Chapter 15 of the US Bankruptcy Code: Some Observations from a UK Perspective

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As readers will be aware from Selinda Melnik's article in the previous issue of this journal,[2] the US Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ('BAPCPA') will bring about substantial changes to the way that insolvency proceedings outside the United States will be recognized in the United States. These changes, enacted through the new Chapter 15 of the US Bankruptcy Code (the 'Bankruptcy Code') which comes into force on 17 October 2005, result from the incorporation of the UNCITRAL Model Law on Cross-Border Insolvency (the 'Model Law') into the Bankruptcy Code. Chapter 15 will replace section 304 of the Bankruptcy Code, which has assumed a vital place in the tool kit for dealing with non-US insolvencies and restructurings which have a US dimension. The purpose of this article is to consider, from a UK perspective, some of the challenges and opportunities which the move to Chapter 15 will present practitioners.

The new definition of 'foreign proceeding'

For the purposes of section 304 of the Bankruptcy Code, a 'foreign proceeding' was widely defined and included any:

> proceeding, whether judicial or administrative and whether or not under bankruptcy law ... for the purpose of liquidating an estate, adjusting debts by composition, extension or discharge, or effecting a reorganization.[3]

The definition of 'foreign proceeding' under Chapter 15 is narrower (tracking the definition in the Model Law) and encompasses only:

> collective judicial or administrative proceeding[s] ... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.[4]

The new requirement to have the assets and affairs of a debtor subject to court control or supervision could present a significant challenge for UK practitioners. Many debt restructurings in the UK are effected using schemes of arrangement or company voluntary arrangements (CVAs). A scheme of arrangement is a mechanism under which a debtor can effect a compromise with his creditors where a statutorily-defined majority of creditors votes in favour of such a compromise and the court sanctions the compromise, although it should be noted that the scheme of arrangement mechanism derives from UK corporate law (and indeed can be used to effect an arrangement with shareholders as well as with creditors) and not from UK bankruptcy/insolvency law. A CVA is an alternative mechanism (which does derive from UK bankruptcy/insolvency law) under which a debtor can make a compromise with his creditors where a statutorily-defined majority of creditors votes in favour of such a compromise (subject to a right for creditors to appeal to the court).[5]

A shared feature of schemes of arrangement and CVAs is that they can be proposed by debtors without those debtors ever entering into any formal UK insolvency proceeding (such as administration or liquidation); in many cases the restructuring terms are proposed by the directors (although they can of

Notes

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2 S. Melnik, 'US cooperation in foreign proceedings: prepare to welcome Chapter 15' (2005) 2 *International Corporate Rescue* 3.

3 Code §101 prior to amendment by BAPCPA.

4 §802(b) of BAPCPA.

5 There are important differences between schemes of arrangement and company voluntary arrangements; discussion of such differences is beyond the scope of this article.

course be proposed by administrators and liquidators). In most recent large UK restructurings, some (or indeed all) of the debt obligations to be restructured have been governed by New York law and many creditors and/or assets have been located in the US. It has therefore been regarded as crucial that these restructurings should be made binding in the US and this has been done by way of filings under section 304 of the Bankruptcy Code. Schemes and CVAs are clearly judicial or administrative proceedings for the purpose of adjusting debts or effecting a reorganization and so have readily fitted within the section 304 test for a 'foreign proceeding'.[6] Examples of UK restructurings implemented this way (and proposed by directors, rather than insolvency office holders) include Brunner Mond Group plc and Telewest Communications plc.

Whether director-proposed schemes of arrangement or CVAs will fall within the new Chapter 15 definition of 'foreign proceeding' is, however, much less clear. It seems hard to argue that either procedure provides for the assets and affairs of the debtor being 'subject to control or supervision' by the court, certainly when set against the level of control and supervision that would apply to a debtor subject to Chapter 11 proceedings or a debtor to whom a UK liquidator or administrator had been appointed. Whilst the court has to sanction a scheme of arrangement, this sanction is principally to ensure the fairness of the terms of the restructuring to minority creditors; it is not to control or supervise the debtor's assets and business. In the case of a CVA, a nominee must be appointed but his statutory role is to supervise the implementation of the CVA itself; the nominee has no statutory remit to supervise the debtor's assets or affairs. On the face of it, director-proposed schemes and CVAs may well fall outside the Chapter 15 definition of 'foreign proceeding'.

