

Cross-Border Insolvency

The Association of Commercial Finance Attorneys

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I. Introduction

In recent years, an increasing number of multinational enterprises with assets located in several different countries have commenced insolvency proceedings. This memorandum summarizes the options that are available to such enterprises under United States bankruptcy laws and principles. The options available to a foreign debtor are as follows:

1. Commence a full Chapter 7 or Chapter 11 proceeding.
2. Commence an ancillary proceeding under Bankruptcy Code Section 304.
3. Petition a court to invoke international comity and to enjoin creditors from bringing any action on their claims, except in a foreign proceeding.
4. Seek extra-territorial enforcement of United States laws.

Proposed legislation that would create a new Chapter 15 of the Bankruptcy Code governing ancillary and cross-border cases has recently been passed by both houses of the United States Congress. This memorandum also summarizes the purpose, provisions and anticipated effect of new Chapter 15.

II. Chapter 7 Liquidation or Chapter 11 Reorganization

A foreign debtor can initiate a voluntary, full Chapter 7 liquidation or Chapter 11 reorganization in the United States provided it satisfies the criteria of Section 109 of the Bankruptcy Code. Pursuant to Section 109, a debtor is generally eligible for relief under the Bankruptcy Code if it "resides or has a domicile, a place of business, or property in the United States..." 11 U.S.C. § 109(a).

A. Residence & Domicile

Foreign corporations seeking Chapter 7 or Chapter 11 bankruptcy relief generally do not satisfy Section 109's eligibility requirements by having a domicile or residence in the United States. Because a corporation's domicile is its state of incorporation, a foreign corporation that is incorporated in a foreign country generally does not have a domicile in the United States. The concept of a corporation's residence is also somewhat slippery, and "must be determined by the context, purpose, and objective of the statute in which the term is used..." Pennsylvania Ins. Guar. Ass'n v. Charter Abstract Corp., 790 F.Supp. 82, 85 (E.D.Pa.1992). See, e.g., 28 U.S.C. § 1392(c) (providing that "[f]or purposes of venue under this chapter, a defendant that is a corporation shall be deemed to reside in any judicial district in which it is subject to personal jurisdiction at the time the action is commenced."). Thus, in practice, eligibility for bankruptcy relief often turns on the more concrete determination of whether a foreign corporation has a place of business or property in the United States.

B. Place of Business

A foreign corporation generally has a place of business in the United States if such corporation conducts business in the United States or business is conducted in the United States on the

corporation's behalf. In re Paper I Partners L.P., 283 B.R. 661, 672 (S.D.N.Y. 2002) See In re Petition of Brierley, 145 B.R. 151, 161 (Bankr.S.D.N.Y.1992)(English corporation deemed to have a place of business in the U.S. where the corporation's accountant, who was employed as an independent contractor, performed accounting functions from the New York office of Arthur Anderson.). A foreign corporation need not have its "principal place of business" in the United States to satisfy Section 109. Rather, the mere presence of a "place of business" in the United States is sufficient to qualify for relief. See In re Paper I Partners L.P., 283 B.R. 661, 672 (Bankr.S.D.N.Y.2002)(rejecting argument that Section 109 was not satisfied because partnership agreements provided for a principal place of business in Luxembourg.). In determining whether a foreign corporation has a "place of business" in the United States, courts have examined factors such as the continuous presence of employees or representatives in the United States, the degree to which business activities are conducted in the United States and the extent to which the debtor's United States presence is represented to third parties. See In re Petition of Brierley, 145 B.R. 151 (Bankr.S.D.N.Y. 1992).

C. Property

A foreign corporation may also qualify as a debtor under Section 109 by having "property" in the United States. Issues concerning "property" generally involve the amount or type of property that is sufficient to satisfy Section 109 and whether such property is located in the United States.

The mere possession of a bank account in the United States, regardless of the account's balance, is sufficient to demonstrate entitlement to relief under Section 109. See In re Global Ocean Carriers Ltd., 251 B.R. 31, 39 (Bankr.D.Del.2000)(concluding "that bank accounts constitute property in the United States for purposes of eligibility under section 109 of the Bankruptcy Code, regardless of how much money [is] actually in them on the petition date."). See also In re Berthoud, 321 F. 529 (S.D. N.Y. 1916)(concluding that the obligation of a New York bank to pay a depositor is sufficient to confer jurisdiction on a U.S. Bankruptcy Court over a foreign debtor.) However, a foreign debtor cannot "manufacture eligibility" under Section 109 "by virtue of their having acquired U.S. mailing addresses and opening small bank accounts in the U.S.". In re Head, 233 B.R. 648, 652 (Bankr.W.D.N.Y.1998).

