Energia*,[1] confirms the advantages that can derive from the recognition of a foreign plan of reorganization. Most significantly, the court in *Rede Energia* acknowledged that, absent U.S. recognition, Bank of New York Mellon, the New York indenture trustee ("BNYM"), might have refused to take action to implement the foreign plan. The decision shows how Chapter 15 can lend crucial force to a foreign reorganization plan or scheme whose success depends on the participation of U.S. parties and on obtaining a binding effect in the United States. By applying the three-step analytical framework first introduced by the Fifth Circuit in *Vitro*,[2] the decision also shows that the *Vitro* recognition framework may be here to stay.

> By applying the three-step analytical framework first introduced by the Fifth Circuit in *Vitro*, the decision also shows that the *Vitro* recognition framework may be here to stay.

In *Rede Energia*, Judge Chapman not only granted full implementation of the debtor's Brazilian plan of reorganization but also authorized and directed BNYM to carry out the plan's terms by assigning the debtor's notes and making related payments to noteholders, some of whom were based in the United States. Under the plan's terms, plan proponent Energisa S.A. ("Energisa") would invest over three billion Brazilian real[3] in the debtor and its nondebtor subsidiaries. A portion of the funds invested would be used to pay the debtor's creditors a percentage of the principal amount of their claims, in exchange for an assignment of those claims to Energisa. The debtor's foreign representative sought judicial relief in the United States because BNYM had indicated that it would not assign the notes to Energisa without the Chapter 15 court's direction. In turn, without the indenture trustee's cooperation, Energisa would be unlikely to fund distribution in the United States, and the plan would not be feasible.

The court employed *Vitro*'s three-step analysis, applying sections 1521 and 1507 of the Bankruptcy Code, to determine that the Brazilian plan should receive recognition in the United States First, the court considered whether the relief requested here by the foreign representative was of a type specifically enumerated in section 1521(a) and (b). Because the relief requested could not be found in section 1521(a)'s non-exhaustive list, the court considered instead whether a broader reading of section 1521(a) would allow for plan recognition. Section 1521(a) gives a court discretion to grant "any appropriate relief" that gives effect to Chapter 15 purposes and that protects a debtor's assets or creditors' interests.[4] The court determined that the relief requested satisfied this general discretionary grant and noted that no party contested the availability of plan recognition under section 1521.

1 *In re Rede Energia S.A.*, No. 14-10078, 2014 Bankr. LEXIS 3617 (Bankr. S.D.N.Y. Aug. 27, 2014).

2 *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1054 (5th Cir. 2012).

3 R$3 billion is more than $1 billion USD.

4 11 U.S.C. § 1521(a). In *Vitro*, the court defined "appropriate relief" as "relief previously available under Chapter 15's predecessor, § 304." *Vitro*, 701 F.3d at 1054.

Even though the court acknowledged that it "need not reach the issue" of whether relief would be available as "additional assistance" under section 1507[5] because section 1521 already allowed the relief requested, it nevertheless discussed section 1507. Section 1507 presents a somewhat more challenging path for a foreign representative seeking plan recognition because it explicitly requires implementation consistent with comity principles and invites a comparative law analysis between foreign and U.S. bankruptcy law. Applying the section 1507 requirements, the *Rede Energia* court evaluated the fair treatment of creditors generally, the treatment of U.S. creditors in the foreign proceeding, the absence of avoidable transfers, and finally the existence of a distribution scheme "substantially in accordance" with the U.S. Bankruptcy Code's priority scheme.[6] The court then concluded that plan recognition and enforcement was also available under section 1507.

