Global Distress Signal

Developments in International and Cross-Border Insolvency

Davis Polk

Welcome to the first issue of *Global Distress Signal* – a periodic newsletter with articles, analysis and thoughts on global insolvency law and practice.

The past 12 months have been a very active period in U.S. cross-border insolvency. In the midst of a noticeable increase in Chapter 15 activity, U.S. courts seem increasingly willing to take a second look at transactions by non-U.S. debtors affecting U.S. assets (or assets perceived to be in the U.S.) instead of granting comity to recognized foreign main insolvency proceedings. Additionally, especially at the Circuit level, U.S. courts appear to be applying a "plain meaning" approach to Chapter 15. These decisions are likely to decrease the predictability of cross-border insolvency proceedings with a U.S. dimension. In particular, superimposing U.S. insolvency law standards on foreign main insolvency proceedings or applying rigid "plain meaning" interpretations of Chapter 15 without regard to context may make it more difficult to achieve the purposes of Chapter 15.

Two decisions discussed in the articles that follow are of particular interest. In the first, the Fourth Circuit in *Qimonda*[1] affirmed the Chapter 15 court's decision that the licensees' interests against the debtor licensor were entitled to be "sufficiently protected" under section 1522(a) of the Bankruptcy Code, and that such protection warranted the application of a provision (section 365(n) of the Bankruptcy Code – entitling IP licensees to special protections) even though that provision does not automatically apply in Chapter 15 cases and there is no analogue under German law. The *Qimonda* court interpreted Chapter 15 as enabling the court to ensure that foreign insolvency rules do not impinge excessively on any U.S. party's interests and, if they do so impinge, to enforce countervailing provisions of U.S. law even where they are inconsistent with the law of the foreign main proceeding. The decision highlights the extent to which U.S. courts may be inclined to protect the U.S. insolvency law treatment of certain issues where the law of the foreign main proceeding differs from U.S. law.

Superimposing U.S. insolvency law standards on foreign main insolvency proceedings or applying rigid "plain meaning" interpretations of Chapter 15 without regard to context may make it more difficult to achieve the purposes of Chapter 15.

Secondly, in the broadly reported *Octaviar* Chapter 15 case, the Second Circuit held that a foreign representative applying for Chapter 15 recognition must make a showing of the same jurisdictional

[1] *Jaffé v. Samsung Elec. Co.*, 737 F.3d 14 (4th Cir. 2013) (*Qimonda*).

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EDITORS

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

Giorgio Bovenzi
giorgio.bovenzi@davispolk.com
212 450 4260

requirements that apply to Chapter 11 debtors, i.e., a domicile, place of business or property in the United States, making section 109(a) of the Bankruptcy Code applicable to Chapter 15.[2] As a practical matter, courts have interpreted these requirements broadly, making a plenary Chapter 11 case generally available to foreign debtors with only minimal U.S. property. Chapter 15, however, was intended to be even more broadly available to foreign debtors to deal not only with assets, but also with creditors in the United States where the main insolvency proceeding is pending abroad. If the *Drawbridge* decision is followed by other U.S. courts, it will make careful planning mandatory for any Chapter 15 case and may prompt new arguments about what constitutes qualifying U.S. property.

A different, but also important aspect of *Drawbridge* is the *dictum* in which the court suggests that other remedies outside of Chapter 15 may be available to a foreign debtor. Even if this is so, it is clear from Chapter 15's legislative history that Congress intended to concentrate all questions relating to ancillary assistance to foreign proceedings in one court, the Chapter 15 court, and that Chapter 15 was intended to become the portal for a foreign debtor's access to the U.S. court system. By noting that foreign representatives could avail themselves of discovery in aid of the foreign proceeding regardless of the Chapter 15 recognition of their foreign proceeding, the Second Circuit appears to be sanctioning parties seeking relief from multiple courts, thus dealing (perhaps inadvertently) a blow to the Chapter 15 architecture and creating potential procedural confusion. If the language of the Bankruptcy Code is deficient or ambiguous on this point, Congress may have to address it.

