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Donald S Bernstein

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Chapter 1

BARNET AND BEMARMARA

MUST A FOREIGN DEBTOR HAVE US ASSETS TO BE ELIGIBLE FOR RELIEF UNDER CHAPTER 15 IN THE UNITED STATES?

Donald S Bernstein, Timothy Graulich, Damon P Meyer and Christopher S Robertson[1]

In last year's edition of *The International Insolvency Review*, we discussed the tension between the 'universalist' and 'territorialist' approaches to cross-border insolvencies. Universalists believe that cross-border insolvencies should be governed by the laws of a single country[2] to increase the efficiency and predictability of cross-border insolvencies,[3] whereas territorialists dispute both the feasibility and purported benefit of a unified

1 Donald S Bernstein and Timothy Graulich are partners, Damon P Meyer is a senior associate and Christopher S Robertson is an associate at Davis Polk & Wardwell LLP.

2 See, for example, Jay Lawrence Westbrook, 'Theory and Pragmatism in Global Insolvencies: Choice of Laws and Choice of Forum', 65 Am. Bankr. L.J. 457, 461 (1991) (under the universalist principle 'all of the debts of the enterprise would be administered through one central proceeding in the "home country"'); Andrew T Guzman, 'International Bankruptcy: In Defense of Universalism', 98 Mich. L. Rev. 2177, 2203 (2000) (arguing that universalism is a 'better framework for reorganisations' because of the centralisation of assets in a single court); Todd Kraft and Allison Aranson, 'Transnational Bankruptcies: The Section 304 and Beyond', 1993 Colum. Bus. L. Rev. 329, 336 (1993) (one proceeding – held in a country with great interest in the debtor or the property – minimises administrative costs and maximises judicial efficiency).

3 See, for example, Jay Lawrence Westbrook, 'A Global Solution to Multinational Default', 98 Mich. L. Rev. 2276, 2288 (2000) (because bankruptcy is a market-symmetrical law, a global market requires a global bankruptcy law); John A E Pottow, 'Procedural Incrementalism: A Model for International Bankruptcy', 45 Va. J. Int'l L. 936, 946 (2005) (arguing that a territorialist insolvency system would 'undermine the market-symmetric and orderly disposition of a debtor's assets').

approach[4] and argue that adopting a single 'home' jurisdiction for a multinational corporation would inevitably lead to 'forum shopping'.

The universalist approach received a big boost in 1997, when the United Nations Commission on International Trade Law (UNCITRAL) promulgated the Model Law on Cross-Border Insolvency (the Model Law), which, generally, endorses recognition of a 'main' insolvency proceeding in a single country with the possibility of one or more local ancillary proceedings to support the foreign main proceeding. The Model Law thus creates a unified approach that could force creditors in different countries to look to a single country's law for recovery on their claims.

Key to the Model Law (enacted in 21 jurisdictions, including as Chapter 15 to Title 11 of the United States Code (the Bankruptcy Code) in the United States)[5] is a presumption that debtors could fairly access local courts to protect local assets, defend or commence local lawsuits and otherwise maximise the assets of the estate. However, in its recent decision in *Barnet*,[6] the United States Court of Appeals for the Second Circuit surprised many observers by holding that the same eligibility standard applies to ancillary Chapter 15 cases as to plenary cases in the United States – specifically, that a foreign debtor must have at least some property in the United States to commence proceedings under Chapter 15. Unless Chapter 15 is amended, the *Barnet* decision is likely to result in continuing confusion among courts and foreign debtors, inefficiencies in administration of cross-border cases and an increasing resort to creative ways to establish that debtors have property in the United States.

I IN RE BARNET

Octaviar Administration Pty Ltd (Octaviar), an Australian investment company, was placed into 'external administration' in Australia on 3 October 2008. Less than a year later, on 31 July 2009, the Supreme Court of Queensland ordered that Octaviar be liquidated. As part of the liquidation of Octaviar, the liquidators conducted examinations of directors, officers and professionals of Octaviar to determine whether there were potential causes of action that could bring assets into the estate. Following these investigations, the liquidators of Octaviar sought to recover claims in Australia against various Australian affiliates of Drawbridge Special Opportunities Fund LP (Drawbridge), a fund affiliated

4 See, for example, Lynn M LoPucki, 'Cooperation in International Bankruptcy: A Post-Universalist Approach', 84 Cornell L. Rev. 696, 709 (1999) (the problems with universalism are overwhelming); Lynn M LoPucki, 'Universalism Unravels', 79 Am. Bankr. L.J. 143, 148 (2005) (universalists have tried to ignore the uncomfortable fact that someone must be given the power to decide what a country's courts – and thus what a country's law – will control).