Rede Energia takes a different approach from *Sino-Forest*,[7] a 2013 decision in which the same bankruptcy court (albeit a different judge, Judge Glenn) granted recognition of a Canadian plan but deliberately chose not to follow *Vitro*. The *Sino-Forest* court favored instead a straightforward review of the propriety of the relief as "additional assistance" under section 1507,[8] in furtherance of the approach taken by the same court (and judge) in *Metcalfe*[9] and consistent Canadian precedents. While *Rede Energia* does not comment on its divergence from *Sino-Forest*, the adoption of the *Vitro* three-step framework seems useful, particularly where a court is dealing with a jurisdiction whose legal system and legal principles are different from those which exist in the United States.[10] As a result, *Rede Energia* may be distinguishable from *Sino-Forest*.

In light of *Rede Energia*, foreign representatives would be well-advised to analyze the propriety of foreign plan recognition as both "appropriate relief" under section 1521 and "additional assistance" under section 1507. A court might not need to consider "appropriate relief" in section 1507, however, if it can first determine that recognition is appropriate under a specific or even general application of section 1521(a) and (b).

5 11 U.S.C. § 1507.

6 *See* 11 U.S.C. § 1507(b).

7 *In re Sino-Forest Corp*., 501 B.R. 655 (Bankr. S.D.N.Y. 2013).

8 *Id*. at 663 n.3.

9 *In re Metcalfe & Mansfield Alt. Invs.*, 421 B.R. 685 (Bankr. S.D.N.Y. 2010).

10 *Compare Sino-Forest*, 501 B.R. at 663 (quoting *Metcalfe*, 421 B.R. at 698) ("[T]he U.S. and Canada share the same common law traditions and fundamental principles of law. Canadian courts afford creditors a full and fair opportunity to be heard in a manner consistent with standards of U.S. due process. U.S. federal courts have repeatedly granted comity to Canadian proceedings."), *with Rede Energia*, 2014 Bankr. LEXIS 3617, at *4 ("[T]here are certainly aspects of the Brazilian proceeding that differ in form and substance from what might occur in the United States . . . .").

SPECIAL REPORT

by Reinout Vriesendorp, Ruud Hermans and Rob van den Sigtenhorst

The Netherlands Proposes Modern Restructuring Legislation

Unlike Chapter 11 of the U.S. Bankruptcy Code, the Netherlands does not have such an effective corporate reorganization regime, but that is likely to change soon. A draft bill went into public consultation this year that would introduce a restructuring procedure inspired by international restructuring practice, in particular the English scheme of arrangement and Chapter 11. The draft bill is expected to be implemented (possibly with changes) in the beginning of 2016. It will provide the Netherlands with state-of-the-art legislation to restructure companies and groups of companies. The law would offer a framework for creditors of distressed companies and will undoubtedly give rise to new opportunities for investors; on the other hand, it will be critical for parties doing business in the Netherlands to understand how the new legislation may impact their legal position.

Current Situation

Currently, the Netherlands' bankruptcy law for regular commercial debtors only contemplates formal liquidation proceedings and moratorium of payment proceedings. The latter were once intended to enable debtors to reorganize, but due to various flaws in the legislation, the proceedings are not suited for doing so in modern-day circumstances. For example, the legislation has no effective mechanism to bind dissenting stakeholders, unlike Chapter 11 and the English scheme of arrangements. Hence, restructurings in the Netherlands have typically been effectuated as asset sales by bankruptcy trustees, with the intent to transfer the enterprise of a debtor to a new company, comparable with section 363 sales under U.S. law. These limited options have considerable downsides and fundamentally fall short for restructuring debtor companies as a going concern.

Main Characteristics of the New Law

A lean and mean debtor-driven procedure with limited court involvement

The new law introduces a statutory procedure to bind creditors and/or shareholders, or any class of them, to a composition (*akkoord*) amending the rights of creditors and/or shareholders with the approval of a Dutch court. This can be accomplished without having to initiate any formal insolvency proceedings. As such, the procedure is meant to be "lean and mean," with the hope that restructurings can be quick and inexpensive. In the current draft of the legislation, mandatory court involvement is limited to the end of the procedure, when the court is asked to confirm the composition (or, in more familiar U.S. terms, the plan of reorganization) and declare it binding on all stakeholders. As no formal insolvency proceedings are opened, the debtor stays in possession and no external trustee or other official is assigned. The very limited and late-in-the-process court involvement has been the subject of criticism by commentators and other parties, so we will wait to see if this aspect is amended before the legislation is implemented.