It is difficult to predict whether Chapter 15 or appellate courts outside the relevant Circuits will follow the *Qimonda* and *Drawbridge* decisions. The *Drawbridge* rationale was rejected by a Delaware bench decision less than one week after it was issued, in which the court took the view that nothing in Chapter 15 requires a foreign debtor to have U.S. assets.[3]

Although these decisions highlight a somewhat unartfully drafted statute,[4] other considerations seem to be at work. Cross-border insolvency practice is highly complex because, by definition, it involves two or more jurisdictions and, with them, layers of laws, regulations and policies that may be inconsistent since they emanate from different legal systems and commercial cultures. The UNCITRAL Model Law on Cross-Border Insolvencies (including Chapter 15 of the U.S. Bankruptcy Code, which implemented it into the U.S.) is deceptive in its apparent simplicity. The realities of each cross-border insolvency case are complex, and cross-border cooperation, the differences in legal systems, and the competition between international comity and local interests creates a looming trap for the unwary.

As businesses globalize, the globalization of insolvency law is inevitable. Courts that are open to accepting differences in foreign legal systems will encourage reciprocal treatment from their foreign counterparts, consistent with the original objectives of the Model Law. Courts that are overtly protective of their own approach to insolvency will encourage the opposite, leading to a balkanized, unpredictable global insolvency system that in the long run is incompatible with commercial interests in their own countries and abroad.

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

[3] *In re Bemarmara Consulting a.s.*, Case No. 13-13037 (KG) (Bankr. D. Del. Dec. 17, 2013). See *infra*.

[4] A bill adding section 365(n) to the list of sections of the U.S. Bankruptcy Code that automatically apply in a Chapter 15 case is pending before the U.S. Senate. See *infra*.

Judge Lifland's Universalism

By Donald S. Bernstein

On January 12, 2014, Judge Burton R. Lifland, the former Chief Judge of the United States Bankruptcy Court for the Southern District of New York, died at the age of 84. Still as active as ever as a Senior Judge, handling among other cases the contentious Madoff bankruptcy, Judge Lifland was probably the single most experienced and internationally respected United States jurist handling cross-border bankruptcy cases. Apart from his many seminal decisions in cross-border cases like *Nakash, The Singer Company, Bear Stearns,* and *Fairfield Sentry*, Judge Lifland was also a member of the Official United States Delegation to the Working Group of the United Nations Commission on International Trade Law (UNCITRAL) that negotiated and drafted UNCITRAL's Model Law on Cross-Border Insolvency, which formed the basis for Chapter 15 of the Bankruptcy Code.

Judge Lifland was committed to the universalist ideal of having a single set of legal rules govern a multinational insolvency case. Insolvency regimes, based as they are on local commercial and legal cultures, differ from jurisdiction to jurisdiction, but Judge Lifland recognized that rules that are different are not necessarily unfair, and just as the United States wants its insolvency rules to apply to the distribution of assets and the treatment of creditors of its domestic debtors wherever those assets and creditors are located, other jurisdictions want the same.

Businesses and lenders inevitably share Judge Lifland's universalist aspiration. They want a single set of predictable legal rules to apply to failing enterprises because predictability reduces the cost of doing business.

Decisions like the ones described in this inaugural edition of *Global Distress Signal* represent a recent trend among national courts around the world, even in countries that have passed the Model Law, to retreat from this universalist ideal. While each of the decisions is understandable in isolation, and each in different ways can be attributed to infelicitous statutory language or bad facts, the decisions are hard to reconcile with the broader purposes of Chapter 15.

One can only wonder whether if the judges in these important cases all had Judge Lifland's deep experience in international insolvency and Chapter 15 they would have reached different conclusions that, in the larger scheme of things, would better serve the interests of U.S. stakeholders in a globalized commercial world.

Deference to Foreign Insolvency Proceedings: Will the Exceptions Swallow the Rule?

Chapter 15 is predicated on the idea that when a debtor's assets span multiple jurisdictions, its insolvency proceedings should nonetheless be managed in a single forum and governed by a single set of laws, the laws of the foreign main proceeding, even when those laws depart from those of the U.S. By and large, U.S. courts have respected this premise. And yet, creditors and others have recently stepped up their challenges to recognition of foreign insolvency proceedings and post-recognition relief, seeking to thwart the deference to the foreign proceeding. We review three recent decisions in Chapter 15 cases that show how the landscape is evolving.

