



## Second Circuit Sets a Low Bar for Foreign Debtors Seeking Chapter 15 Relief

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### Introduction

Continued globalization of trade and investment led Congress, through the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”), to amend the Bankruptcy Code (“the Code”) in 2005 to include chapter 15.<sup>1</sup> Chapter 15 adopted UNCITRAL’s Model Law on Cross-Border Insolvency<sup>2</sup> —both aim to guide parties through cross-border insolvency proceedings.<sup>3</sup> In addition to the policy objectives for all bankruptcies,<sup>4</sup> chapter 15 specifically aspires to foster cooperation between the United States and foreign countries involved in cross-border insolvency cases and promote greater legal certainty in global trade and investment.<sup>5</sup> A chapter 15 case is generally meant to supplement the plenary case brought in the debtor’s home country.<sup>6</sup> Among other situations,<sup>7</sup> Chapter 15 applies where “assistance is sought in the United States by a ... foreign representative in connection with a foreign proceeding.”<sup>8</sup>

<sup>1</sup> See 8-1501 Collier on Bankruptcy P 1501.01; see also Chapter 15 Overview: US Bankruptcy Cases Ancillary to Foreign Proceedings, Practical Law Practice Note 7-520-4512.

<sup>2</sup> 8-1501 Collier on Bankruptcy P 1501.01

<sup>3</sup> 8-1501 Collier on Bankruptcy P 1501.01

<sup>4</sup> Insert bankruptcy objectives from earlier chapters

<sup>5</sup> 11 U.S.C. 1501(a)(1), (2).

<sup>6</sup> 8-1501 Collier on Bankruptcy P 1501.01. However, in the absence of a foreign insolvency proceeding, a debtor may still file a plenary bankruptcy case in the US without filing a Chapter 15 case (but must meet the Code’s jurisdictional requirements). See Chapter 15 Overview: US Bankruptcy Cases Ancillary to Foreign Proceedings, Practical Law Practice Note 7-520-4512.

<sup>7</sup> See 11 U.S.C. 1501(b)(2)-(4)

<sup>8</sup> 11 U.S.C. 1501(b)(1)

This Article will discuss the steps necessary to commence a Chapter 15 case and the Second Circuit’s recent ruling requiring foreign debtors to meet the eligibility requirements of section 109(a). Part I-A will discuss how to commence a Chapter 15 case, focusing on obtaining recognition as a foreign main or non-main proceeding. Part 1-B will discuss recent rulings in the Second Circuit requiring debtors to meet an additional eligibility requirement in section 109(a). Part II will discuss the implications of these rulings by highlighting a possible circuit split between the Second and Third Circuits and the effect the second circuit rulings will have on future debtors.

## **I. COMMENCING A CHAPTER 15 CASE**

A Chapter 15 case is commenced when a foreign representative files a “petition for recognition of a foreign proceeding under §1515.”<sup>9</sup> To obtain bankruptcy relief in the U.S., a Chapter 15 debtor must demonstrate that “it is subject to a proceeding abroad that is entitled to ‘recognition’ in the U.S.”<sup>10</sup> Although filing a petition for recognition technically commences a chapter 15 case, much of the relief sought in Chapter 15 is unavailable until the recognition of the foreign proceeding is granted.<sup>11</sup> Under the Code, a foreign proceeding is defined as a “collective judicial or administrative proceeding in a foreign country ... under a law relating to insolvency ... 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.”<sup>12</sup>

### ***A. Recognition of a Foreign Proceeding***

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<sup>9</sup> See Alesia Ranney-Marinelli, “Overview of Chapter 15 Ancillary and Other Cross-Border Cases,” 82 Am. Bankr. L.J. 269, 280-81 (2008)

<sup>10</sup> A Bark Louder Than Its Bite Article from Sharfman (Norton)

<sup>11</sup> See Ranney-Marinelli, 82 Am. Bankr. L.J. 269, 280-81.

<sup>12</sup> 11 U.S.C 101(23).