In addition, the legislation is limited to legal entities and natural persons who practice an independent profession or carry on a business. Importantly, there is no requirement that the debtor company be insolvent (or any other formal financial test linked to liquidity, solvency, or otherwise) for a composition to be offered.

The debtor itself would initiate the process by offering "a composition to restructure its debts" to all or part of its creditors and/or shareholders. However, a creditor can also offer a composition to other stakeholders if the debtor refuses to do so itself. This is to protect creditors against directors (or, by proxy, shareholders) of a debtor company that intentionally does not propose a composition, for example, to shield the shareholders' interests.

Contents of the composition, stakeholders involved, classes, voting and notification procedures: flexibility all around.

A number of key characteristics make the proposed legislation a highly flexible tool. First, the bill does not fundamentally limit what the composition may contain. It may, in principle, amend the rights of the stakeholders by any appropriate means. For example, if a debt for equity swap for the benefit of creditors is proposed, the composition can stipulate that preemptive rights of existing shareholders are bypassed and the articles of association are amended to provide for an increase in the nominal capital of the company to enable the issuance of new shares.

The new legislation is meant to be "lean and mean," with the hope that restructurings can be quick and inexpensive.

Furthermore, the composition can, for example, provide for a division or sale of the debtor company or a portion of its assets.

Second, a composition does not have to be offered to all stakeholders, but only to creditors and shareholders whose rights would be affected by the scheme. This means, for instance, that in a purely financial restructuring at one level of the

capital structure, if a sufficient majority (but not all) of the of the creditors in that class agree on a restructuring, a composition can be offered solely to that one class without the need to involve any other stakeholders of the company. The possibility to limit the scope of the composition may make it feasible to minimize the publicity of the restructuring, so as to mitigate risk to operations. If a company needs to be restructured in more profound ways, as many classes (and types) of stakeholders as necessary can be part of the scheme; only labor contracts are generally excluded.

Similar to Chapter 11, the proponent of the scheme has the discretion to classify stakeholders, subject to the requirement that stakeholders with dissimilar rights may not be grouped into the same class.

No automatic stay; no discretionary powers

Unlike Chapter 11, the current draft of the bill does not provide for an automatic stay of litigation, collection and enforcement actions against the debtor. The court may, in its discretion, however, stay formal bankruptcy (e.g., liquidation or moratorium) proceedings once a composition has been proposed. The bill also does not contain broad discretionary powers for the court – unlike certain provisions of the U.S. Bankruptcy Code. However, the court is empowered to order all measures it deems necessary to adequately protect the interests of the debtor or the creditors in stayed bankruptcy proceedings.

Creditors can therefore in principle continue to take individual measures against the debtor to protect their rights, for example, by levying attachments, when a composition is offered. These points have also received criticism, and practitioners seem to agree that the powers of the court should be expanded so that it can stay any individual actions by the creditor against the debtor, instead of solely staying formal bankruptcy proceedings. Furnishing the court with such broad powers would enable it to better protect and enhance potentially successful going-concern restructurings. We may yet see this change in the final version of the bill.

Voting and confirmation; possibilities of cramdown

Like Chapter 11 plan voting, a class approves a composition if within that class:

i. an absolute majority in number of the creditors or shareholders that took part in the vote, voted in favor of the composition; and

ii. that absolute majority represents at least two-thirds of the total value of:
   - claims held by the creditors placed in the class and who voted, or
   - the issued capital held by the shareholders placed in the class and who voted.