ABC Learning (3rd Cir.): "Commonwealth" Approach to Secured Creditors Does Not Preclude Recognition

Since Chapter 15 was enacted, U.S. courts have granted recognition to numerous foreign proceedings under regimes that diverge, at times sharply, from the U.S. Bankruptcy Code. The *ABC Learning* decision continues this universalist trend, with the Third Circuit affirming a Bankruptcy Court order granting recognition to the Australian administration (and later, liquidation) proceeding of ABC Learning Centres ("ABC"), a proceeding that entailed a decidedly non-U.S. notion of control over "property of the estate" given that ABC's secured creditors were vested with the authority to manage or dispose of the company's encumbered assets.[1]

An international child care business based in Australia, ABC was placed into Australian voluntary administration in November 2008 and then into liquidation in June 2010. Concurrently with the commencement of voluntary administration, ABC's secured creditors, a banking syndicate whose loans were secured by charges on substantially all the assets of the company, appointed receivers to maximize their recovery. ABC's administrators (later, liquidators) delegated management of the company to the receivership, in recognition of the fact that the receivers could otherwise have seized control of substantially all of ABC's assets (including U.S. assets) and left behind a near-empty shell, given that no excess proceeds from the collateral were expected to be available for distributions to unsecured creditors.

> *ABC Learning (3rd Cir.):* "Without Chapter 15 recognition, RCS could skip ahead of the priorities of the secured creditors."

To stay a U.S. enforcement action by RCS Capital Development, a judgment creditor, the liquidators filed a Chapter 15 petition. RCS objected to recognition on various grounds – mainly, the lack of a collective Australian proceeding due to the pending receivership and the absence of an interest held by ABC in the U.S. assets that the receivership was managing for the benefit of the secured creditors.

In rejecting these arguments and affirming recognition, the Third Circuit held that Chapter 15 accommodates the recognition of foreign insolvency proceedings that are very different from those in the U.S., particularly with respect to the rights of secured creditors. RCS argued that in bifurcating the estate between encumbered and unencumbered assets, the Commonwealth approach to insolvency taken by Australian insolvency law is both less collective and less likely to rehabilitate the debtor than the process followed under U.S. law. Yet, the Third Circuit noted that failure to recognize the foreign proceeding on these grounds would have led to a result that was even less collective or rehabilitative than either insolvency regime, where ABC's business would be ruptured by creditors seizing U.S. assets in a race to the courthouse. Thus, the Third Circuit affirmed recognition, stating that that Australian law merely "established a different way to achieve similar goals."[2]

> *ABC Learning (3rd Cir.):* "Allowing an unsecured creditor to recover a judgment under these circumstances would require a hodgepodge of United States and Australian bankruptcy law. This is one of the outcomes Chapter 15 was designed to prevent."

This decision reinforces the comity foundation on which Chapter 15 is premised but also shows the importance of analyzing the ultimate goals the foreign system pursues and their general (as opposed to specific) compatibility with U.S. bankruptcy goals.

Sino-Forest and Post-Recognition Relief Under "Principles of Comity"

Even after Chapter 15 recognition of the foreign proceeding is granted, the need to analyze and compare different legal systems resurfaces in the context of requests for post-recognition relief that present issues of conflict or inconsistency

[1] *In re ABC Learning Centres Ltd,* 728 F.3d 301 (3d Cir. 2013), *cert. denied* (Feb. 24, 2014).

[2] 728 F.3d at 310. The court also stated that "[t]he sole difference here is that Australian law allows secured creditors to realize the full value of their debts, and tender the excess to the company, whereas secured creditors in the United States must generally turn over assets and seek distribution from the bankruptcy estate."

Chapter 15 in Aid of the Resolution of Foreign Financial Institutions

The Chapter 15 case filed by Irish Bank Resolution Corp. (IBRC) has broad implications for the analysis of cross-border resolution of financial institutions. IBRC is the Irish corporation that was created by the Credit Institutions (Stabilization) Act 2010 as successor to Anglo Irish Bank Corp. (Anglo Irish) (formerly one of the largest Irish banks, then nationalized in 2009) and to the Irish Nationwide Building Society. In 2013, IBRC filed a Chapter 15 petition in Delaware for the recognition of its Irish liquidation proceeding and to protect the liquidation of various loan portfolios in the United States. U.S. creditors objected to the Chapter 15 recognition of the Irish liquidation alleging that the Irish proceeding discriminated against U.S. creditors and denied their due process rights.