While original business documents may be "property" for purposes of establishing eligibility to file bankruptcy in the United States, copies of business documents are insufficient. See In re Global Ocean Carriers Ltd., 251 B.R. 31 (Bankr.D.Del.2000)(copies of business documents, as opposed to original business documents, located in the United States did not support conclusion that the company held property in the United States). Additionally, a retainer paid by a foreign debtor to its American counsel may be "property" under Section 109. See In re Global Ocean Carriers Ltd., 251 B.R. at 39 ("The retainers were paid on behalf of all the Debtors and, therefore, all the Debtors have an interest in those funds...Thus, we conclude that the Debtors do have sufficient property in the United States to make them eligible to file bankruptcy petitions under section 109 of the Bankruptcy Code.").

A contingent property interest may be insufficient "property" under Section 109. In order to satisfy Section 109, the "property" must be real and cannot be "some type of remote or inchoate claim against property in the United States." In re Head, 233 B.R. 648, 652 (Bankr.W.D.N.Y.1998) In In re Head, the court rejected the foreign debtors' argument that contingent claims against the surplus of a trust fund held for the benefit of a third party was sufficient "property" in the U.S. The court likewise rejected arguments that "doing business in" the U. S. was equivalent to having "property" in the U.S.,

and that having substantial debts in the U.S. constituted having "property" in the U.S. *Id.* at 652. Similarly, in *In re Kava Bowl*, 41. B.R. 244(Bankr.D.Haw.1984) the court dismissed the petition for Chapter 11 relief of an American Samoan corporation with some cash and the collection of some accounts receivable in Hawaii. Despite the above-mentioned property in Hawaii, the court concluded that "the 'property' which [the debtor] maintains in Hawaii is not even property in the sense that there is no value to the records to any entity other than [the debtor]. This 'property' is not sufficient for jurisdiction..." *In re Kava Bowl*, 41. B.R. at 247.

Even if a foreign debtor has a sufficient amount of "property," such property must be located in the United States to satisfy Section 109. Courts have held that a bank account "is property 'in' the district in which the deposit account is located, even though bank deposits may be viewed as being 'in' the place of residence of the depositor for certain other purposes." *In re McTague*, 198 B.R. 428 (Bankr.W.D.N.Y.1996) See also *Bank of America v. World of English*, 23 B.R. 1015, 1023 (N.D.Ga.1982)(concluding that "the situs of the bank accounts is the location of the bank accounts themselves..."); *In re Berthoud*, 231 F.529 (S.D.N.Y. 1916)(concluding that the obligation of a New York bank to pay its depositor, the debtor, was property in New York.); *In re Head*, 233 B.R. 648, 652 (Bankr.W.D.N.Y.1998)(stating that "the obligation to pay exists wherever the obligor is located. The fact that the obligee is in the U.S. does not equate to having property in the U.S.").

D. Dismissal or Abstention

Even if a debtor satisfies the criteria of Section 109, a bankruptcy court may dismiss a Chapter 7 liquidation or a Chapter 11 reorganization "for cause." 11 U.S.C. §§ 707(a), 1112(b). Furthermore, a bankruptcy court may dismiss or suspend a bankruptcy case if the interests of the creditors and the debtor would be better served by such dismissal or suspension or if there is both a foreign proceeding pending and the factors specified in Section 304(c) (see Section III below) warrant such dismissal or suspension. 11 U.S.C. § 304(c). See *In re Spanish Cay co., Ltd.*, 161 B.R. 715 (Bankr.S.D.Fla.1993)(dismissing case because both the debtor and creditors reasonably expected Bahamian insolvency law to govern their disputes.); *In re Xacur*, 219 B.R. 956, 969-70 (Bankr.S.D.Tex.1998)(abstaining from an involuntary bankruptcy filed against a Mexican debtor when its creditors could pursue bankruptcy relief in Mexico and it appeared as though Mexican courts would refuse to recognize and enforce U.S. bankruptcy court orders.); *In re Ionica PLC*, 241 B.R. 829, 838 (Bankr.S.D.N.Y.1999)(dismissing case out of deference to laws of United Kingdom where insolvency proceedings involving debtor were pending and Section 304(c) factors "tip[ped] in favor of dismissal.")

III. Ancillary Proceeding Under Bankruptcy Code Section 304

A. General Provisions

Section 304 of the Bankruptcy Code provides an avenue for a foreign representative to commence an "ancillary," or limited, proceeding in the United States to assist a foreign proceeding. A Section 304 proceeding is meant only to supplement the foreign proceeding, not to supplant it. The purpose of a Section 304 proceeding is generally to obtain injunctive relief against the enforcement of collection actions in the United States. In order to initiate a Section 304 proceeding, the following two

requirements must be met: 1) a foreign proceeding must be pending; and 2) the party petitioning for relief must be a "foreign representative."

