

US Cooperation in Foreign Proceedings: Prepare to Welcome Chapter 15

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On 20 April 2005, President George W. Bush signed into law Bill S.256: 'The Bankruptcy Abuse Prevention & Consumer Protection Act of 2005,' ushering in extensive reforms to the United States ('US') Bankruptcy Code. The legislation enacted was the product of years of protracted political wrangling stimulated by vociferous lobbying by divergent interests. While a good portion of the proposed reform legislation was (and remains) steeped in controversy, one section attracted little debate – new Chapter 15 ('Ancillary and Other Cross-Border Cases'),² which will replace current Bankruptcy Code Section 304 ('Cases Ancillary to Foreign Proceedings') with an expanded substantive and procedural mechanism.

Adding an entire chapter to the US Bankruptcy Code – as opposed to amending or adding a section – is rare and significant. Despite this, Chapter 15 passed through the thorny political process with little fanfare, in part because the topic it addresses is of interest and import, at least at this juncture, to a narrow segment of those who currently interface with the US Bankruptcy Code. The ease with which Chapter 15 sailed through the system to become law, however, does not ensure that its application and implementation will proceed without incident, controversy and dispute. Thus, while Chapter 15 clearly was intended to assure greater certainty in cross-border proceedings, it remains to be seen how expensive and lengthy the process of attaining such certainty will prove to be.

Like the majority of the 2005 Act, Chapter 15 does not become effective until 17 October 2005 and will only apply to cases commenced on or after that date.

Later this year, *International Corporate Rescue* will publish a comprehensive analysis of the new US bankruptcy legislation, including Chapter 15. In the interim, the following is designed to briefly introduce readers to the altered US mechanism respecting proceedings affecting more than one nation and to note a few of the challenges it may present.

What is Chapter 15?

Chapter 15 incorporates into the US Bankruptcy Code the Model Law on Cross-Border Insolvency (the 'Model Law') formulated by the United Nations Commission on International Trade Law ('UNCITRAL') in 1997.³ The UNCITRAL Model Law was the result of more than three years of meticulous deliberations by representatives of official UN member countries in consultation with experts on international insolvency law drawn from multinational institutions such as the International Monetary Fund and the World Bank and from international non-governmental organizations such as INSOL International, the International Bar Association and the Group of 30.

Chapter 15 largely tracks the UNCITRAL Model Law, following its language and section numbering in most instances, but with certain additions and alterations required to adapt it to unique aspects of US law. Chapter 15's purpose is articulated in section 1501(a) of the US Bankruptcy Code:

§1501(a) The purpose of this chapter is to incorporate the Model Law on Cross-Border Insolvency so

Notes

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- 2 The US Bankruptcy Code is set forth in Title 11 of the United States Code, 11 U.S.C. §§ 101 et seq. New Chapter 15 of the US Bankruptcy Code is contained in 11 U.S.C. §§ 1501 through 1532.
- 3 Bound copies of the UNCITRAL Model Law and its accompanying Guide to Enactment (United Nations Publication Sales No. E.99.V.3, ISBN 92-1-133608-2) may be obtained through the United Nations publications office, <www.un.org>. The text of the Model Law and Guide also may be downloaded from the UNCITRAL website, <www.uncitral.org>.

as to provide effective mechanisms for dealing with cases of cross-border insolvency with the objectives of –

- (1) cooperation between –
 - (A) United States courts, United States trustees, trustees, examiners, debtors, and debtors in possession; and
 - (B) the courts and other competent authorities of foreign⁴ countries involved in cross-border insolvency cases;
- (2) greater legal certainty for trade and investment;
- (3) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor;
- (4) protection and maximization of the value of the debtor's assets; and
- (5) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

The scope and applicability of Chapter 15

To a significant extent, the development of the UNCITRAL Model Law drew on the principles underlying US Bankruptcy Code Section 304. Accordingly, those principles remain reflected in new US Chapter 15. However, Chapter 15 goes beyond Section 304 both with respect to the types of proceedings it is intended to facilitate and the range of relief available.