Chapter 15 recognition of a foreign proceeding provides foreign debtors with especially important protections such as the automatic stay<sup>13</sup> that may be otherwise unavailable under applicable international insolvency laws.<sup>14</sup> In the U.S., Chapter 15 is the only option for a foreign representative to obtain relief from litigation in US courts that would interfere with a foreign plenary bankruptcy proceeding.<sup>15</sup>

The authorized representative of a foreign proceeding must file a petition requesting recognition by a U.S. bankruptcy court.<sup>16</sup> Courts will grant recognition of a foreign proceeding pursuant to section 1517 of the Bankruptcy Code as long as (1) the proceeding is a “foreign main proceeding or foreign non-main proceeding;”<sup>17</sup> (2) “the foreign representative applying for recognition is a person or body;”<sup>18</sup> and (3) the petition for recognition meets the requirements of section 1515 of the Bankruptcy Code.<sup>19</sup>

***1: Requirement that the proceeding be a foreign main or non-main proceeding***

The subsection one requirement that the proceeding be a foreign main or non-main proceeding stems from a policy determination from UNCITRAL and Congress that US bankruptcy courts should not assist a foreign action unless the debtor has its center of main interests or an establishment in the country where the plenary action is pending.<sup>20</sup> Identifying whether a foreign proceeding is a “main” or a “non-main” proceeding depends on whether its

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<sup>13</sup> Unlike plenary bankruptcy cases where the automatic stay is effectuated the moment the bankruptcy petition is filed, filing a Chapter 15 petition does not trigger the automatic stay; rather, only recognition of a foreign proceeding provides automatic relief. Further, recognition of a foreign non-main proceeding only affords the foreign representative permissive relief, not automatic. *See* Chapter 15 Overview: US Bankruptcy Cases Ancillary to Foreign Proceedings, Practical Law Practice Note 7-520-4512.

<sup>14</sup> *See* NYLJ “Conflicting Decisions Create Uncertainty on Key Chapter 15 Issue”

<sup>15</sup> *See* Chapter 15 Overview: US Bankruptcy Cases Ancillary to Foreign Proceedings, Practical Law Practice Note 7-520-4512

<sup>16</sup> 11 U.S.C. 1515

<sup>17</sup> 11 U.S.C. § 1517(a) (quoting language defined by 11 U.S.C. 1502).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *See* 8-1517 Collier on Bankruptcy P 1517.01.

plenary action is located at the debtor’s “center of main interests” (“COMI”) or its establishment, respectively.<sup>21</sup>

A debtor’s center of main interests is said to be generally equal with “the concept of a principle place of business in United States Law.”<sup>22</sup> There is a rebuttable presumption that the debtor’s registered office (or place of incorporation) is its center of main interests.<sup>23</sup>

Additionally, the court may consider “the location of the debtor’s ‘nerve center,’ including from where the debtor’s activities are directed and controlled, in determining a debtor’s COMI.”<sup>24</sup>

Generally, determining COMI is not controversial; however, a recent Cayman Islands filing stirred up debate as to where the Debtor’s COMI was at the time of the commencement of Chapter 15 case.<sup>25</sup>

In *In re Suntech Power Holdings Co., LTD.*, the presumption that the debtor’s registered office at the time of filing was, in fact, the Cayman Islands as the filing stated.<sup>26</sup> The debtor, Suntech Power Holdings Co., Ltd., was incorporated in the Cayman Islands with its principal executive offices in China.<sup>27</sup> Solyndra, plaintiffs in an action against the debtor in the California, opposed recognition of the Chapter 15 case arguing the appointed liquidators manipulated its COMI.<sup>28</sup> However, the court distinguished its holding in *In re Fairfield Sentry Ltd.*,<sup>29</sup> which the

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<sup>21</sup> See 11 U.S.C. § 1502(4)-(5).

<sup>22</sup> See *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122, 129 (Bankr. S.D.N.Y. 2007) (quoting *In re Tri-Continental Exchange Ltd.*, 349 B.R. 627, 633–34 (Bankr. E.D. Cal. 2006)).

<sup>23</sup> See 11 U.S.C.A. § 1516(c)

<sup>24</sup> See *In re Suntech Power Holdings Co., Ltd.*, 520 B.R. 399, 416 (Bankr. S.D.N.Y. 2014).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> See *In re Suntech Power Holdings Co., Ltd.*, 520 B.R. 399, 404–405 (Bankr. S.D.N.Y. 2014).

<sup>28</sup> See *In re Suntech Power Holdings Co., Ltd.*, 520 B.R. 399, 418 (Bankr. S.D.N.Y. 2014).