5 'United Nations Commission on International Trade Law (UNCITRAL): UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment', 30 May 1997, available at www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf.

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

with the Fortress Group. Avoidance claims and related equitable claims were brought seeking to recover A$210 million.[7]

On 13 August 2012, the liquidators of Octaviar, acting as its 'foreign representatives',[8] filed a petition for recognition under Section 1515 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. At the time, Octaviar did not transact business in the United States or have any operations in the United States; however, the foreign representatives asserted that it might have assets in the United States in the form of inchoate claims or causes of action against Drawbridge affiliates located in the United States. Indeed, one of the principal purposes for filing the Chapter 15 petition was to conduct discovery to determine if there were, in fact, any such claims. The foreign representatives sought recognition of the Australian proceeding as Octaviar's foreign main proceeding, as defined in Section 1502(4) of the Bankruptcy Code. Recognition of the foreign main proceeding would allow the bankruptcy court to authorise the requested discovery under Section 1521(a)(4) of the Bankruptcy Code.

Drawbridge objected to recognition on the grounds that Octaviar did not reside or have a domicile, a place of business, or property in the United States and thus could not be a 'debtor' under Section 109(a) of the Bankruptcy Code. The issue stems from the language of the Bankruptcy Code. Specifically, Section 109(a) provides that 'only a person[9] that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under [the Bankruptcy Code]'.[10] Section 103(a), in turn, purports to make Section 109(a) applicable in a Chapter 15 case, with one exception that is not relevant here.[11] Chapter 15, however, contains its own definition of 'debtor'. Section 1502 states that, for the purposes of Chapter 15, a 'debtor' is 'an entity that is the subject of a foreign proceeding'.[12]

Drawbridge asserted that the plain language of Section 109(a) requires that a debtor have property in the United States and Section 103(a) makes this requirement applicable in a Chapter 15 case.[13]

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7 *In re Barnet*, 2012 Bankr. LEXIS 6233 at *6 (Bankr. S.D.N.Y. 28 November 2012).

8 See 11 U.S.C. §§ 101(24), 1509.

9 As per 11 U.S.C. § 101(41), '[t]he term "person" includes individual, partnership, and corporation'.

10 11 U.S.C. § 109(a).

11 11 U.S.C. § 103(a) (except as provided in Section 1161 of this Title, Chapters 1, 3, and 5 of this Title apply in a case under Chapter 7, 11, 12, or 13 of this Title, and this Chapter, Sections 307, 362 (o), 555 through 557, and 559 through 562 apply in a case under Chapter 15).

12 11 U.S.C. § 1502(1).

13 Objection of Drawbridge Special Opportunities Fund LP to Alleged Foreign Representatives' Verified Petition Under Chapter 15 for Recognition of Foreign Main Proceeding at 4, Case No. 12-13443 (Bankr. S.D.N.Y. 30 August 2012), ECF No. 13.

The foreign representatives raised a number of arguments in support of their petition. First, they argued that Section 109(a) does not apply in Chapter 15 cases.[14] 'A "debtor" as described in Section 109(a)', the foreign representatives noted, 'is an entity that commences a case to "create an estate" under Section 541 of the Bankruptcy Code'.[15] Because no estate is created in Chapter 15, there is no debtor as that term is used in Chapter 7 or Chapter 11.[16] Moreover, Section 1502 contains a unique definition of a debtor, which it defines as 'any entity that is the subject of a foreign proceeding'.[17] Octaviar certainly would qualify as a debtor under this definition. Second, the Chapter 15 venue provision in Section 1410 of the Bankruptcy Code provides for venue in a Chapter 15 case in which a debtor does not have assets or place of business in the United States, which implies that such a debtor could file for Chapter 15 in the first place.[18] Third, case law under Section 304 of the Bankruptcy Code, the predecessor to Chapter 15, supported the conclusion that the bankruptcy courts had jurisdiction over the affairs of foreign debtors with no assets or business in the United States.[19] Fourth, two recent decisions in the Southern District of New York had held that the presence of assets in the United States was not necessary to grant relief under Chapter 15.[20] In *In re Toft*, the bankruptcy court observed that '[t]he eligibility standards in Section 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'.[21] Likewise, in *In re Fairfield Sentry Ltd*, the bankruptcy court found that 'Section 1521(a)(4) … allows for discovery in the United States whether or not a debtor has assets here'.[22]