Unlike Section 304, the prescriptions and proscriptions of Chapter 15 apply not only where a foreign court or foreign representative seeks assistance in the US ancillary to and in connection with a pending foreign proceeding, but also apply where:

- both a foreign proceeding and a plenary case under the US Bankruptcy Code are pending concurrently respecting the same debtor;
- creditors or other interested persons in a foreign country wish to request the commencement of a case or proceeding under the US Bankruptcy Code or to participate in such a case or proceeding; and
- assistance is sought in a foreign country in connection with a case pending under the US Bankruptcy Code. (11 U.S.C. § 1501(b))

Chapter 15 clarifies that foreign banks will not be eligible for relief if they have a branch or agency

within the United States. In contrast, foreign insurance companies doing business in the US are eligible for Chapter 15 relief, although US insurance regulators may petition the US court under Bankruptcy Code section 305 to abstain from recognizing such proceedings under appropriate circumstances. In addition, Chapter 15 prohibits the US Bankruptcy Court from granting relief under that Chapter respecting 'any deposit, escrow, trust fund, or other security required or permitted under any applicable State insurance law or regulation for the benefit of claim holders in the United States.' (11 U.S.C. § 1501(d))

How Chapter 15 differs from Section 304

Chapter 15 divides foreign proceedings for which assistance is sought into 'foreign main proceedings' – those pending in the country where the debtor has its 'center of main interests' – and 'foreign nonmain proceedings' – proceedings in a foreign country that are ancillary to a foreign 'main' proceeding. The US Bankruptcy Court is authorized by Chapter 15 to provide differing treatment and relief to foreign 'main' versus 'nonmain' proceedings.

Under Section 304, once a foreign proceeding was granted recognition, the relief available depended upon the subjective determination by the US Bankruptcy Court that granting the requested relief would satisfy certain specified criteria listed in Section 304(c). Thus, for example, the grant of an injunction against acts by creditors against the foreign debtor or its assets was discretionary.

In contrast, under Chapter 15, once a foreign 'main' proceeding has been granted recognition, the duly authorized foreign representative is eligible to obtain relief prescribed under Chapter 15, including the benefit of certain provisions of the US Bankruptcy Code beyond Chapter 15 such as the injunctive relief provided by the 'automatic stay' contained in US Bankruptcy Code Section 362, the power to use, sell or lease property of the debtor within the territorial jurisdiction of the US pursuant to US Bankruptcy Code Section 363, and the authority to continue to operate the foreign debtor's business in its ordinary course (11 U.S.C. § 1520(a)). In addition, the foreign main proceeding foreign representative may seek additional relief not only from the US Bankruptcy Court, but from other US State and Federal Courts as well.

This objective entitlement to relief, however, continues to remain subject to the subjective determination of the US Bankruptcy Court in certain circumstances, respecting which Section 304 remains 'alive and well.'

Notes

⁴ The term 'foreign' for purposes of this article is defined as 'non-United States.'

At the core, the US Bankruptcy Court retains the power to refuse to take an action otherwise authorized by Chapter 15 if that action ‘would be manifestly contrary to the public policy of the United States.’ (11 U.S.C. §1506). Moreover, if the U.S. Bankruptcy Court is asked to provide additional assistance beyond the relief expressly set forth in Chapter 15 – including assistance under other Bankruptcy Code sections or US Federal or State laws – the Bankruptcy Court is required to consider whether such additional assistance will, consistent with principles of comity, reasonably assure the five standards currently required by Section 304(c):

- (1) just treatment of all holders of claims against or interests in the debtor’s property;
- (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
- (3) prevention of preferential or fraudulent disposition of property of the debtor;
- (4) distribution of proceeds of the debtor’s property substantially in accordance with the order prescribed by [the Bankruptcy Code]; and
- (5) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns. (11 U.S.C. §1507)

Further discretion is granted the US court when it is asked to grant relief upon recognition of either a main or nonmain proceeding ‘where necessary to effectuate the purpose of [Chapter 15] and to protect the assets of the debtor or the interests of the creditors ...’ (11 U.S.C. §1521).

Moreover, pending recognition under Chapter 15, Section 1519 provides that, upon filing a petition for recognition, the foreign representative may seek limited ‘provisional’ or temporary relief, including stay of execution against and other preservation of the foreign debtor’s assets, if the US Court determines that appropriate cause for expeditious action is shown. However, in the case of a foreign main proceeding, Section 1519(c) provides that it is a ground for denial of provisional relief that granting such relief would interfere with the administration of the foreign main proceeding. It is unclear whether denial under Section 1519(c) is mandatory or discretionary. However, Section 1519(d) expressly prohibits the US court enjoining a policy or regulatory act of a governmental unit, including criminal action or proceeding.