Of course it is perfectly possible for a debtor to enter into an insolvency proceeding and for the relevant insolvency office holder to propose a scheme or a CVA. But there are often very good reasons why a formal insolvency proceeding is best avoided by a debtor; for example, the appointment of an insolvency office holder is usually much more likely to trigger termination rights in contracts and if those contracts are valuable then this will be an outcome that the debtor and its stakeholders will want to avoid. In the absence of some quite liberal and creative US judicial interpretation, debtors in the UK (and other like jurisdictions) may therefore be faced with an unenviable choice: proceed with a restructuring that they might not be able to have recognized in the United States or proceed with a restructuring that will be recognized but risk the destruction of value. The new definition of 'foreign proceeding' could present real structuring challenges for UK practitioners.

Main and nonmain proceedings

As corporate activities have become increasingly global, so have insolvency proceedings and multiple proceedings in respect of any one debtor are not uncommon. Chapter 15 recognizes, as does the Model Law and the EC Regulation on Insolvency Proceedings 2000 (the 'EC Regulation') that, where there are multiple proceedings in relation to a debtor, one of those proceedings should be regarded as the principal proceeding (the 'main proceeding') while other proceedings should be regarded as secondary and subordinate proceedings ('nonmain proceedings'). It appears that Chapter 15 intends that when a US bankruptcy court grants recognition of a foreign proceeding it will have to make a decision as to whether that proceeding is main or nonmain. As with the Model Law and the EC Regulation, the main proceeding for the purposes of Chapter 15 will be the proceeding pending in the country where the debtor's centre of main interests ('COMI') is located. All other proceedings in countries where the debtor has an establishment will be nonmain proceedings. In common with the EC Regulation, Chapter 15 contains a presumption that a debtor's COMI will be located in the same place as its registered office[7]. As with the EU Regulation, this is a presumption that can be rebutted.

The issue of where a debtor's COMI is to be found is a highly topical and contentious one. Practitioners in Europe are hopeful that the dispute between Dr Bondi, the Italian insolvency administrator of Parmalat, and the creditors of Eurofood IFSC Limited (an Irish subsidiary of Parmalat), which is currently before the European Court of Justice ('ECJ') for determination,[8] will clarify this issue as far as European law is concerned. In that case the ECJ is faced with a choice in deciding how COMI is to be determined: is it where the centre of operations is located or is it where the 'mind of management' resides? The great danger for practitioners is that the view of the US courts as to how COMI is to be determined will differ from that of the ECJ, particularly given that common law and civil law approaches are often not easily reconciled.

Notes

6 See for example *In re Board of Directors of Hopewell Inter'l Ins. Ltd 238 B.R. 25 (Bankr. SDNY 1999)* and *275 B.R. 699 (SDNY 2002)* in relation to a scheme of arrangement under Bermudian corporate law, which is a virtually identical procedure to a UK scheme.

7 Code §1516(c) after amendment by BAPCPA.

8 Case C-341/04 of the Court of Justice of the European Communities, *Enrico Bondi v Bank of America N.A. and others.*

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An example of the chaos that could result from this danger can readily be drawn from the Eurofood example. In that case, there are competing insolvency proceedings for the debtor in Ireland and in Italy, with the Irish Supreme Court finding (subject to the guidance of the ECJ) that, even if main proceedings for the debtor had properly been opened in Italy, the Irish courts were entitled not to recognize them for reasons of public policy (due to defects in procedure in Italy that deprived the Irish provisional liquidator of the debtor of the opportunity to be properly heard in the Italian proceedings). Imagine if both the Italian and the Irish office holders approached the US courts for recognition. How would the US courts decide which of the two is the main proceeding, particularly if US jurisprudence favours a finding at odds with European jurisprudence? How could the estate of a debtor sensibly be managed if the US and European courts were at odds as to which proceeding should be regarded as the main proceeding? It is to be hoped that courts will be able to ensure some consistency in this matter regardless of their varying jurisprudential heritages, but practitioners will not be able to take this for granted.