The Chapter 15 case saw months of IBRC wrangling with creditors, including U.S. creditors, Irish investors, and U.S. borrowers and owners of U.S. real estate that was mortgaged to Anglo Irish and cross-collateralized to secure acquisition and development loans. Among the noteworthy objections raised in the case: Anglo Irish should not be eligible for Chapter 15 because it had agencies in the U.S. that engaged in banking business in the U.S.; the Irish liquidation is not collective in nature because it will only provide distributions to Irish taxpayers by reducing the Irish government's losses as sole shareholder of Anglo Irish; and the Irish proceeding is not subject to oversight as required under Chapter 15. The Delaware Chapter 15 court recognized the Irish liquidation noting on the record that it was a "close call." On April 30, 2014 the court issued its findings of fact and conclusions of law on the recognition of the Irish liquidation. This decision will be the subject of a forthcoming update. Stay tuned.

with U.S. law. Like recognition, post-recognition relief can be denied because it is "manifestly contrary" to U.S. public policy, because "the interests of creditors and other interested entities" are not "sufficiently protected" or because the "distribution of proceeds" in the foreign proceeding is not "substantially in accordance" with the Bankruptcy Code.[3]

In *Sino-Forest,*[4] S.D.N.Y. Bankruptcy Judge Martin Glenn granted the recognition and enforcement of third-party releases approved in the debtor's Canadian insolvency proceeding in conjunction with the settlement of securities class action litigation. Judge Glenn reiterated the principle he had previously articulated in his opinion in *Metcalfe*, namely that under Chapter 15's comity standard, the court's task is not "to make an independent determination about the propriety of individual acts of a foreign court" but to determine whether the foreign procedures "meet our fundamental standards of fairness."[5]

The *Sino-Forest* decision is particularly interesting for its relationship to *Vitro*, in which the Fifth Circuit affirmed a bankruptcy court order refusing to recognize Vitro's Mexican plan.[6] *Sino-Forest* deals with a scenario similar to the one in *Vitro* – the implementation of third-party releases approved by the foreign court – and it is the first Chapter 15 decision to address such a request since *Vitro*. Armed with his deep familiarity with the *Metcalfe* facts, Judge Glenn used the same factors that the *Vitro* court had used to distinguish *Metcalfe*, including the near-unanimous support for the plan, the absence of insider votes, the Canadian court's evaluation of the sensitivities involved with the approval of third-party releases, and the lack of objections to the requested belief, but reached a conclusion opposite the conclusion reached in *Vitro*. However, there is not a dramatic divergence between *Sino-Forest* and *Vitro*. Bad facts could still lead to *Vitro*-type negative outcomes even in a Circuit that is willing to recognize third-party releases in appropriate circumstances, like the Second Circuit.

[3] 11 U.S.C. §§ 1506, 1507, 1522(a).

[4] *In re Sino-Forest Corp.,* No. 13-10361 (Bankr. S.D.N.Y. Nov. 25, 2013).

[5] *In re Metcalfe & Mansfield Alternative Invest.*, 421 B.R. 685 (Bankr. S.D.N.Y 2010), distinguishing *In re Vitro S.A.B. de C.V*, 701 F.3d 1031 (5th Cir. 2012). Notably, a portion of the *Sino-Forest* opinion was devoted to distinguishing the decision in *In re Vitro SAB de CV*, 701 F.3d 1031 (5th Cir. 2012), and the *Sino-Forest* court declined to apply *Vitro*'s three-step framework for determining the appropriateness of post-recognition relief.

[6] *In re Vitro SAB de CV*, 701 F.3d 1031 (5th Cir. 2012). The main reasons for the court's refusal to implement the Mexican plan were that the Mexican plan did not sufficiently protect creditors' interests under section 1522(a), limited bondholders' recoveries while releasing third-party guarantees issued for the benefit of the bondholders, allowed equity to retain substantial value, and had been approved by majority votes cast by insiders.

Qimonda (4th Cir.): Chapter 15 with "Strings Attached"?