This means that companies will have an effective tool to bind dissenting minority stakeholders. Within a class, the majority as set out above, is determinative, irrespective of any agreements or bylaws between the relevant stakeholders or with the debtor to the contrary. On a related note, the legislation provides that if the economic interest in a claim or share rests with someone other than the creditor or shareholder, the economic stakeholder has the exclusive right to vote on the composition. All impaired classes are entitled to vote, including those classes that receive no distribution.

With limited exceptions, if all impaired classes have approved the composition, the court must declare the composition universally binding on all creditors and shareholders. Two important exceptions are that the court must decline to declare the composition universally binding if it compromises the interests of one or more creditors or shareholders in a disproportionate manner or if fulfilment of the obligations of the debtor under the composition is not sufficiently guaranteed (feasibility).

The legislation also contemplates the possibility of a cramdown of non-accepting classes. If a class or multiple classes of stakeholders vote against the composition, the court may still declare the composition universally binding if it deems the composition to be fair, taking into account all circumstances at hand. The cramdown standard appears rather high at first glance; the court must determine that "the classes that did not vote in favor of the composition could reasonably not have

come to such voting behavior."

According to the legislator's Explanatory Memorandum, this cramdown is to prevent a class of stakeholders from voting against the composition without a valid reason, and may sound similar to the standard in the United States to designate the vote of a creditor that is not cast in good faith. However, as explained by the Dutch legislator in the explanatory memorandum accompanying the draft bill, the economic reality is likely to be determinative in the Netherlands: a class of stakeholders would in principle have no valid reason to vote against a composition if those stakeholders are not expected to receive any payment in case of a liquidation of the debtor company. Shareholders will therefore usually have no valid reason to reject a composition of an insolvent debtor. Similarly, classes that are impaired, but whose distribution pursuant to a composition is at least what they would have received in a liquidation, will also likely not have a valid reason to oppose the composition. The court will, however, not confirm a composition that was not approved by all classes in cases of disproportionate prejudice to creditors, deceit, favoritism or if there are other compelling reasons not to do so.

When enacted, the bill will provide all market participants with new opportunities.

Compared to Chapter 11, the tests for confirming and cramming down a plan on certain classes in the proposed Dutch bill could be considered less stringent. For instance, there is no explicit absolute priority rule. This may make the proposed legislation procedure a more flexible tool than Chapter 11. However, those in Dutch practice familiar with foreign proceedings are expecting that norms and standards in international practice, such as the absolute priority rule, are likely to be informally "imported" by courts.

Restructuring of groups of companies

The legislation would also facilitate the restructuring of a group of companies through one composition because a composition may amend the rights of creditors against guarantors and joint debtors, which is a necessity for the efficient restructurings of any debtor with a complicated corporate structure. It should be noted, however, that the legislation focuses mainly on debtors having their center of main interest (COMI) in the Netherlands pursuant to the European Insolvency Regulation.

Challenges and Opportunities

When enacted, the bill will provide all market participants with new opportunities. Debtors will have a modern, flexible and cost-effective tool to restructure their balance sheets or businesses. Creditors and other stakeholders will benefit by the increased chance of maintaining a going-concern debtor. Currently, in the Netherlands, liquidation always looms large for distressed companies, and creditors (even secured creditors) risk highly limited recoveries, if out-of-court restructuring techniques or the stopgap "363 sale" fail. In addition, creditors supportive of a restructuring will have the ability to neutralize holdouts through sensible restructurings or other amendments of financings, and shareholders can be forced to accept a debt for equity swap.

The legislation may also provide a boost for claims trading, by enabling previously infeasible loan-to-own and distressed trading strategies. Lehman Brothers aside, the Netherlands does not have a very active market of funded debt trading of distressed companies. However, institutionally, it remains to be seen whether Dutch banks and other traditional par holders will be willing to cash out and leave the company and the other creditors to figure out a solution.