The bankruptcy court granted recognition of Octaviar's Australian proceeding over Drawbridge's objection. In so holding, the bankruptcy court was persuaded by the *Toft* and *Fairfield Sentry* decisions[23] and by law and practice developed under former Section 304 of the Bankruptcy Code.[24] Both parties indicated an intent to appeal

14 Petitioners' Response to Objection of Drawbridge Special Opportunities Fund LP to Verified Petition Under Chapter 15 for Recognition of a Foreign Main Proceeding at 4, Case No. 12-13443 (Bankr. S.D.N.Y. 5 September 2012), ECF No. 16.

15 Id.

16 Id.

17 Id. Note that this definition is not included in the text of the Model Law. The legislative history to Chapter 15 states that the definition 'is necessary to eliminate the need to refer repeatedly to "the same debtor as in the foreign proceeding"'. H.R. Rep. No. 109-31, pt.1, at *107 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 170. This legislative history seems to indicate that had Congress adopted the Model Law without making this change, the word 'debtor' in Chapter 15 would have been replaced with 'debtor in a foreign proceeding'.

18 Id. at 5.

19 Id. at 7.

20 Id. at 7-8.

21 *In re Toft*, 453 B.R. 186, 193 (Bankr. S.D.N.Y. 2011).

22 *In re Fairfield Sentry, Ltd.*, 458 B.R. 665, 679 n.5 (Bankr. S.D.N.Y. 2011).

23 *In re Barnet*, 2012 Bankr. LEXIS 6233 at *8.

24 Id. at *10–11.

any adverse decision of the district court if it were to hear and decide an appeal of the recognition order in the first instance, which prompted the bankruptcy court to certify the matter for direct appeal to the Second Circuit Court of Appeals.[25]

The Second Circuit reversed, accepting Drawbridge's argument that the language of Section 109(a) applied in a Chapter 15 case and that Octaviar therefore could not be a debtor under Chapter 15 without a domicile, a place of business, or property in the United States.[26] The court rejected each of the foreign representatives' textual arguments. Notably, however, the opinion does not address former Section 304 of the Bankruptcy Code or the precedent cases that were persuasive in the proceeding below (but were not binding on the Court of Appeals). On appeal, the foreign representatives suggested that the purpose of Chapter 15 would be undermined by application of Section 109(a), but the court countered that none of the delineated purposes set forth in the express purpose section of Chapter 15 were dispositive to whether Section 109(a) applies, and so the clear language of the statute must control.[27] The Second Circuit nevertheless acknowledged that the Model Law contains no similar requirement,[28] and, perhaps as a result, in its order, took the rare step of directing the Clerk of the Court to forward copies of the opinion to Congress.

The foreign representatives subsequently pursued discovery against Drawbridge outside Chapter 15, under 28 U.S.C. 1782.[29] 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 US counsel with a $10,000 retainer. Following this and over 18 months after Octaviar's first Chapter 15 case was filed, the foreign representatives refiled Octaviar's Chapter 15 case (creating a 'Chapter 30', perhaps the first in US history).[30]

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.[31]

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25 Id. at *14.

26 *In re Barnet*, 737 F.3d at 247. The court reached this holding after finding that Drawbridge had standing to appeal the discovery order entered in the bankruptcy case; that appeal brought up for review the recognition order. Id. at 243.

27 Id. at 250–51.

28 Id. at 251.

29 This statute is entitled 'Assistance to foreign and international tribunals and to litigants before such tribunals' and allows for district courts to order a person to give testimony, a statement or produce a document for use in a proceeding in a foreign or international tribunal.

30 *In re Octaviar Admin. Pty. Ltd.*, Case No. 14-10438 (SCC) (Bankr. S.D.N.Y. 27 February 2014), ECF No. 1.