Vitro is not alone in giving teeth to section 1522(a)'s requirement that "the interests of the creditors and other interested parties, including the debtor, [be] sufficiently protected."[7] Other Chapter 15 courts have followed *Vitro*'s lead, and section 1522(a) has in fact become the preferred tool for U.S. creditors and bondholders challenging their treatment in the foreign proceeding by requesting the implementation of creditor protections available under U.S. bankruptcy law. Relying on *Vitro*, the Fourth Circuit in *Qimonda* recently interpreted section 1522(a) as requiring a "particularized balancing analysis," potentially affording creditors with protection not existing in the main insolvency forum.[8]

Qimonda was at one time the world's largest manufacturer of dynamic random access memory, or "DRAM." Upon commencing insolvency proceedings, its primary assets consisted of its portfolio of patents, including about 4,000 U.S. patents all of which were cross-licensed to Qimonda's competitors pursuant to an industry practice designed to prevent a scenario in which overlapping patent rights (defined in the industry as a "patent thicket") would thwart technological innovation by creating fear of patent infringement. After a successful Chapter 15 petition, Qimonda's insolvency administrator sought – as "appropriate relief" under 11 U.S.C. 1521 – to be "entrusted" with the debtor's U.S. patents and, simultaneously, to cancel and relicense the patents for cash royalties as permitted by German law. Exercising his rights under the German insolvency code, the Qimonda administrator sought to cancel the existing licenses and then renegotiate them on terms more favorable to Qimonda. Notably, the German insolvency code does not contain a provision equivalent to section 365(n) of the U.S. Bankruptcy Code protecting IP licensees. Further, even though the Qimonda administrator had obtained Chapter 15 recognition, and certain sections of the U.S. Bankruptcy Code are made applicable to a Chapter 15 case, section 365(n) is not one of them.

In objecting to the relief, licensees of Qimonda's U.S. patents argued that they should not be deprived of U.S. Bankruptcy Code protections for patent licensees, arguing that unilateral cancellation of the cross-licenses would "undermine a fundamental U.S. public policy promoting technological innovation." Thus, the Qimonda licensees objected mainly on public policy grounds.[9]

The *Qimonda* court applied a balancing test by which it considered the harm that the cancellation of licenses under German bankruptcy law would have on U.S. licensees, and balanced that harm against the foreign representative's interest in obtaining the ability to transfer Qimonda's U.S. patents free of the existing IP licenses. The Court concluded that protecting the U.S. licensees' interests by making section 365(n) applicable was warranted to countervail the excessive harm that the U.S. licensees would have suffered had the cancellation of IP licenses effected under German law been given effect in the U.S. The *Qimonda* court decided so, even though evidence showed that application of section 365(n) would result in less value being realized by the Qimonda estate.[10]

> ***Qimonda (4th Cir.):*** "[I]t is far from clear whether, having once facilitated the termination of license rights in a foreign insolvency proceeding, the genie could ever be put back into the bottle. Rather, . . . it would seem all too likely that such a result would introduce a dangerous degree of uncertainty to a licensing system that plays a critically important role . . . [Chapter 15] represents a full commitment of the United States to cooperate with foreign insolvency proceedings . . . But the United States' commitment is not untempered."

As increasing numbers of creditors in Chapter 15 cases object to the relief granted by non-U.S. insolvency courts, *Qimonda* represents a trend of expansive use of "sufficient" protection under section 1522(a) to introduce substantive provisions of U.S. law into foreign proceedings.

[7] See Fn. 6, *supra.*

[8] *Jaffé v. Samsung Elec. Co.*, 737 F.3d 14 (4th Cir. 2013) (*Qimonda*).

[9] Section 1506 provides that "[n]othing in [Chapter 15] prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States." The Qimonda licensees, and later on the district court, viewed section 365(n) as the expression of a public policy of the United States. *In re Qimonda AG*, 462 BR 165 (Bankr. E.D. Va. 2011).

[10] On December 5, 2013, the U.S. House of Representatives passed a bill that would amend section 1522 as follows:

> Section 365(n) shall apply to cases under this chapter. If the foreign representative rejects or repudiates a contract under which the debtor is a licensor of intellectual property, the licensee under such contract shall be entitled to make the election and exercise the rights described in section 365(n).

Innovation Act, H.R. 3309, 113th Congress § 6(d)(1). The bill was referred to the Senate Judiciary Committee on December 9, 2013.

