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Bankruptcy Tourism: How a COMI Change Can Serve as Ammunition in Debt Wars

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Introduction

In general, Chapter 15 of title 11 of the United States Code (the "Bankruptcy Code") provides a mechanism to recognize a "foreign proceeding." Upon recognition of a foreign proceeding, the foreign representative will be allowed to sue and be sued in the United States.[1] However, Chapter 15 distinguishes between "foreign main proceedings" and "foreign nonmain proceedings."[2] Upon recognition of a "foreign main proceeding" section 1520 of the Bankruptcy Code provides for certain automatic relief, including an automatic stay of proceedings against the debtor in the United States.[3] There is no automatic relief conferred upon recognition of a foreign nonmain proceeding.[4] Nevertheless, a court may grant substantially the same relief in connection with a foreign nonmain proceeding.[5] However, recognition is not a "rubber stamp exercise" and

[1] *See* 11 U.S.C. § 1509(b)(1), (b)(2) (2012).
[2] 11 U.S.C. § 1517(a)(1).
[3] *See* 11 U.S.C. §1520.
[4] *See In re* SPhinX Ltd., 371 B.R. 103, 115 (Bankr. S.D.N.Y. 2007).
[5] *See* 11 U.S.C. § 1521(a) ("Upon recognition of a foreign proceeding, whether main or nonmain, where necessary to effectuate the purpose of this chapter [Chapter 15] and to protect the assets of the debtor or the interests of the creditors, the court may… grant any appropriate relief.").

the foreign representative bears the burden of proving the debtor meets the requirements for recognition under section 1517.[6]

Under section 1517 of the Bankruptcy Code, a bankruptcy court must recognize a foreign proceeding if certain requirements are met. Section 1517(a) states that subject to the section 1506 public policy exception, a foreign proceeding shall be recognized if it meets three requirements: (1) the proceeding is a foreign main or nonmain proceeding within the meaning of section 1502, (2) the foreign representative applying for recognition is a person or body, and (3) the petition meets the requirements of section 1515.[7] Section 1502(5) defines foreign nonmain proceeding as "a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment."[8] Foreign main proceeding is defined as "a foreign proceeding pending in the country where the debtor has the center of its main interests."[9] Therefore, in order to gain recognition as a foreign main proceeding, a debtor must prove that its center of main interests ("COMI") is the same place in which the proceeding is pending.

Thus, COMI is the essential element in determining whether a foreign proceeding is a foreign main proceeding. This memorandum discusses the way courts analyze a debtor's COMI shift within recognition proceedings. Part I examines the factors a court will consider in determining a debtor's COMI. Part II discusses recent cases in which the debtor shifted its COMI from its historical location to a new location on the eve of the Chapter 15 filing.

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[6] *In re* Creative Fin. Ltd., 543 B.R. 498, 514 (Bankr. S.D.N.Y. 2016) (quoting *In re* Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 389 B.R. 325, 335 (Bankr. S.D.N.Y. 2008)).
[7] *See* 11 U.S.C. § 1517(a).
[8] 11 U.S.C. § 1502(5).
[9] 11 U.S.C. §1517(b)(1); 11 U.S.C. §1502(4).

I. Establishing that COMI is in the Place where the Court Proceeding is Pending

A. *The Rebuttable Presumption is the Court's Starting Point*

The Bankruptcy Code does not define COMI, however, section 1516(c) provides courts with a starting point. Section 1516(c) provides in part that "[i]n the absence of evidence to the contrary, the debtor's registered office…is presumed to be the center of the debtor's main interests."[10] To determine the debtor's COMI, courts may consider the §1516 presumption, but are required to make an independent determination.[11] This independent inquiry is supported by the legislative history of section 1516(c), which explains, "the presumption…is included for speed and convenience of proof where there is no serious controversy."[12] Therefore, because COMI is not statutorily defined, courts are free to consider relevant factors depending on the facts and circumstances of each case.[13]

B. *Courts Have Developed Factor-Based Analyses for this Judicial Inquiry*

Factors that may be considered in a COMI analysis include: (1) the location of the debtor's headquarters; (2) the location of those who actually manage the debtor; (3) the location of the debtor's primary assets; (4) the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case; and (5) the jurisdiction whose law would apply to most disputes.[14]

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[10] 11 U.S.C. § 1516(c).
[11] *See In re* Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122, 126, 128 (Bankr. S.D.N.Y. 2007) ("This presumption is not a preferred alternative where there is a separation between a corporation's jurisdiction of incorporation and its real seat.").
[12] H.R. REP NO. 109-31, 1516 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 175.
[13] *See In re* Oi Brasil Holdings Cooperatief U.A., 578 B.R. 169, 195 (Bankr. S.D.N.Y. 2017).
[14] *In re SPhinX Ltd.*, 351 B.R. at 117. These factors are to be treated as a "helpful guide," and none are exclusive nor dispositive. *In re Ocean Rig UDW Inc.,* 570 B.R. 687, 703 (Bankr. S.D.N.Y. 2017) (quoting *In re Fairfield Sentry Ltd*., 714 F.3d 127, 137 (2d Cir. 2013)).