<sup>29</sup> See generally, *Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*, 714 F.3d 127, (2d Cir. 2013).

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court analogized to a simpler Chapter 7 proceeding, and paralleled the case here to a chapter 11 provisional liquidation where the debtor continues to operate.<sup>30</sup>

The second circuit found that the appointed liquidators managed the debtor's affairs from the Cayman Islands and, through changing the debtor's principal offices address in its SEC filings to the Cayman Islands and opening a Cayman Islands bank account, effectively changed the debtor's center of main interests.<sup>31</sup>

Alternatively, a debtor's establishment for recognition as a non-main proceeding means "any place of operations where the debtor carries out a non-transitory economic activity."<sup>32</sup> The Southern District explicitly equates non-transitory economic activity with "a local place of business."<sup>33</sup> Although somewhat similar to main proceedings, recognition as a non-main proceeding offers much less relief. Here, debtors only receive permissive relief—"discretionary and subject to the requirement that all creditors be 'sufficiently protected'"—whereas main proceeding recognition triggers the sought-after automatic stay protection.<sup>34</sup>

Nevertheless, if the proceeding is not pending in a country where the debtor has its center of main interests or an establishment,<sup>35</sup> then a bright line is drawn: the foreign proceeding is not eligible for recognition under Chapter 15.<sup>36</sup> Though, as long as the three-§1517 requirements are met, the court must grant recognition.<sup>37</sup>

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<sup>30</sup> See *In re Suntech Power Holdings Co., Ltd.*, 520 B.R. 399, 417 (Bankr. S.D.N.Y. 2014) ("the foreign proceeding is a provisional liquidation more like a chapter 11 case in which a trustee has been appointed but the debtor continues to operate subject to the trustee's supervision and control).

<sup>31</sup> See *In re Suntech Power Holdings Co., Ltd.*, 520 B.R. 399, 418–419 (Bankr. S.D.N.Y. 2014).

<sup>32</sup> See 11 U.S.C.A. § 1502(2).

<sup>33</sup> See *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122, 131, (Bankr. S.D.N.Y. 2007) *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008).

<sup>34</sup> See Chapter 15 Overview: US Bankruptcy Cases Ancillary to Foreign Proceedings, Practical Law Practice Note 7-520-4512.

<sup>35</sup> See 11 U.S.C.A. § 1502(4)-(5).

<sup>36</sup> See 8-1517 Collier on Bankruptcy P 1517.01.

<sup>37</sup> See 8-1517 Collier on Bankruptcy P 1517.01. However, even if the requirements are satisfied, the court could decline to grant recognition using the "manifestly contrary to the public policy" exception found in section 1506. 11 U.S.C. 1506.

**B. Eligibility: Who may be a debtor**

Typically, meeting the requirements of section 1517 concluded the recognition analysis. However, recently, the Second Circuit extended the recognition analysis to address debtor eligibility in Chapter 15 cases. Chapter 15 of the Code includes its own definition of a debtor—“an entity that is the subject of a foreign proceeding.”<sup>38</sup> In the cases discussed below, the second circuit concluded that the eligibility requirements found in section 109(a) of the Code apply in Chapter 15 cases.<sup>39</sup> Chapter 1 supplies the general provisions of the Code;<sup>40</sup> specifically, section 103(a), which addresses the applicability of chapters, provides:

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.<sup>41</sup>

The leading bankruptcy treatise, Collier’s on Bankruptcy, interpreted the Code to mean only section 103 applies to chapter 15 cases, not section 109(a)—which should apply only to chapter 7, 11, 12, and 13 cases.<sup>42</sup> Further, the treatise asserts that there is no indication in chapter 15 that

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<sup>38</sup> 11 U.S.C. § 1502(1)

<sup>39</sup> See generally *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013); see also *In re Suntech Power Holdings Co., Ltd.*, 520 B.R. 399 (Bankr. S.D.N.Y. 2014)

<sup>40</sup> See generally 11 U.S.C. §101-112.

<sup>41</sup> 11 U.S.C. §103(a).

<sup>42</sup> See 8-1501 Collier on Bankruptcy P 1501.03.