Bitcoin Exchanges: MtGox's Japanese Bankruptcy and Chapter 15 Likely to Raise Novel Issues

On March 9, 2014, MtGox Co., Ltd., a Japanese corporation and at one time one of the world's largest online bitcoin exchanges, filed a petition for Chapter 15 relief in Northern District of Texas bankruptcy court following the mysterious disappearance of nearly all of its and its customers' approximately 850,000 bitcoins, worth a staggering $473 million. MtGox's Chapter 15 is ancillary to its liquidation proceeding pending in the Tokyo District Court pursuant to the Japanese Bankruptcy Act. At the June 17, 2014 recognition hearing, the Texas bankruptcy court indicated that it would grant recognition of the Japanese proceeding.

Leaving aside the myriad issues related to the unprecedented digital loss of bitcoins that occurred prior to MtGox's bankruptcy filing and the current investigations, MtGox's proceedings are relevant to companies that specialize in holding, managing or exchanging bitcoins.

Various U.S. regulators have adopted different positions regarding the bitcoin business since the MtGox events, from Federal Reserve's Chair Janet Yellen's statement that the Federal Reserve does not have the authority to regulate or supervise bitcoin, to the U.S. Commodity Futures Trading Commission looking at whether the agency has jurisdiction over bitcoin and other virtual currencies, to the New York Department of Financial Services' public release that it will accept applications for the establishment of regulated virtual currency exchanges in New York State.

A Davis Polk bitcoin team across multiple practice areas is monitoring bitcoin developments in this brave new world of cryptocurrencies.

Did the Second Circuit Alter the Chapter 15 Architecture?

On December 12, 2013, the Second Circuit unexpectedly decided that a foreign debtor must have property or a place of business in the U.S. in order for such debtor's foreign insolvency proceeding to be recognized under Chapter 15. The decision departs from prior case law, and could preclude foreign debtors with no U.S. assets from utilizing the Chapter 15 process to obtain key discovery relating to such foreign debtor's main insolvency proceedings, modifying the fundamental notion of Chapter 15 as the principal portal for foreign representatives that want to access the U.S. court system.

The Octaviar Group was an Australian-incorporated conglomerate. Following its downfall in 2008, the foreign administrator of Octaviar's remaining estate filed a Chapter 15 petition seeking recognition of Octaviar's 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, an indirect owner of an Australian entity from which Octaviar's administrators had sought to recover over $200 million in an Australian lawsuit, filed an objection to Octaviar's Chapter 15 petition on the basis that Octaviar must have "a domicile, a place of business, or property in the United States" in order to be a debtor under Chapter 15.[1]

Reversing the Bankruptcy Court's decision[2], the Second Circuit on direct appeal vacated the Bankruptcy Court's recognition order.[3] The Second Circuit reasoned that because section 103(a) of the Bankruptcy Code makes all of Chapter 1 of Title 11 applicable to Chapter 15 and, because section 109(a) of the Bankruptcy Code is part of Chapter 1, recognition should not have been granted because Octaviar's foreign representative "made no attempt to establish that [Octaviar] has a domicile, place of business or property in the United States[.]"[4] The Court expressly rejected the argument that the purpose of Chapter 15 would be undermined by applying section 109(a), finding that, in substance, such argument did "not suffice to outweigh the express language of Congress used . . . [particularly] where other provisions of federal law [, *e.g.* 28 U.S.C. § 1782(a),] provide the relief that the Model Law was intended to provide."

> "Congress . . . may have intended to limit the relief provided by Chapter 15 because it knew that additional relief was already available outside of Chapter 15."

The Second Circuit's decision did not go unnoticed. Just five days later, in a bench ruling following an evidentiary hearing on a Czech foreign representative's petition for recognition, Delaware Bankruptcy Judge Kevin Gross declared that the Delaware Bankruptcy Court "does not agree with the decision of the Second Circuit."[5] Judge Gross suggested that a "scrivener's error" may account for why section 109(a) conceivably could apply to Chapter 15, whereas it is clear that, when read in combination with section 1502 ("'debtor' means an entity that is the subject of a

[1] 11 U.S.C. § 109(a).

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

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

[4] Notably, the Second Circuit did not consider various precedents, including a Bankruptcy Court decision entered in 2011 in which S.D.N.Y. Bankruptcy Judge Allan Gropper wrote that "the eligibility standards in § 109 for filings under the various chapters of the Bankruptcy Code do not require that a debtor in a foreign proceeding have a place of business or property in the United States." *In re Toft*, 453 B.R. 186, 193 (Bankr. S.D.N.Y. 2011).