Since a Section 304 case is ancillary to a foreign proceeding, there must first exist a foreign proceeding. The term "foreign proceeding" is defined in 11 U.S.C. § 101(23) as follows:

[a] proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension or discharge, or effecting a reorganization.

The broad definition of "foreign proceeding" is designed to encompass proceedings under reorganization schemes that, in other countries, may be contained in law other than bankruptcy law. See In re Fracmaster, Ltd., 237 B.R. 627 (Bankr.E.D.Tex. 1999)(rejecting argument that legislative history of § 304 indicates an intent to limit the scope of a foreign proceeding to foreign bankruptcy cases). Additionally, an administrative proceeding in a foreign country may qualify as a "foreign proceeding." See, e.g., Georg v. Parungao (In re Georg), 844 F.2d 1562 (11th Cir. 1988), cert. denied, 488 U.S. 1034, 109 S.Ct. 850, 102 L.Ed.2d 981 (1981) (concluding that a German administrative proceeding of a decedent's insolvent estate was a "foreign proceeding" under § 304). In practice however, in determining whether a foreign proceeding qualifies for Section 304, bankruptcy courts often examine the degree of judicial involvement in or review of the process and the degree of creditor access to the courts.

In addition to the requirement that there must be a pending "foreign proceeding," Section 304(a) requires that the case be commenced by the filing of a petition by a "foreign representative." 11 U.S.C. § 304(a). The Bankruptcy Code defines a "foreign representative" as a "duly selected trustee, administrator, or other representative of an estate in a foreign proceeding." 11 U.S.C. § 101(24). Generally, whether an entity is a foreign representative within the Bankruptcy Code's definition simply depends upon whether such person was "duly selected" in a proceeding that qualifies as a "foreign proceeding."

Typically, a Section 304 proceeding is initiated for the purpose of granting comity to a foreign proceeding and to obtain injunctive relief against the enforcement of collection actions in the United States so as to allow all assets of the foreign debtor to be administered pursuant to the law governing the foreign proceeding. U.S. bankruptcy courts are able to grant such relief pursuant to Section 304(b), which authorizes bankruptcy courts to enjoin the creation or enforcement of any liens against the debtor with respect to property involved in the foreign proceeding, to order the turnover of any property of the foreign estate, or to grant any "other appropriate relief." 11 U.S.C. § 304(b). Section 304(c) sets forth specific criteria for bankruptcy courts to consider in determining whether to grant any such relief. Pursuant to Section 304(c), in determining whether to grant any such relief, bankruptcy courts are guided by "what will best assure an economical and expeditious administration of such estate" consistent with six factors:

1. just treatment of all holder's claims against or interests in such estate;
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 dispositions of property of such estate;
4. distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
5. comity; and
6. if appropriate, the provisions of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

11 U.S.C. § 304(c). These considerations are guidelines for the court and no weight is given to any particular factor. As such, bankruptcy courts are afforded maximum flexibility in granting ancillary relief.

B. Injunctive Relief

The most common relief sought under the Section 304 is an injunction against the enforcement of collection actions in the United States. Because the filing of a Section 304 petition does not trigger an automatic stay, the foreign representative generally seeks an immediate injunction in the nature of a stay on the day the Section 304 petition is filed. Despite Section 304(c)'s guidance as to whether injunctive relief should be granted, some disagreement exists amongst courts regarding the proper standard for awarding preliminary injunctive relief.

In In re MMG LLC, 256 B.R. 544 (Bankr.S.D.N.Y.2000), Chief Judge Stuart M. Bernstein of the United States Bankruptcy Court for the Southern District of New York discussed the standards governing the issuance of a preliminary injunction in a Section 304 case. The MMG court explained that "[o]rdinarily, a party seeking preliminary injunction relief must show irreparable harm and either (a) a likelihood of success on the merits or, (b) a sufficiently serious question going to the merits to make it a fair ground for litigation, and the balance of hardships tipping decidedly in the movant's favor." 256 B.R. at 550-51 (citations omitted) The MMG court noted that these requirements have not been uniformly applied in Section 304 cases. Specifically, some courts have just looked to the Section 304(c) factors, which approach does not require a showing of irreparable harm because irreparable harm is not mentioned in Section 304(c). Whereas other courts have insisted that the Section 304 applicant meet the usual preliminary injunction test, and thus, show irreparable harm.