While chapter 1 of the Bankruptcy Code applies in chapter 15 cases by section 103, the section 109(a) criteria should apply only to cases under chapters 7, 11, 12 and 13. Section 1501(c) specifies that foreign proceedings involving certain regulated-entity and consumer debtors are not within the scope of chapter 15 and implements this exclusion by reference to sections 109(b) and (e). Chapter 15 nowhere indicates that debtors in foreign proceedings must meet the section 109(a) criteria that apply to ‘a debtor under this title’ or that foreign proceedings involving debtors who do not meet those criteria cannot be recognized.

Sections 301, 302 and 303 apply to commencement of voluntary, joint and involuntary cases under chapters other than chapter 15. Those sections are located in a subchapter of the Bankruptcy Code entitled “Commencement of a Case,” and each speaks in terms of “an entity ... that may be a debtor.” Consequently, they depend on the eligibility criteria of section 109(a), which is entitled ‘Who may be debtor.’ But sections 301 through 303 do not apply to a chapter 15 case. Chapter 15 contains its own commencement provision, section 1504, ‘Commencement of ancillary case,’ which speaks only in terms of ‘recognition of a foreign proceeding’ and not of entities that may be debtors.

8-1501 Collier on Bankruptcy P 1501.03.

debtors must meet the section 109(a) criteria<sup>43</sup> or that “proceedings involving debtors who do meet those criteria cannot be recognized.”<sup>44</sup> Courts, however, have interpreted the eligibility part of the code differently.

Recently, the Second Circuit in *In re Barnett* interpreted the Bankruptcy Code to find, for the first time, that the section 109(a) eligibility requirement applies to Chapter 15 cases. Specifically, a foreign debtor must have property in the United States to receive Chapter 15 relief.<sup>45</sup> The statute expressly states that the debtor must have property located in the U.S. (absent domicile or place of business).<sup>46</sup> However, the statute does not indicate how property must be in the U.S. and does not order an “inquiry into the circumstances surrounding the debtor’s acquisition of the property.”<sup>47</sup> Consequently, on remand, the Bankruptcy Court for the Southern District of New York (now *In re Octaviar Administration Pty Ltd.*)<sup>48</sup> held that the foreign representatives had property in the United States in the form of claims and causes of action as well as an undrawn retainer constituting property for the purposes of section 109(a).<sup>49</sup>

In the latest ruling on the topic in *In re Suntech Power Holdings Co., Ltd.*, the bankruptcy court for the Southern District followed the Second Circuit’s holding that section 109(a) eligibility requirements apply to Chapter 15 cases.<sup>50</sup> There, the debtor had no business or property in New York, or anywhere in the U.S. To meet the time requirements, the appointed

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<sup>43</sup> Section 109(a) provides that “[n]otwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.” 11 U.S.C. §109(a).

<sup>44</sup> *Id.*

<sup>45</sup> See generally *Drawbridge Special Opportunities Fund LP v. Barnett (In re Barnett)*, 737 F.3d 238 (2d Cir. 2013).

<sup>46</sup> *Id.*

<sup>47</sup> *In re Octaviar*, 511 B.R. at 373.

<sup>48</sup> *In re Barnett* represents the first Chapter 15 petition, which subsequently went up to the Second Circuit. After the Second Circuit remanded the first petition back to the Bankruptcy Courts, the foreign representatives filed a second petition, which the bankruptcy court ruled on in *In re Octaviar*.

<sup>49</sup> See *In re Octaviar Administration Pty Ltd.*, 511 B.R. 361, 365 (Bankr. S.D.N.Y. 2014).

<sup>50</sup> See *In re Suntech Power Holdings Co., Ltd.*, 520 B.R. 399 (Bankr. S.D.N.Y. 2014).

liquidators opened a New York bank account and transferred funds into that same account.<sup>51</sup> The liquidators then filed a Chapter 15 petition the day following the money transfer.<sup>52</sup> Accordingly, the bankruptcy court held that a foreign debtor established property in the U.S. by opening a U.S. bank account,<sup>53</sup> much like its decision in *In re Octaviar*, thereby satisfying the eligibility requirements of §109(a).<sup>54</sup>