[5] *In re Bemarmara Consulting A.S.,* Case No. 13-13037 (Bankr. D. Del. Dec. 17, 2013).

foreign proceeding"), 109(a) does not apply to Chapter 15. Judge Gross also posited that there is nothing in section 1502, the section containing the Chapter 15 definitions, that would require the foreign debtor to have assets in the U.S.

The Bankruptcy Code contains two separate definitions of the term "debtor." The first is the general definition of a "debtor" in section 101(13) of the Bankruptcy Code, referring to a "person . . . concerning which a case under this title has been commenced." The second is a special definition of "debtor" contained in section 1502, applicable to Chapter 15, which refers to "an entity that is the subject of a foreign proceeding." The Second Circuit acknolwedged the existence of the separate section 1502 definition, but concluded that the definition merely supplants section 101(13) but not the section 109 reference to "a debtor under this title." However, the existence of a special definition of "debtor" for purposes of Chapter 15 could easily have been read to support the idea that the requirements of section 109 were intended to be applicable solely to debtors commencing plenary cases under Title 11, and not to debtors "subject to a foreign proceeding" whose foreign representatives are seeking recognition under Chapter 15.

Commentators have noted one important implication of *Drawbridge*: the application of section 109(a) to Chapter 15 may limit the use of Chapter 15 as a tool for administrators of foreign estates with no assets or business in the U.S. to obtain, via discovery, evidence supporting certain claims at issue in foreign proceedings, or investigate possible causes of action in the U.S.[6]

What has gone largely unnoticed, however, is a deeper implication that could be drawn from *Drawbridge*: at the conclusion of its decision, the Second Circuit noted in passing that "28 U.S.C. § 1782(a) provides for discovery in aid of foreign proceedings without any requirement akin to Section 109(a). Congress, therefore, may have intended to limit the relief provided by Chapter 15 because it knew that additional relief was already available outside of Chapter 15." The Second Circuit also noted that in fact Octaviar's foreign representatives had commenced in S.D.N.Y. an action under 28 U.S.C. § 1782 to obtain production of documents.[7] This may induce foreign representatives and creditors or other parties in interest to seek relief from multiple courts, state and federal, contrary to the traditional Chapter 15 goal that one court, the Chapter 15 court, should have sole control of all questions related to ancillary relief for a foreign proceeding.[8]

The result would be that parties may then avoid the scrutiny of the bankruptcy court, with the risk of inconsistent applications of comity by a multitude of courts.

Takeaways

Octaviar's foreign representatives initially filed a Chapter 15 petition but, once the Chapter 15 proceeding was stayed by the Second Circuit, proceeded to discovery under 28 U.S.C. § 1782(a). Contrary to a key objective of Chapter 15, *Drawbridge* may reopen multiple "doors" that foreign representatives can use to access the U.S. legal system.

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INSIGHT

To File or Not to File: *Oui Financing* and the "Comity" Alternative

In September 2012, Oui Management, a *société par actions simplifiée* based in Paris, commenced a *sauvegarde* procedure in the Paris Commercial Court that culminated in the approval, roughly eight months later, of a restructuring plan that provided for the repayment of Oui Management's debts over a seven-year period. Oui Management did not commence a Chapter 15 case. One creditor, Oui Financing, sued Oui Management and Steven Dellar, its president and principal shareholder and a non-debtor guarantor of Oui Management's debt, in the Southern District of New York for breach of contract and fraud relating to the failure to repay the loan.

The SDNY court dismissed Oui Financing's complaint against both Oui Management and Mr. Dellar, on comity grounds, finding that Second Circuit precedent counsels in favor of "deference to a foreign court of proper jurisdiction . . . so long as the foreign proceedings are procedurally fair and do not violate public policy." The SDNY refused to accept Oui Financing's arguments that the French proceeding was unfair because Oui Financing was unable to air its grievances before the restructuring plan was confirmed, noting that the plaintiff had participated in Oui Management's safeguard proceeding and had submitted objections to the repayment plan. As to the claim levelled against Mr. Dellar, the court concluded that plaintiff's attempt to sue the non-debtor guarantor, whose obligations the court found to be closely intertwined with Oui Managements,' constituted an "end-run around a parallel foreign bankruptcy proceeding," which, as an act of a sovereign nation, was entitled to "a proper level of respect" even where the parties' agreement had selected a different forum for disputes.[1]

In many ways, the Second Circuit's decision in *Drawbridge* may open the door for *Oui Financing*-like comity rulings related to foreign insolvency proceedings for which no Chapter 15 case was filed. *Oui Financing* makes clear one alternative to a Chapter 15 case: a foreign debtor can simply (1) "wait and see" whether creditors attempt to thwart the debtor's foreign insolvency proceeding by commencing a lawsuit in U.S. court and (2) if a lawsuit is filed, move to dismiss the suit on comity grounds (if specific circumstances warrant such dismissal).