The MMG court concluded that the appropriate standard depends on the status of the case. If the petition is not contested, then upon the expiration of the objection timeframe or following the entry of an order overruling any objections or defenses, the court should just be guided by the Section 304(c) factors and award, if appropriate, any of the of relief under Section 304(b), including an injunction. However, as is often the case with the preliminary injunction request, if the objection timeframe has not expired, the MMG court stated that a bankruptcy court cannot award relief against a party in interest under Section 304(b) because the preamble of Section 304(b) gives the court power to provide relief "if a party in interest does not timely controvert the petition, or after trial..." Consequently, in situations when a petition has been controverted, the MMG court explained that a bankruptcy court is not powerless because it may, in the exercise of its inherent equitable powers under Section 105(a), issue a preliminary injunction to maintain the status quo pending its determination of the ancillary case. In such situations, the MMG court concluded that the traditional standard for preliminary injunctive relief applies and the Section 304(c) factors must be considered under the likelihood of success on the merits prong.

Although this conflict amongst the courts makes the Section 304 preliminary injunction analysis a bit uncertain, the uncertainty is minimized by the numerous decisions that have found that irreparable harm exists whenever local creditors of the foreign debtor seek to collect their claims or obtain preferred positions to the detriment of the other creditors. See *MMG*, 256 B.R. at 555; *In re Davis*, 191 B.R. 577, 587 (Bankr.S.D.N.Y. 1996); *In re Lines*, 81 B.R. 267, 270 (Bankr.S.D.N.Y.1988); *Vitrix*, 825 F.2d at 715. Since most preliminary injunctions are sought to prevent such creditor actions, irreparable harm can generally be shown.

C. Turnover

Preliminary injunctive relief is not the only relief available to a foreign debtor under Section 304. Pursuant to Section 304(b)(2), a United States bankruptcy court may also order the turnover of the property of the estate or the proceeds thereof to the foreign representative. However, before such property may be turned over, a court must apply local law to determine whether the debtor has a valid ownership interest in the property. *In re Koreag, Controle Et Revision S.A.*, 961 F.2d 341, 349 (2d Cir. 1992)(citations omitted). Only after such a determination is made may a court consider whether relief is appropriate under Section 304(c). See *In re Grandote Country Club Co.*, 208 B.R. 218, 224 (D.Colo.1997), *aff'd*, 252 F.3d 1146 (10th Cir. 2001)(stating that the language of § 304(b)(2) "presupposes an initial determination of property interests as a condition to the turnover of property to a foreign representative" and holding that Colorado, rather than Japanese fraudulent conveyance law, applied to the validity of the tax deeds for Colorado real property in which the Japanese trustee claimed an interest.).

In an important recent decision, the Court of Appeals reversed the bankruptcy and district court's conclusion that certain restrictions that apply to a United States trustee's turnover rights did not apply to a foreign representative's turnover rights. *In re Treco*, 239 B.R. 36 (S.D.N.Y. 1999) *vacated and remanded*, 240 F.3d 148 (2nd Cir. 2001). In *In re Treco*, the court-appointed liquidator of a Bahamian debtor corporation commenced an ancillary proceeding under Section 304 and demanded the turnover of the debtor's property in the United States, including funds that were pledged to a secured creditor as collateral. The secured creditor resisted the turnover relief in part because Bahamian law was less favorable to the secured creditor. In particular, Bahamian law permitted liquidated related administrative expenses to be paid ahead of the secured creditor's claim and the request for turnover was not conditioned on the provision of adequate protection of the secured creditor's security interest. The bankruptcy court ordered turnover and the secured creditor appealed.

The district court affirmed the bankruptcy court's decision, concluding that the turnover order was not an abuse of the bankruptcy court's discretion where the secured creditor's claim will be recognized as secured in the foreign proceeding but subordinated to the administrative expenses. The district court also found that "Nothing in the bankruptcy code...provides that turnover orders in an ancillary proceeding pursuant to 11 U.S.C. § 304(b)(2) are subject to the requirement of adequate protection, and in fact the wide discretion accorded to the bankruptcy court under § 304 implies that no such requirement was intended." *In re Treco*, 239 B.R. at 43.

The Court of Appeals for the Second Circuit reversed both the bankruptcy court and district court orders, concluding that turnover would be improper "...because of the extent to which the distribution of the proceeds of these funds in the Bahamian bankruptcy proceeding would not be 'substantially in accordance with the order prescribed by' the United States Bankruptcy Code...". *In re Treco*, 240 F.3d

at 151 (quoting 11 U.S.C. § 304(c)(4)). The Court of Appeals noted that the Bahamian law threatened to wipe out the secured creditor's claim because of the strong possibility that the debtor's estate would have little or no funds after payment of administrative expenses. Thus, the Bahamian law would not be substantially in accordance with United States law with respect to distribution and the strong protection afforded to secured creditors. Accordingly, the Court of Appeals held that the lower courts abused their discretion by ordering turnover.