A smoother path to recognition

One of the advantages of Chapter 15 over section 304 is that the process of obtaining recognition should be more straightforward. Whilst the documentary burden on a foreign representative seeking recognition under section 304 can be significant, under Chapter 15 a foreign representative will only need to provide a certified copy of the order commencing the foreign proceeding and appointing the foreign representative and a certificate from the foreign court confirming such commencement and appointment with his petition.[9] Thereafter, assuming the petition is procedurally in order, an order of the US court granting recognition can only be denied if such action 'would be manifestly contrary to the public policy of the United States'. Clearly, this is a high hurdle to get over for anyone seeking to object to recognition and is a significant improvement for foreign representatives over the more discretionary position under section 304(c) (which required the court to be guided by considerations of comity in deciding whether or not to grant relief). Additionally, once recognition has been granted, a significant degree of relief will apply automatically to the debtor. This will include the application of the Bankruptcy Code's automatic stay to the debtor and its property to the extent they are subject to US territorial jurisdiction.[10] This is a significant advantage over the position under section 304 which requires relief to be particularized and requested of the court.

Maintaining section 304's flexibility

One of the great advantages of section 304 for foreign representatives has been the latitude and discretion it has given to the US courts to fashion relief on an ad hoc basis and without prescriptive limits. One example of this is the way in which section 304 has been used to provide relief to subsidiaries and affiliates of a debtor where those subsidiaries or affiliates have not themselves been the subject of foreign insolvency proceedings.[11] US legislators have sought to preserve this flexibility: section 1507 of Chapter 15 allows the US courts to grant 'additional assistance' to foreign representatives. In order to obtain this assistance a foreign representative will have to follow substantially the same procedure that he would have followed when filing a petition under section 304 (i.e. satisfying comity considerations) but this added burden will allow him to try to avail himself of the reliefs and remedies built up by the US courts through the years of operating section 304. From a UK perspective, it is pleasing to see that the extensive jurisprudence that has developed under section 304(c) to craft appropriate relief should still be available for use by debtors.

Protocols

One of the key innovations that has come about with the increasingly cross-border nature of restructurings and insolvencies has been the development of judicial protocols between courts of different countries to regulate how they will interact with each other in relation to a debtor.[12] Protocols undoubtedly assist in the efficient management of a large insolvency but their jurisprudential basis has, in many countries, been somewhat fraught. Sections 1525 to 1527 of Chapter 15 specifically permit the US bankruptcy courts to enter into protocols and this too is to be welcomed from a UK perspective since it provides greater certainty and flexibility for foreign debtors.

Notes

9 Code §1515 after amendment by BAPCPA.

10 Code §1520(a) after amendment by BAPCPA.

11 See for example *In re Corporación Durango*, Case No. 04-13487 (RDD), *In re Parmalat Finanziaria S.p.A.*, Case No. 04-14268 (RDD) and *In re Northern Offshore Ltd*, Case No. 05-B-41451(SMB).

12 Examples of US/UK protocols include *In re Maxwell Communications Corporation plc*, Case No. 91-B-15741 (TLB) and *In re Federal-Mogul Global Inc., T&N Limited et al.*, Case No. 01-10578 (SLR).

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Conclusion

US legislators have demonstrated their willingness to enhance cross-border co-operation in insolvency-related proceedings by incorporating the Model Law into the Bankruptcy Code through the enactment of Chapter 15. In so doing, they have stolen a march on the UK and other developed economies; the UK is expected to follow suit in Spring 2006 but this is some six years after Parliament first provided a legislative means to implement the Model Law in the Insolvency Act 2000. Chapter 15 appears to provide some significant benefits to debtors and practitioners in the UK but, at the same time, it presents them with a number of challenges, particularly when set against the familiar position under section 304. Practitioners will doubtless have some fraught, but interesting, experiences in the near future as Chapter 15's capabilities and limits are explored.

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