

CLIENT UPDATE

SECOND CIRCUIT LIMITS AVAILABILITY OF CHAPTER 15

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In a recent opinion on an issue of first impression,¹ the United States Court of Appeals for the Second Circuit held that foreign entities seeking recognition under Chapter 15 of the Bankruptcy Code must, in addition to satisfying the requirements for recognition set forth in that chapter, have a residence, domicile, place of business or assets in the United States. The Second Circuit's decision reversed an earlier Bankruptcy Court ruling that granted recognition under Chapter 15 to an Australian company that had not introduced evidence of any assets or operations in the U.S and conflicts with a recent ruling of the Bankruptcy Court for the District of Delaware holding that a Chapter 15 debtor is not required to have assets in the U.S.² In so doing, the Second Circuit added an additional barrier to Chapter 15 recognition, which could be problematic for foreign companies looking to benefit from the advantages of the U.S. legal system.

BACKGROUND

In connection with its ongoing liquidation proceedings in Australia, the foreign representatives of Octaviar Administration Pty Ltd., an Australian company, petitioned the Bankruptcy Court for an order recognizing the Australian liquidation as a "foreign main proceeding" under Chapter 15. The Bankruptcy Court granted recognition and shortly thereafter, Octaviar's foreign representatives

¹ *Drawbridge Special Opportunities Fund LP v. Barnett (In re Barnett)*, 2013 WL 6482499 (2d Cir. Dec. 11, 2013).

² *In re Bemarmara Consulting a.s.*, Case No. 13-13037 (KG) (Bankr. D. Del. Dec. 17, 2013).

filed a motion seeking discovery from Drawbridge Special Opportunities Fund LP in connection with an ongoing lawsuit in Australia. Drawbridge appealed the recognition order and requested a stay of discovery pending appeal. The Bankruptcy Court granted the parties' joint application for certification of the recognition order for direct appeal to the Second Circuit on the grounds that there was no controlling precedent governing whether or not a "debtor" within the meaning of Chapter 15 is or is not required to comply with the domicile, residence, place of business or property requirement set out in Section 109(a) of the Bankruptcy Code. According to the Bankruptcy Court, resolution of that issue could "dramatically impact the jurisdiction of the United States bankruptcy courts and the use of Chapter 15 to assist in the administration of cross-border insolvency cases." The Second Circuit granted the joint application and issued a stay of discovery pending its decision.

CHAPTER 15 AND RECOGNITION OF FOREIGN ENTITIES

The substantive question at issue was whether or not the definition of "debtor" found in Section 1502(1) of the Bankruptcy Code renders the separate requirement of Section 109(a) inapplicable with respect to whether a foreign entity is entitled to recognition under Chapter 15. Although "debtor" is defined in Section 101 of the Bankruptcy Code, Chapter 15 contains its own definition of "debtor" — "an entity that is the subject of a foreign proceeding" — which applies only for purposes of Chapter 15. Section 109(a), however, mandates that "only a person that resides or has a domicile, a place of business, or property in the United States...may be a debtor under this title." Drawbridge argued that, since Section 103 of the Bankruptcy Code is clear that (with limited exceptions not relevant to this case) the provisions of Chapter 1 of the Bankruptcy Code apply to Chapter 15 cases, a foreign entity must qualify as a "debtor" under Section 109(a) in order to qualify for recognition under Chapter 15.

THE SECOND CIRCUIT'S DECISION

While the Bankruptcy Court rejected Drawbridge's argument, the Second Circuit agreed that the requirements of Section 109(a) apply to foreign "debtors" under Chapter 15. Emphasizing the "straightforward nature of [its] statutory interpretation," the Second Circuit rejected the foreign representative's argument that Octaviar was a "debtor" under Australian law only, and therefore was not required to qualify as a "debtor" under the provisions of Chapter 1 to be granted the requested relief under Chapter 15. Instead, the Second Circuit held that a foreign entity seeking recognition under Chapter 15 was a "debtor" under the plain meaning of the statute since "the presence of a debtor is inextricably intertwined with the very nature of a Chapter 15 proceeding, both in terms of how such a proceeding is defined and in terms of the relief that can be granted." The Court also rejected the argument that the definition of "debtor" in Section 1502, which explicitly applies in the Chapter 15 context, "blocks" application of Section 109, finding that the two provisions serve distinct functions, which is in direct contrast to the Delaware Bankruptcy Court decision in *Bemarmara*.

The foreign representative also made several arguments related to the context and purpose of Chapter 15 more generally, all of which were dismissed by the Court. Perhaps most persuasively, the foreign representative pointed to the statute governing venue for Chapter 15 cases³ which provides for venue even when “the debtor does not have a place of business or assets in the United States.” However, the Second Circuit determined that the venue statute was “purely procedural” and should not control the outcome of the case. Finally, the Court was not persuaded by the fact that such a requirement was not included in the model statute on which Chapter 15 is based, reasoning that it would have been well within Congress’s purview to add additional requirements to Chapter 15 that it believed were appropriate under the circumstances.

IMPLICATIONS

Although the Second Circuit’s decision clearly imposes a new requirement on foreign entities seeking Chapter 15 recognition in the Second Circuit, it remains to be seen whether the requirement will serve as a material barrier to access to Chapter 15 relief. In most cases, foreign companies seeking recognition in the U.S. do so in order to protect their U.S. assets from creditor actions and will, therefore, be unaffected by the Second Circuit’s ruling. In some circumstances, however, foreign debtors seek Chapter 15 recognition in order to avail themselves of certain benefits of U.S. law that may otherwise be unavailable to it in its foreign proceeding. To the extent these entities do not have assets in the U.S. at the time of filing, this new requirement may still be satisfied through, for example, the opening of a U.S. bank account or other minimal efforts to establish assets in the U.S. In addition, courts in other jurisdictions (for example, the Delaware Bankruptcy Court) may not follow the Second Circuit’s ruling. Foreign entities seeking Chapter 15 recognition should consult with U.S. bankruptcy counsel in order to determine the requirements applicable in the anticipated filing jurisdiction and what (if anything) may be required prior to seeking such relief.

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Please do not hesitate to contact us with any questions.

December 20, 2013

³ 28 U.S.C. § 1410(2).