In reaching its conclusion, the Court of Appeals stated as follows: "we are not announcing a rule that whenever § 304(c) is implicated, turnover over other § 304 relief should be denied. Second, we are not creating a presumption against affording comity to Bahamian bankruptcy proceedings. We expect that the case specific analysis required by § 304 will in many, or most, cases support the granting of the requested relief." In re Treco at 161. Subsequently, some bankruptcy courts have construed In re Treco narrowly and have granted the requested relief. See In re Thornhill Global Deposit Fund, Ltd., 245 B.R. 1 (Bankr.D.Mass. Feb.1, 2000), aff'd, 247 F.3d 328 (1st Cir. 2001)(concluding that the provisions of the Bahamian liquidation proceedings were in substantial conformity with U.S. bankruptcy law and that certain funds were subject to turnover.); In re Board of Compania General de Combustibles, S.A., 269 B.R. 104 (Bankr.S.D.N.Y.2001)(rejecting creditors' claim that, pursuant to In re Treco, U.S. courts will not grant § 304 relief if any U.S. creditor would receive materially worse treatment under the foreign proceeding.).

III. The Doctrine of International Comity

A foreign representative also has the option of petitioning a United States court to invoke international comity and to enjoin creditors from bringing any action on their claims, except in the foreign proceeding. The U.S. Supreme Court has described comity as:

The recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to the international duty and convenience, and to the rights of its own citizens or of other persons who are under protection of its laws. Hilton v. Guyot, 159 U.S. 113, 16 S.Ct. 139, 40 L.Ed. 95 (1895).

The purpose of extending comity to foreign bankruptcy proceedings "is to enable the assets of a debtor to be disbursed in an equitable, orderly and systematic manner, rather than in a haphazard, erratic or piecemeal fashion. Consequently, American courts have consistently recognized the interest of foreign courts in liquidating or winding up the affairs of their own domestic business entities." New Line Intern. Releasing, Inc. v. Ivex Films, S.A., 140 B.R. 342, 344 (Bankr.S.D.N.Y.1992) citing Cunard S.S. Co., Ltd. V. Salen Reefer Servs. AB, 773 F.2d. 452, 458 (2d Cir. 1985). An increasing number of U.S. bankruptcy courts have recognized foreign proceedings under the doctrine of international comity. See In re Ancillary Petition regarding Phillipine Airlines, Inc. a Phillipine corporation, No. 98-3-2705-TC (Bankr. N.D. Cal. 1998)(recognizing a Phillipine rehabilitation law as worthy of comity under § 304); Haarhuis v. Kunnan Enterprise, Ltd., 233 B.R. 252 (D.D.C.1998)(recognizing Taiwan's reorganization proceedings as worthy of comity); New Line, 140 B.R. 342 (S.D. N.Y. 1992)(extending comity to insolvency proceedings in Spain and dismissing

complaint filed in United States); Smith v. Dominion Bridge Corporation, 33 BCD 1263 (E.D.Pa. March 1999)(extending comity to Canadian stay and exercising its power to stay a class action suit).

The extension of comity, however, is not unfettered. The comity a U.S. court affords to a foreign court may be limited by the following: the extent to which persons affected by the foreign order are given notice and the opportunity to be heard in the foreign proceeding; the jurisdiction of a foreign court to hear the insolvency proceeding; and whether extension of comity would be contrary or prejudicial to local law. See New Line Intern. Releasing, Inc. v. Ivex Films, S.A., 140 B.R. 342 (Bankr.S.D.N.Y.1992) ("Comity is extended to foreign bankruptcy proceedings 'where the foreign court has jurisdiction over the bankrupt, and the foreign procedure neither prejudices forum citizens and forum creditors' rights, nor violates the forum's laws or public policies'...Before extending comity, a court 'must first satisfy itself that forum creditors will be protected' in the foreign proceeding'." citing Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B., 65 B.R. 466 (S.D.N.Y.1986); See also Somportex Ltd. V. Philadelphia Chewing Gum Corp., 453 F.2d 435, 443 (10th Cir. 1971).