Conversely, all parties transacting in the Netherlands should ensure that they take into account the new legislation in their credit and risk analysis. Lenders, for instance, should note that unanimous lender consent provisions may be less effective or altogether ineffective in the context of a composition. Savvy creditors will understand that the legislation is similar to Chapter 11 and English schemes in this regard. Similarly, all stakeholders should recognize that their rights against their debtor may be amended through a composition, including through a class cramdown.

All in all, the new bill should be a great improvement over existing Dutch insolvency law. If the bill is implemented on January 1, 2016, the Netherlands will offer a state-of-the-art restructuring toolbox to companies and groups of companies in financial distress.

The public consultation that started on August 14, 2014 means that the bill may yet be subject to amendment. But, given the support by the various interest groups and stakeholders, we predict that the framework and underlying principles of the legislation will be implemented largely unchanged.

For more information, please refer to www.debrauw.com/wco2.

On Our Radar:
Chapter 15 Cases to Monitor

In 2014, more than 80 petitions have been filed in bankruptcy courts under Chapter 15, slightly below filings in 2013. There are several Chapter 15 cases in progress that are likely to generate interesting and important decisions.

Here are a few that are worth keeping an eye on:

In re Bumi Investment Pte Ltd, et al. Case No. 14-13296 (Bankr. S.D.N.Y.) (Gerber, J.)

Three special-purpose vehicles of PT Bumi Resources Tbk, an Asian coal mining operation, filed Chapter 15 petitions. On January 22, 2015, the bankruptcy court recognized the Singapore insolvency proceeding as the foreign main proceeding for this Chapter 15 "mega case."

In re Suntech Power Holdings Co. Ltd., Case No. 14-10383 (Bankr. S.D.N.Y.) (Bernstein, J.)

Now that Suntech has been ruled eligible for Chapter 15, it will be interesting to see where this case takes us. On January 23, 2015, Solyndra filed a motion to lift the automatic stay to continue its antitrust litigation against Suntech.

In re Fairfield Sentry Ltd., Case No. 10-13164 (Bankr. S.D.N.Y.) (Bernstein, J.)

With the Second Circuit's remand of the case to the U.S. bankruptcy court to conduct a section 363 hearing, this case promises to yield at least one more interesting decision. The timing of any sale hearing is uncertain, however. Farnum, the purchaser of Fairfield Sentry's SIPA Claim, may still file a petition for certiorari, asking the Supreme Court of the United States to review the Second Circuit's decision.

INSOLVENCY AND RESTRUCTURING PRACTICE CO-CHAIRS

Donald S. Bernstein
donald.bernstein@davispolk.com
212 450 4092

Marshall S. Huebner
marshall.huebner@davispolk.com
212 450 4099

Notice: This publication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. If you have received this email in error, please notify the sender immediately and destroy the original message, any attachments thereto and all copies. Refer to the firm's privacy policy located at davispolk.com for important information on this policy. Please consider adding Davis Polk to your Safe Senders list or adding dpwmail@davispolk.com to your address book.

© 2015 Davis Polk & Wardwell LLP
Davis Polk refers to Davis Polk & Wardwell LLP and its associated entities.

Global Distress Signal

EDITORS

Timothy Graulich
timothy.graulich@davispolk.com
212 450 4639

Darren S. Klein
darren.klein@davispolk.com
212 450 4725

ISSUE CONTRIBUTORS

Damian S. Schaible
damian.schaible@davispolk.com
212 450 4580

Damon P. Meyer
damon.meyer@davispolk.com
212 450 4029

Kevin J. Coco
kevin.coco@davispolk.com
212 450 3022

Alexandra (Z-Z) L. Cowen
alexandra.cowen@davispolk.com
212 450 3103

Jordan Weber
jordan.weber@davispolk.com
212 450 3248

Reinout Vriesendorp
reinout.vriesendorp@debrauw.com
+31 20 577 1060

Ruud Hermans
ruud.hermans@debrauw.com
+31 20 577 1947

Rob van den Sigtenhorst
rob.vandensigtenhorst
@debrauw.com
+31 20 577 1812