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

This holding runs somewhat counter to the holding in *In re Fairfield Sentry Ltd*,[32] by a different bankruptcy judge in the Southern District of New York (the same court as the *Octaviar* case) the previous year. 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.[33] Nevertheless, the *Octaviar* court found that the flexible test employed 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.[34] In *Octaviar*, the claims were asserted under US 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 from those in related actions in Australia, and the US courts had both personal and subject matter jurisdiction.[35]

The *Octaviar* 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.[36] Drawbridge argued that depositing the retainer constituted a 'bad-faith attempt to "manufacture eligibility"' to file for Chapter 15.[37] The court found that Octaviar had acted in good faith and that, '[i]n any event, as the Second Circuit emphasised 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'.[38] Furthermore, the imposition of a requirement that the property be 'substantial' would 'subvert the intent of Congress and the plain meaning of the statute'.[39]

The state court action is currently stayed by stipulation of both parties pending the final disposition of the federal action.[40] The substantive litigation is proceeding in the

32 *In re Fairfield Sentry Ltd.*, 484 B.R. 615 (Bankr. S.D.N.Y. 2013). This is a different *Fairfield Sentry* decision from the one that the bankruptcy court cited in the first Chapter 15 proceeding in support of recognition.

33 Id. at 623.

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

35 Id. at 372.

36 Id.

37 Id.

38 Id. at 373.

39 Id.

40 *Katherine Elizabeth Barnet and William John Fletcher, as Liquidators of Octaviar Admin. Pty. Ltd. (in Liquidation) v. Drawbridge Special Opportunities Fund, LP*, Sup. Ct., NY County, Index No. 650656/14 (1st Dep't 2014).

District Court for the Southern District of New York.[41] On 20 June 2014, Drawbridge filed a motion to dismiss the litigation.[42] Motion practice is ongoing as of this writing.

II BEMARMARA

Mere days after the Second Circuit's *Barnet* decision, the bankruptcy court for the District of Delaware faced the same question of whether Section 109(a) applied to eligibility for a Chapter 15 case and concluded, contrary to *Barnet*, that it did not.[43] On 22 August 2012, Bemarmara Consulting a.s. (Bemarmara), a company specialising in the manufacture of welded steel structures, facilities and machine parts, filed a voluntary insolvency petition under the Czech Insolvency Act. The County Court in Prague, Czech Republic announced the commencement of Bemarmara's insolvency proceedings the following day.

In May of 2009, more than four years before the commencement of Bemarmara's Czech insolvency proceedings, Terex USA, LLC (Terex), a customer of Bemarmara, commenced an action in the federal district court in Delaware against Bemarmara. The action sought a declaratory judgment with respect to various contract and warranty claims. Following an unsuccessful attempt at mediation, Terex filed a motion seeking sanctions (related to Bemarmara's failure to respond to requests for depositions) and entry of a default judgment against Bemarmara. Separately, Terex filed a claim in Bemarmara's Czech proceeding for $26 million.

On 15 November 2013, the foreign representatives of Bemarmara filed for Chapter 15 relief and sought provisional relief staying the Terex action.[44] Terex objected to recognition of Bemarmara's Czech insolvency proceedings on the grounds that Bemarmara had no assets, employees or operations in the United States. In fact, Bemarmara had no US creditors other than Terex and no pending litigation in the United States other than the Terex action.

The Delaware bankruptcy granted recognition to Bemarmara's Czech proceeding and stated, rather bluntly, that '[t]he decision of the Second Circuit [in *Octaviar*] is not controlling in this Court. And this Court does not agree with the decision of the Second Circuit'.[45] Rather, the Delaware bankruptcy court held that '[i]n the absence of a finding that the motion for recognition is manifestly contrary to public policy, recognition is mandatory in aid of the main proceeding'.[46] Further, the court held that this public policy exception should be 'narrowly construed' and invoked only under 'exceptional

41 See *Katherine Elizabeth Barnet and William John Fletcher, as Liquidators of Octaviar Admin. Pty. Ltd. (in Liquidation) v. Drawbridge Special Opportunities Fund, LP*, Case No. 14-1376 (PKC) (S.D.N.Y. 2014).

42 Id. ECF. No. 31 (20 June 2014).

43 *In re Bemarmara Consulting a.s.*, Case No. 13-13037 (KG) (Bankr. D. Del. 17 December 2013) ECF. No. 38.

44 *In re Bemarmara Consulting a.s.*, ECF. No. 1.

45 *In re Bemarmara Consulting a.s.*, ECF. No. 38 at *8.

46 Id. at *6-7.

circumstances'.[47] With respect to the textual argument upon which the Second Circuit based its decision in *Octaviar*, the Delaware bankruptcy court postulated that perhaps the failure to carve Chapter 15 out from Section 109(a)'s requirement that a debtor have assets in the United States was a 'scrivener's error' and that the 'intent was that 109(a) not apply'.[48] The court pointed to the language of Section 1502, which has no requirement that a Chapter 15 'debtor' have assets in the United States, and found that the Section 1502 definition of 'debtor' should apply.