United States bankruptcy courts are not compelled by the doctrine of international comity to recognize international arbitration clauses. In In re United States Lines, Inc., 197 F.3d 631 (2d Cir. 1999) a reorganization trust, as successor-in-interest to the reorganized debtor shipping companies, brought an adversary proceeding seeking a declaratory judgement against domestic and foreign mutual insurance clubs that had insured the debtors' fleets under prepetition contracts. The Second Circuit Appeals Court addressed an international comity issue regarding an apparent conflict between the Federal Arbitration Act (9 U.S.C.A. § 1, et seq.) mandate, and the discretionary power of a bankruptcy court pursuant to the Bankruptcy Code. The Court of Appeals acknowledged that the parties had entered into valid agreements, some of which called for international arbitration, and that the FAA mandates enforcement of valid arbitration agreements. The Court further recognized that the arbitration preference is particularly strong for international arbitration agreements. See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 619, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985)("[C]oncerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require enforce[ment of] the parties' [arbitration] agreement, even assuming that a contrary result would be forthcoming in a domestic context.").

The Court of Appeals, however, ultimately held that a bankruptcy court has the power to enjoin international arbitration proceedings. The Court stated that "Like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command." Id. at 639 citing Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220, 226, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987). The Court then concluded that "congressional intent to permit a bankruptcy court to enjoin arbitration [was] sufficiently clear to override even international arbitration agreements." Id. at 639.

IV. Extra-territorial Enforcement of United States Laws

A foreign representative may also seek to have United States laws enforced in a foreign proceeding. Generally, there is a presumption against the extraterritorial application of U.S. laws absent a clear expression from Congress that such laws were meant to reach foreign conduct. See Maxwell Communication Corp. v. Societe Generale (In re Maxwell Communication Corp.), 93 F.3d 1036, 1048

(2nd Cir. 1996)(holding that U.S. avoidance law did not apply to foreign transfers where such transfers' "center of gravity" was overseas).

The Ninth Circuit, however, recently held in In re Simon, 153 F.3d 991 (9th Cir. 1998), cert. Denied, 199 WL 80418, 67 U.S.L.W.3412, 67 U.S.L.W.3513 (U.S.Feb22, 1999)(No.98-869) that the discharge provisions of the Bankruptcy Code are to be afforded extraterritorial application, especially with respect to a Hong Kong bank that had fully participated in the bankruptcy proceeding in the United States. In that case, a U.S. bankruptcy court had entered an order granting the debtor a discharge of all debts and had issued an injunction enjoining all creditors from taking any action to collect the discharged debt. The Hong Kong bank had filed a proof of claim in the proceeding, and was afforded the opportunity to object to the granting of the discharge. Subsequent to the U.S. bankruptcy court's order, the bank sought a determination that the discharge and injunction were not enforceable outside the United States. The bankruptcy court dismissed the complaint, noting that "although the discharge injunction was not directly enforceable in Hong Kong, it was enforceable in the United States district court via the imposition of sanctions against [the bank] followed by appropriate collection proceedings against [the bank's] property located in the United States." In re Simon, 153 F.3d at 995. Furthermore, the bankruptcy court found "that such enforcement did not contemplate the extraterritorial application of a United States statute." Id. at 995.

The Court of Appeals affirmed the bankruptcy court's decision, noting that the presumption against extraterritorial effect does not apply where "...the failure to extend the scope of the statute to a foreign proceeding will result in adverse effects within the United States," and where the regulated conduct is "intended to, and results in, substantial effects within the United States." Id. at 995 quoting Laker Airways Limited v. Sabena Belgian World Airlines, 731 F.2d 909 (D.C. Cir. 1984). The Court of Appeals concluded that "as to actions against the bankruptcy estate, Congress clearly intended extraterritorial application of the Bankruptcy Code." In re Simon at 996.

In reaching its decision, the Court of Appeals rejected the bank's argument that pursuant to Maxwell and the doctrine of international comity, the Court was required to vacate the bankruptcy court's injunction and to defer to the courts of Hong Kong. The Court of Appeals further rejected the view that the U.S. Bankruptcy Code supports either a "territorial" or "universalist" theory of international bankruptcy. Id. at 998. Rather, "the Code provides for a flexible approach to international insolvencies dependant upon the circumstances of the particular case." Id.

V. New Chapter 15 of the United States Bankruptcy Code

Proposed legislation that would create a new Chapter 15 of the Bankruptcy Code, "Ancillary and Other Cross-Border Cases," has been passed by both houses of the United States Congress. See, e.g. Bankruptcy Reform Act of 2001, S.420, 107th Cong. § 801(a) (2001); Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. § 801(a) (2001). New Chapter 15 is based largely on the Model Law on Cross-Border Insolvency adopted by the United Nations Commission on International Trade Law, and would not represent a significant change from current U.S. law because it rests on many of the same premises as Section 304, which it would replace.