Additionally, a court may examine whether a "chapter 15 debtor's COMI would have been ascertainable to interested third parties."[15] This inquiry is derived from the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency (the "UNCITRAL Guide").[16] International sources such as the UNCITRAL Guide may be considered in a court's COMI analysis.[17] Relevant in this inquiry is whether the debtor's COMI is regular and ascertainable through the lens of "the public domain."[18] Therefore, the debtor is required to conduct some actual activity in the place in which it is claiming its COMI lies. The analysis aims to protect against COMI manipulation, presuming that a COMI that is "regular and ascertainable is not easily subject to tactical removal."[19]

C. *The Relevant Time Period is the Chapter 15 Petition Filing, Subject to a Good Faith Inquiry*

To adequately assess a debtor's COMI, a court must choose a point in time in the debtor's operations in which to evaluate the factors. In some cases, the court's choice in timing could change the results completely.[20] The Court of Appeals for the Second Circuit, in *In re Fairfield Sentry*, held that the "debtor's COMI is determined as of the time of the filing of the Chapter 15 petition."[21]

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[15] *In re* Fairfield Sentry Ltd., 714 F.3d 127, 136 (2d Cir. 2013); *see also In re* Millennium Glob. Emerging Credit Master Fund Ltd., 458 B.R. 63, 72 (Bankr. S.D.N.Y. 2011), aff'd 474 B.R. 88 (Bankr. S.D.N.Y. 2012) ("Courts also take into consideration expectations of creditors and other interested third parties.").
[16] *See In re* Fairfield Sentry, 714 F.3d at 136.
[17] *See* 11 U.S.C. § 1508; *see also In re* Fairfield Sentry, 714 F.3d at 132 *quoting* H.R. REP No. 109–31, 106 n.101 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88 (discussing the indication in the legislative history of Chapter 15, that the UNCITRAL guide should be used "for guidance as to the meaning and purpose of [Chapter 15's] provisions").
[18] *In re Fairfield Sentry*, 714 F.3d at 137 (discussing international case law concerned with a "letterbox company not carrying out any business in the territory of the Member State in which its registered office is situated.").
[19] *Id*.
[20] *See In re* Ran, 607 F.3d 1017, 1025 2015 (5th Cir. 2010) ("In fact … an inquiry into the debtor's past interests could lead to a denial of recognition in a country where a debtor's interests are truly centered, merely because he conducted past activities in a country at some point well before the petition for recognition was sought.").
[21] 714 F.3d at 133, 137.

Prior to the *In re Fairfield Sentry decision*, some courts in the Second Circuit chose to evaluate COMI by examining earlier activities in the debtors' operations.[22] This approach considered the COMI to be static once the foreign proceeding began, thus a COMI shift in many instances would not be considered.[23] After the *In re Fairfield Sentry* decision, Second Circuit courts are required to evaluate COMI based on the debtor's activities "at or around the time the Chapter 15 petition is filed."[24]

This approach to timing is followed by a majority of federal courts outside of the Second Circuit.[25] Specifically, in *In re Ran* the Fifth Circuit opined on the timing issue.[26] However, both the Fifth and Second Circuits have raised concerns about the potential for bad faith manipulation in cases where the COMI shift was undertaken near the time of the Chapter 15 filing.[27] Therefore, the *Fairfield Sentry* court was cognizant of the potential for manipulation under its decision.

The *Fairfield Sentry* court recognized the need for flexibility in the application of the new timing rule, stating, "the relevant time period is the time of the Chapter 15 petition, subject to an inquiry into whether the process has been manipulated."[28] While the Second Circuit did not define the parameters of this inquiry, possible indications of bad faith were identified. These potential bad faith activities support a denial of recognition and include: "insider exploitation,