1 *Oui Financing LLC v. Dellar*, 2013 U.S. Dist. LEXIS 146214 at *31 (S.D.N.Y. Oct. 9, 2013) (internal citations omitted).

[6] See, e.g., David J. Molton, "2nd Cir. Raises a Drawbridge to Ch. 15," *Law360* Dec. 20, 2013.

[7] See Stip. & Order, *In re Application of Barnet*, 13-Misc.-214, Dkt. No. 32 (S.D.N.Y. Oct. 4, 2013).

[8] House Rep. No. 109-31, Pt. 1, 109th Cong, 1st Sess. 100-111 (2005).

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The other effect of *Drawbridge* is that a foreign debtor without hard U.S. assets will have to assert that it nevertheless has "property" in the U.S. in the form of contract rights, receivables, professional fees retainers, electronic mail stored on servers in the U.S. or other property sufficient to satisfy the requirements of section 109(a). This would force Chapter 15 courts to confront exceedingly nettlesome conflicts of law and property law questions to identify the territorial *situs* of property rights, contrary to the mechanical nature that the recognition of a foreign proceeding was intended to have.

Ultimately, these could well become issues for Congress to address appropriately, in the interest of clarity, uniformity and predictability.[9]

On Our Radar: Chapter 15 Cases to Monitor

In 2013, 89 petitions were filed in bankruptcy courts under Chapter 15 of the U.S. Bankruptcy Code, a roughly 25% decrease from the 121 petitions that were filed in 2012. Four Chapter 15 cases involved assets in excess of $500 million, and three cases involved assets between $100 and $500 million. As Chapter 15 cases have become more common, the quantity and quality of the court filings and court decisions has increased, generating an uptick in attention towards the Chapter 15 forum. We think that the following Chapter 15 cases are worth keeping an eye on:

***In re Irish Bank Resolution Corporation Limited (In Special Liquidation)*, Case No. 13-12159 (Bankr. D. Del.) (Sontchi, J.)**

Liquidation of Anglo Irish Bank Corp., at one point one of Ireland's largest banks. Recognition of foreign main proceeding granted, but a "close call." The Chapter 15 court's opinion on the recognition of the Irish proceeding is noteworthy and will be discussed in a forthcoming Davis Polk update.

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

Parent holding company whose main subsidiary was a large maker of photovoltaic cells. The intersection of U.S., Cayman Islands (jurisdiction of Suntech's main proceeding) and Chinese law (jurisdiction of Suntech's subsidiary's main proceeding) may create testing grounds for creditors exploring how to gain bargaining leverage against debtors.

***In re Octaviar*, Case No. 14-10438 (Bankr. S.D.N.Y.) (Chapman, J.)**

The Octaviar case keeps surprising. On February 27, 2014, Octaviar's foreign representatives filed a new Chapter 15 case seeking recognition of the Australian foreign main proceeding, again, this time specifically pleading that Octaviar does indeed have property in the U.S. in the form of a $10,000 undrawn retainer with U.S. counsel, in addition to claims and causes of action against entities located in the U.S. The existence of two Chapter 15 cases filed by the same foreign representatives with respect to the same foreign proceeding is unprecedented.

[9] Tellingly, the Second Circuit concluded its opinion by directing the court's clerk to forward the opinion to Congress.

Global Distress Signal

EDITORS

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

Giorgio Bovenzi
giorgio.bovenzi@davispolk.com
212 450 4260

ISSUE CONTRIBUTORS

Giorgio Bovenzi
giorgio.bovenzi@davispolk.com
212 450 4260

Aryeh Ethan Falk
aryeh.falk@davispolk.com
212 450 4563

Adam L. Shpeen
adam.shpeen@davispolk.com
212 450 4478

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