## II. IMPLICATIONS

### A. *Potential Conflict with Delaware/Third Circuit*

Six days after the *In re Barnet* decision, the Bankruptcy Court for the District of Delaware issued a bench ruling rejecting the Second Circuit's analysis and conclusion and stated that the Court of Appeals for the Third Circuit would likely reject *Barnet*—although this is a distinction without a difference.<sup>55</sup> In *In re Bemarmara Consulting A.S.*, the bankruptcy judge held that the requirements of section 109(a) do not apply to a foreign representative seeking recognition in the United States; therefore, there is no need to determine whether the debtor has assets located in the United States to entitle a debtor to Chapter 15 relief.<sup>56</sup> The Delaware Bankruptcy Court concluded that section 109(a) provides requirements for debtors, but in Chapter 15 cases, “the foreign representative, not the debtor, petitioned the court for relief.”<sup>57</sup>

Additionally, the court wrote that there is “nothing in the definition of “debtor” in section 1502

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<sup>51</sup> See *In re Suntech*, 520 B.R. at 410.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.* at 413.

<sup>54</sup> See *In re Suntech*, 520 B.R. at 410 (the court also found that the debtor rebutted the presumption under NY law that the titleholder of the bank account, KCC, owns the account by showing KCC held the funds as the debtors agent).

<sup>55</sup> See *In re Bemarmara Consulting A.S.*, No. 13-13037 (KG) (Bankr. D. Del. Dec. 17, 2013). “[T]his Court does not agree with the decision of the Second Circuit. And it is the Court's belief that there is a strong likelihood that the Third Circuit, likewise, would not agree with that decision.” Transcript of Hearing Before Honorable Kevin Gross United States Bankruptcy Judge, at 8-9, *In re Bemarmara Consulting A.S.*, No. 13-13037 (KG) (Bankr. D. Del. Dec. 17, 2013).

<sup>56</sup> See Richards Layton & Finger, “Delaware Bankruptcy Court and Second Circuit Take Different Views of Whether a Debtor with No Assets Located in the United States Is Eligible for Chapter 15 Relief” (2013), available at <http://www.rlf.com/Publications/5535>.

<sup>57</sup> *Id.*



which reflects upon a requirement that a Debtor have assets.”<sup>58</sup> Section 1502 merely states that a “debtor’ is an entity that is involved in a foreign proceeding.”<sup>59</sup>

### ***B. Second Circuit***

The *Octaviar* decision confirms that although a foreign debtor must satisfy the eligibility requirements of section 109(a) of the Bankruptcy Code, in practice, a foreign debtor should have very little problem doing so. Indeed, even a nominal amount of property in the U.S. can satisfy the eligibility requirements of section 109(a). For example, as the *Octaviar* decision illustrates, a foreign debtor can satisfy section 109(a) simply by depositing a retainer in its U.S. counsel’s attorney trust account.<sup>60</sup> Likewise, a foreign debtor can establish that it has property in the U.S. by demonstrating that foreign representatives can assert a claim against U.S. defendants in a U.S. court.

The decision in *In re Suntech* makes clear that a debtor need only establish property in the U.S. immediately prior to the Chapter 15 filing in order to meet section 109(a) eligibility requirements. Here, it was insignificant that the account was established the day before the Chapter 15 filing since section 109(a) does not require “an inquiry into the circumstances surrounding the debtor’s acquisition of property.”<sup>61</sup> The Court reasoned that interpreting the Bankruptcy Code to prevent an ineligible foreign debtor from establishing eligibility to support Chapter 15 relief would “contravene the purposes of the statute to provide legal certainty, maximize value, protect creditors and other parties in interests and rescue financially troubled businesses.”<sup>62</sup>

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<sup>58</sup> See “U.S. Causes of Action and Attorney Retainer Fund are Sufficient Assets for Chapter 15 Recognition” *Jnl. of Bankr. L.* 2014.12-2

<sup>59</sup> 11 U.S.C. 1502

<sup>60</sup> *Id.*

<sup>61</sup> *In re Octaviar*, 511 B.R. at 373.

<sup>62</sup> *In re Suntech*

These decisions prove that although there is an additional step to obtain recognition of a foreign proceeding, the bar foreign debtors seeking chapter 15 relief must reach is low.<sup>63</sup> However, it remains to be seen whether other circuits will follow the Second Circuit's ruling and ensure that the door to Chapter 15 remains wide open.

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<sup>63</sup> See *In re Suntech Power Holdings Co*: SDNY Bankruptcy Court Liberally Interprets Chapter 15 Eligibility, Venue and COMI Determinations, Practical Law Legal Update 8-590-5305 (2015).