III THE MODEL LAW

Because the 'assets in the United States' requirement in Section 109(a) requires only *de mimimis* assets, the perceived hurdle the *Octaviar* decision created with respect to a foreign debtor's access to a US bankruptcy court in the Second Circuit is easily overcome – as it was, ultimately, by Octaviar itself. Nevertheless, the split between the Second Circuit and the Delaware bankruptcy court (which sits in the Third Circuit) is important because it demonstrates how US courts are still grappling with integration of the Model Law into the US bankruptcy system. While it makes sense that the Bankruptcy Code would contain a requirement that a company filing a plenary bankruptcy proceeding under the Bankruptcy Code (under Chapter 7 or Chapter 11) have a property-based connection to the United States, as required by Section 109(a), such a requirement makes little sense for a foreign company seeking to use Chapter 15 merely to support its foreign main proceeding. It is also likely to be inconsistent with what the drafters of the Model Law intended, especially because an ancillary foreign proceeding could be necessary or useful to support a debtor's main proceeding even if the debtor does not have property in the non-main jurisdiction.

UNCITRAL has produced and issued a text intended to provide guidance to judges in foreign jurisdictions in interpreting the Model Law (the Judicial Perspective).[49] One of the issues recognised by UNCITRAL in the Judicial Perspective was that '[i]n some circumstances, it might be argued that a particular entity administered by a "foreign representative" is not a "debtor" for the purposes of the domestic law to be applied by the receiving court'.[50] In response to this potential issue, the Judicial Perspective points to the case of *Rubin v. Eurofinance*,[51] in which it was argued that because the debtor in the US plenary proceeding was a 'business trust', which is not a recognised entity under English law, the debtor could not be recognised as a 'debtor' under English law. The English court rejected this argument 'holding that, having regard to the international origins of the UNCITRAL Model Law, a "parochial interpretation" of the term "debtor" would

47 Id. at *7.

48 Id. at *9.

49 'UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective' (Updated 2013), available at www.uncitral.org/pdf/english/texts/insolven/V1188129-Judicial_Perspective_ebook-E.pdf.

50 Id. at 12.

51 Id. at 11.

be "perverse"'.[52] Though not a directly analogous situation, the message is similar. Once a valid plenary proceeding exists, access to the ancillary court to assist with the plenary proceeding is viewed as critical.

IV CHAPTER 15

The legislative history of Chapter 15 further supports the *Bemarmara* holding that the failure to carve Chapter 15 out of Section 109(a) may well have been a 'scrivener's error'. Chapter 15 largely adopts the Model Law verbatim, and the legislative history addresses the places where the language of Chapter 15 strays from that of the Model Law. One of these places is the addition of the definition of 'debtor' in Section 1502, which, as discussed above, appears to have been added largely for convenience.

Section 1508 of the Bankruptcy Code provides an interpretive guide to Chapter 15 and states that 'the court shall consider its international origin, and the need to promote an application of this Chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions'.[53] Further, the legislative history of Section 1508 provides that the interpretation of Chapter 15 is to be aided by the UNCITRAL Case Law on Uniform Texts because it will 'advance the crucial goal of uniformity of interpretation'.[54] With uniformity of interpretation with the Model Law as a stated goal of Chapter 15, it seems unlikely that Congress intended to exclude from Chapter 15 eligibility a whole category of foreign entities that the Model Law would otherwise protect.

V WHY THIS MATTERS

Filing an ancillary proceeding under Chapter 15 or any other insolvency law based on the Model Law may be necessary for companies even if they do not have business operations or property in the ancillary jurisdiction. This is because an ancillary proceeding can be helpful to stay local litigation, pursue claims or bind local creditors who may be outside the reach of the court overseeing the plenary proceeding. In multinational insolvencies based on the Model Law, claims are administered in the plenary proceeding, and the purpose of the ancillary proceeding is, among other things, to help enforce the treatment of local creditors as determined in the main proceedings. The ability to use an ancillary proceeding to ensure global enforcement of the outcome of the main proceeding is one of the principal purposes of the Model Law and this purpose is wholly independent of the location of the debtor's property.

52 Id., citing *Rubin v. Eurofinance*, [2009] EWHC 2129 (Eng.).

53 11 U.S.C. § 1508.

54 H.R. REP. 109-31, pt. 1, at *110 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 172-173.