Creditor protections

Chapter 15 explicitly provides that the US court may grant relief ‘*only if* the interests of creditors and other

interested entities, including the debtor, are sufficiently protected,’ and, in that regard, the court may condition relief granted as the court deems appropriate, including by requiring security or the filing of a bond (11 U.S.C. §1522).

Foreign creditors are more explicitly assured equality of treatment and due process by Chapter 15. Section 1513 expressly provides that foreign creditors have the same rights regarding the commencement of, and participation in, a case under the Bankruptcy Code as do domestic creditors and that their claims may not be treated differently solely because the claim holder is a foreign creditor. Moreover, section 1514 makes clear that foreign creditors must be given timely and adequate notice of the commencement of proceedings and critical deadlines for action which may affect their rights and, where necessary, must be provided additional time to comply with deadlines where reasonable under the circumstances.

While attempting to ensure equitable treatment of foreign creditors, Chapter 15 also includes provisions designed to protect the rights of US creditors. Notably, Section 1521 provides that the US court may, in its discretion, ‘entrust the distribution of all or a part of the debtor’s assets located in the US to the foreign representative ... *provided that* the court is satisfied that the interests of creditors in the United States are sufficiently protected.’

Finally, several sections within Chapter 15 seek to ensure that assets of the debtor in a foreign nonmain proceeding that are located within the US are not transferred to the foreign representative unless the US court is ‘satisfied’ that, under US law, the assets should be administered in the foreign nonmain proceeding and that their transfer would not impair creditors’ rights.

Cross-border cooperation at the core

Chapter 15 stresses cooperation and communication among courts and coordination of multiple proceedings. Indeed, Section 1508, entitled ‘Interpretation,’ instructs:

In interpreting this chapter, 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. (11 U.S.C. §1508)

Subchapter IV of Chapter 15 outlines the requisites of cooperation and direct communication between the US court, trustee or examiner and the foreign court or foreign representative. And Subchapter V of Chapter 15 mandates steps to be taken to coordinate proceedings respecting a single debtor commenced in more than one jurisdiction.

Challenges presented

At this juncture, Chapter 15 obviously is untested. As it travels from the hypothetical to practice, Chapter 15 is destined to spawn significant litigation and case law. It ventures into new and unexplored territory, far broader than the reach of Section 304. It introduces expanded areas of judicial discretion while simultaneously presenting courts ambiguous language to interpret.⁵ And it appears to leave unresolved critical issues respecting foreign debtor proceedings in the US that remain in dispute under Section 304, including, among others, whether a foreign debtor must be 'insolvent' or the subject of a foreign proceeding in

the nature of a US Chapter 11 reorganization to be eligible for protective relief from the US courts.⁶

Despite these impediments, Chapter 15 and its counterparts throughout the world are important evolutionary steps towards resolving the challenges presented by proceedings respecting companies in distress which impact multiple national jurisdictions. While the difficulties and disputes likely to be encountered in their application may serve to raise more issues than they resolve in the short term, these efforts, in the process, will enable enhanced cooperation, coordination and communication necessary to ultimately attain the greater certainty and predictability the international marketplace requires.

Notes

- 5 Despite the addition of definitions to assist in applying Chapter 15 (see, e.g., section 1502), phrases within those definitions in the view of many remain open to interpretation. For example, a 'foreign main proceeding' is defined in Section 1502(4) as 'a foreign proceeding pending in the country where the debtor has the center of its main interests.' Section 1516(c) provides that, in the absence of evidence to the contrary, the debtor's 'registered office, or habitual residence in the case of an individual, is presumed to be the center of the debtor's main interest.' Typically, presumptions under the Bankruptcy Code are deemed to be rebuttable. Accordingly, litigation may ensue respecting whether the foreign proceeding indeed is a 'main' or 'nonmain' proceeding. Similarly, a 'foreign nonmain proceeding' is defined in Section 1502(5) as 'a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment.' 'Establishment' is defined in Section 1502(2) as 'any place of operation where the debtor carries out a nontransitory economic activity.' The phrase 'nontransitory economic activity' is not defined anywhere in the Bankruptcy Code and, thus, remains open to subjective determination and a source of litigation.
- 6 See, generally, 'US Bankruptcy Cases Concerning Foreign Debtors: Evolving Parameters and Pitfalls,' (2005) 2(1) *International Corporate Rescue* 39.