A. Purpose

The purpose of Chapter 15 is "to provide effect mechanisms for dealing with cases of cross-border insolvency" with the following objectives:

- cooperation between the U.S. and foreign countries;
- greater legal certainty for trade and investment;
- fair and efficient administration of cross-border insolvency cases;
- protection and maximization of the value of the debtor's assets; and
- helping the rescue of financially troubled businesses.

B. General Provisions

Chapter 15 preserves the concepts of "foreign proceeding" and "foreign representative," though both definitions are amended to conform to the definitions as set forth in the Model Law. The term "foreign representative" is defined as follows:

A person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding.

This definition is slightly broader than the existing definition and continues to cover the foreign equivalent of a debtor in possession.

Chapter 15 defines the term "foreign proceeding" as follows:

A collective judicial proceeding in a foreign country, including an interim proceeding, under 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.

This revised definition of "foreign proceeding" deletes the requirement that the foreign proceeding must be "in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding." 11 U.S.C. § 101(23). Chapter 15 instead follows the Model law and recognizes the possibility of both a "foreign main proceeding" and a "foreign nonmain proceeding." A "foreign main proceeding" is defined in Section 1502 as "a foreign proceeding taking place in the country where the debtor has the center of its main business interests." While Section 1502 does not define "center of main business interests," Section 1516(c) states that a court may presume that the debtor's registered office, or habitual residence in the case of an individual, is the center of the debtor's main interests. Section 1502 also defines a "foreign nonmain proceeding" as "a foreign proceeding, other than a foreign main proceeding, taking place in a country where the debtor has an establishment." The term "establishment" is defined as "any place of business where the debtor carries out a nontransitory economic activity." Section 1502(2).

The revised definition of "foreign proceeding" also requires that the proceeding must be subject to control or supervision by a "foreign court." The term "foreign court" is defined as "a judicial or other authority competent to control or supervise a foreign proceeding." Section 1502(3). Thus, an

administrative proceeding or proceeding under the control of a nonjudicial authority (e.g. foreign government official) may continue to qualify as a "foreign proceeding."

Section 1503 provides that treaties in which the United States is a party will prevail to the extent that they are in conflict with the provisions of Chapter 15. Section 1505 provides a court with the authority to appoint a trustee or other entity "to act in a foreign country on behalf of an estate created under section 541." Such an entity authorized to act may act in any way permitted by the applicable foreign law.

The Bankruptcy Code's ancillary approach under current law is embodied in Section 1507, which allows a court to provide assistance to foreign representatives if recognition is granted. Similar to the criteria set forth in current Section 304(c), Section 1507(b) provides that in determining whether to offer additional assistance, "a court shall consider whether such additional assistance, consistent with the principles of comity, will reasonably assure" just treatment, protection of U.S. Claim holders, prevention of fraudulent use of property, distribution of proceeds and the concept of a fresh start (if appropriate).

Section 1508 directs a court, when interpreting the provisions of Chapter 15, to "consider [the chapter's] 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."

C. Access of Foreign Representatives and Creditors to the Court

Section 1509 allows foreign representatives, after recognition under § 1515, to sue and be sued in Federal or State Courts and to commence a case under Section 1504. Recognition under Chapter 15 is a prerequisite to the granting of cooperation. Section 1510 provides that the filing of a petition does by under Chapter 15 does not subject the foreign representative to the jurisdiction of U.S. courts for any other purpose. Section 1511 provides that a foreign representative may commence either a voluntary or involuntary case upon filing a petition for recognition. Furthermore, upon recognition, the foreign representative may "participate as a party in interest." Section 1512.

Section 1513 provides that foreign creditors "have the same rights" as domestic creditors. This section also provides that allowance and priority of foreign tax claims or public laws shall be governed by applicable tax treaties. Section 1514 governs notifications to foreign creditors concerning a case commenced under chapter 15, and provides that when notice is to be given to domestic creditors it also must be given to foreign creditors.

D. Recognition of a Foreign Proceeding and Relief

Section 1504 provides that a case is commenced under Chapter 15 by filing a petition for recognition of a foreign proceeding under § 1515. Section 1515, in turn, sets forth the requirements for the filing of a petition for recognition which are generally a copy of the commencement decision in the foreign proceeding which appointed the foreign representative, and a certificate from the foreign court affirming the existence of the foreign proceeding and the appointment of the foreign representative. Section 1516(a) provides that the court is entitled to presume that, if the decision or certificate "indicates" that the foreign proceeding is a foreign proceeding (as defined in Section 101) and that the

person or body is a foreign representative (as defined in Section 101), the requirements for recognition are met.