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[22] *See In re* Millennium Glob., 458 B.R. at 72 ("[T]he date for determining an entity's place of business refers to the business of the entity before it was placed into liquidation").
[23] *See In re* Millennium Glob., 474 B.R. 88, 92 (Bankr. S.D.N.Y. 2012) ("COMI should be determined as of the date of the commencement of the foreign proceeding, rather than—as most of the courts that have looked at the issue have concluded—the date on which the Chapter 15 petition was filed.").
[24] *In re* Fairfield Sentry, 714 F.3d at 137.
[25] *See Id*. at 135 ("Most courts in this Circuit and throughout the country appear to have examined a debtor's COMI as of the time of the Chapter 15 petition.").
[26] *See* 607 F.3d at 1025. ("Congress's choice to use the present tense requires courts to view the COMI determination in the present, i.e., at the time the petition for recognition was filed.").
[27] *See In re* Fairfield Sentry, 714 F.3d at 135 ("The Fifth Circuit left open the possibility (albeit in dicta) of looking at a broader time frame in order to frustrate possible bad-faith COMI manipulation.").
[28] *Id*. at 130; see also *In re* Creative Fin. Ltd., 543 B.R. at 519 (discussing the importance of this judicial inquiry) ("That caveat was important enough to get across that the *Fairfield Sentry* court mentioned it, one way or another, *seven times*.").

untoward manipulation, [and] overt thwarting of third party expectations."[29] Thus, when a debtor's COMI shifted prior to the Chapter 15 filing, "courts may engage in a more holistic analysis to ensure that the debtor has not manipulated COMI in bad faith."[30] In cases subsequent to the *Fairfield Sentry* decision, courts have undertaken in-depth analyses using the factors and bad faith inquiries. As a result, recognition proceedings in cases with recent COMI shifts are fact sensitive determinations.

II. *In re Fairfield*'s Progeny: COMI Shift Case law

A. *Circumstances in which the COMI Shift Satisfied the Court's Inquiry*

Courts are likely to deem a COMI shift legitimate when the debtor conducts some activity in the new COMI and has a good faith purpose for the shift. In *In re Ocean Rig*, the court found the debtors' COMI shift to be legitimate based on the debtors' level of activity and business purpose for the shift.[31] *In re Ocean Rig* involved debtors that filed a Chapter 15 petition for recognition of Cayman Island proceedings.[32] To gain recognition the debtors proved their COMI had shifted to the Cayman Islands where the proceedings were taking place.[33] Approximately a year before the proceedings, the debtors began shifting their COMI to the Cayman Islands from their historical location in the Republic of the Marshall Islands ("RMI").[34] The court found the various activities of the petitioners prior to their chapter 15 filing sufficient to prove the COMI shift.[35] These activities included: (1) their incorporation in the Cayman Islands; (2) the hosting of meetings with creditors and advisors in the Cayman Islands; (3) the specific notice of relocation provided to business associates and creditors; (4) the public notice

[29] *In re* Ocean Rig UDW Inc., 570 B.R. at 706–707 *quoting In re* Fairfield Sentry Ltd., 440 B.R. 60, 66 (Bankr. S.D.N.Y. 2010).
[30] *See In re* Ocean Rig, 570 B.R. at 704.
[31] *See* 570 B.R. at 704–705.
[32] *See id*. at 689.
[33] *See id*. at 696.
[34] *See id*.
[35] *See id*. at 704–705.

that was provided in both press releases and in Securities and Exchange Commission forms; and (5) the active management of the companies in the Cayman Islands, including regular meetings and day to day business operations.[36]

Additionally, the court determined the COMI shift to be done for a "legitimate, good faith purpose."[37] The shift was undertaken because the RMI, the debtors' initial COMI, had not yet adopted a bankruptcy law or other insolvency statute.[38] Therefore, "any insolvency process in the RMI would invariably result in a value-destroying liquidation process."[39] In order to avoid this outcome, the debtors COMI shift was done to "maximize value for their creditors and preserve their assets."[40] The court found these reasons to be legitimate, good faith purposes for a COMI shift.[41] Thus, a COMI shift may be legitimate when a debtor articulates a good faith purpose for the shift and no evidence to the contrary is presented.

Similarly, in *In re SunTech Power Holdings Co., Ltd.,* the court found the debtor's COMI to be the Cayman Islands, despite objections that alleged bad faith manipulation.[42] The court inquired into the liquidators' activities to ensure the COMI was not manipulated in bad faith.[43] The liquidation activities the court focused on included: (1) transferring of stock certificates, shareholder registries, and statutory records to the Cayman Islands; (2) opening the debtor's only Cayman Island Bank account, solely for the payment of professional fees; (3) appointing a director who resided in the Cayman Islands; and (4) holding one board meeting in the Cayman Islands.[44] Notwithstanding the objector's contentions that these activities were only undertaken

[36] *See id.*
[37] *Id*. at 707.
[38] *See id.*
[39] *Id*.
[40] *Id*.
[41] *See id.*
[42] *See* 520 B.R. 399, 419 (Bankr. S.D.N.Y. 2014).
[43] *See id*.
[44] *See id*.

to improve the prospects for obtaining chapter 15 relief, the court found that no bad faith COMI manipulation occurred.[45] The activities were found to be valid because they were consistent with the liquidators' duties, they "served a legitimate business purpose" and were convenient.[46] In both instances, the debtors' activities proved substantial enough to shift their COMI.

B. *Circumstances in which the Court was Not Satisfied with the Shift*

(1) Inadequate Activity under the Factor Test: *In re Creative Finance*

In some circumstances, even when debtors have satisfied statutory requirements, minimal management or business activity may not be enough to satisfy the court's independent inquiry. In *In re Creative Finance, Ltd.*, the court determined that the debtors failed to satisfy the section 1517(a)(1) statutory requirement for recognition.[47] *In re Creative Finance* involved debtors incorporated in the British Virgin Islands ("BVI"), yet much of their business was conducted elsewhere.[48] The debtors intended to establish the BVI as their COMI and initiate foreign proceedings to be recognized by a U.S. court.[49] The court determined recognition was still possible, despite the BVI being a "letterbox jurisdiction" where the debtors conducted none of their business.[50] However, the efforts of the debtor appointed liquidator "were so minimal" that the debtors' COMI never shifted to the BVI.[51] Here, the liquidator took minimal action required by the BVI statutes, such as: (1) completing administrative tasks; (2) providing notice of the BVI insolvency proceedings to relevant parties; (3) notifying creditors to file claims; (4) holding an initial creditor meeting; and (5) issuing formal 60-day reports.[52] Additionally, nothing was done

[45] *See id.* at 420.
[46] *Id*. at 419.
[47] *See* 543 B.R. at 501.
[48] *See id*. at 502.
[49] *See id.*
[50] *Id*. at 502.
[51] *See id*. at 511.
[52] *See id*. at 509.

to manage or liquidate the debtors aside from these minimal functions.[53] Thus, the court found the liquidator's activities to be insufficient management of the debtors to warrant a COMI shift from the place where business was actually conducted to their place of incorporation, the BVI.[54] Insufficient activity is not the only ground for denial of recognition; bad faith activity can also jeopardize a debtor's chances of recognition.

(2) Bad Faith: *In re Oi*

The Southern District's decision in *In re Oi* demonstrates the courts ability to deny recognition based on a bad faith COMI shift.[55] In *In re Oi*, creditors attempted to establish a COMI shift to the Netherlands, after a court had previously recognized the debtors' COMI as Brazil.[56] The court determined that a COMI shift had not occurred, in large part because of the creditors' bad faith activities.[57] Although creditors do not have the same duties or abilities to manipulate COMI as a debtor, the actions of one creditor, Auerilius, created a "disturbing picture."[58] In this case, an unhappy creditor "weaponized Chapter 15" to attack the Brazilian proceedings and the proposed plans.[59] The creditor's actions were inconsistent with and undermined the goals of Chapter 15.[60] Therefore, the court found bad faith COMI manipulation and accordingly denied recognition.[61] The *In re Oi* decision illustrates the consequences of actions taken in bad faith.

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[53] *See id*. at 508.
[54] *See id*. at 512, 520 ("[T]he Liquidator failed to do the basic things that can under normal circumstances cause a change in COMI–even in a liquidation.").
[55] *See* 578 B.R. at 244.
[56] *See id*. at 176.
[57] *See id*. at 243.
[58] *Id*. at 240.
[59] *Id*. at 242 (discussing the bad faith activities of Aurelius, such as: choosing to remain silent at prior recognition hearings in return for stipulations protecting the creditors authority to take further action overseas, and applying frequent and aggressive pressure to the Administrator to press Aurelius' agenda, among others).
[60] *See id*. at 242.
[61] *See id*. at 243.

Recently, the *Oi* court opined on the acts of Auerlius again, after the creditor petitioned the court to modify or vacate the discussion of their bad faith acts in the Southern District's initial decision.[62] The court declined the petitioners' request based on the finding that the court's discussion of Auerlius' acts were fair and accurate given the "robust evidentiary record" before the court.[63] Additionally, Auerlius filed for appeal on April 11, 2018.[64]

Conclusion

In recognition proceedings where a COMI shift occurred, the court's analysis is more fact sensitive. Courts may consider the debtor's activities in the non-historical COMI as of the time of the Chapter 15 filing using factor-based inquiries. Courts will likely find the COMI shift to be legitimate in cases where the debtor's activities meet the minimal requirements of the statute and were taken for a good faith business purpose.

[62] *See In re* Oi Brasil Holdings Cooperatief U.A., No. 17-11888 SHL, 2017 WL 1352690, at 2 (Bankr. S.D.N.Y. Mar. 14, 2018).
[63] *Id*. at 5.
[64] *See* Notice of Appeal at 2, *In re* Oi Brasil Holdings Cooperatief U.A., 578 B.R. 169 (Bankr. S.D.N.Y. 2017), No. 1:18 Civ. 03166 (April 11, 2018).