Pursuant to Section 1517(a), after notice and a hearing, an order recognizing a foreign proceeding shall be entered if the foreign proceeding for which recognition is sought is a foreign main proceeding or foreign nonmain proceeding within the meaning of section 1502, if the foreign representative applying for recognition is a person or body (as defined in section 101) and if the petition meets the requirements of section 1515. Apparently, the court is left to determine whether the proceeding is a foreign main proceeding or a foreign nonmain proceeding – a determination that a court need not make under current Section 304.

Significantly, Section 1517(a) also apparently makes the recognition of a foreign proceeding mandatory if the foreign proceeding and foreign representative definitional requirements are met and if the filing requirements of Section 1515 are met. Under current Section 104, recognition is not mandatory as a court has discretionary authority to dismiss a proceeding even if it qualifies as a foreign proceeding. However, Section 1517(a) is “subject to section 1506,” which provides that “[n]othing in this chapter prevents the court from refusing to take action governed by this chapter if the action would be manifestly contrary to the public policy of the United States.” Thus, a court could decline to enter an order recognizing the foreign proceeding if such an order would be manifestly contrary to the public policy of the United States. Consistent with the Code’s ancillary approach under present law, Section 1517(d) also allows the modification or termination of recognition if the grounds for granting said determination were fully or partially lacking or have ceased to exist. Such a determination would, however, require the court to weigh possible prejudice to the parties relying on the granting of the recognition.

Section 1518 provides that a foreign representative must file with the court “a notice of change of status concerning any substantial change in the status of the foreign proceeding or the status of the foreign representative’s appointment” and any other proceeding which becomes known. Section 1519 provides the court with the authority to grant provisional relief while the petition for recognition is pending “where relief is urgently needed to protect the assets of the debtor or the interests of the creditors.” Such relief, if granted, terminates when the petition for recognition is granted.

Section 1520, in turn, provides that upon recognition of a foreign proceeding that is a foreign main proceeding, sections 361 and 362 will apply with respect to the debtor and that property of the debtor that is within the territorial jurisdiction of the United States, and the transfer, encumbrance or any other disposition of the debtor’s property within the United States will be restrained to the extent that it is property of the estate under §§ 363, 549 and 552. Additionally, a foreign representative is allowed to operate the debtor’s business and exercise the powers of a trustee. Thus, upon recognition of a foreign main proceeding, a foreign debtor will be entitled to the benefits of the automatic stay and the adequate protection requirements of § 361 will apply.

The relief that a court may grant upon recognition is set forth in Section 1521. A court may grant relief, upon recognition, “where necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interest of the creditors...” Section 1521(a). Such relief includes stays, suspension of rights to dispose of assets, examining witnesses and gathering information on a debtor’s assets, entrusting the foreign representative or other court designee with the administration of the debtor’s assets, and any additional relief that may be available. In deciding whether to grant relief

under §§ 1519 or 1521, the court must find that the interests of creditors or other interested persons are sufficiently protected. Section 1522. The court may condition its grant of relief or modify or terminate such relief once granted.

Section 1523 states that "upon recognition of a foreign proceeding, the foreign representative has standing in a case concerning the debtor pending in another chapter of this title to initiate actions" under other sections of this chapter. The section also provides that when the foreign proceeding is a nonmain proceeding, the court must be satisfied that the action initiated "relates to assets that, under United States law, should be administered in the foreign proceeding." Upon recognition, a foreign representative may also intervene in any proceeding in which the debtor is a party. Section 1524.

E. Cooperation with Foreign Courts and Foreign Representatives

Pursuant to Sections 1525 and 1526, a court and a trustee "shall cooperate to the maximum extent possible with foreign courts or foreign representatives." The sections also provide that a court and a trustee are entitled to communicate directly with foreign courts and foreign representatives. Section 1527 sets forth the forms of "cooperation" mentioned in §§ 1525 and 1526, and provides that such cooperation may be implemented by "any appropriate means" including appointment of a person to act at the direction of the court, communication, coordination of administration and supervision of assets, approval and implementation of agreements and coordination of concurrent proceedings.

F. Concurrent Proceedings

Section 1528 also emphasizes the ancillary approach of the United States Bankruptcy Code and represents deference to a foreign main proceeding. Section 1528 provides that upon recognition of a foreign main proceeding, a case may be commenced "only if the debtor has assets in the United States." Furthermore, the section provides that the effects of the case shall be restricted to assets in the United States and other assets if necessary to accomplish coordination and to the extent the other assets are not subject to the jurisdiction and control of a recognized foreign proceeding.

Section 1529 provides that when concurrent foreign and domestic proceedings concerning the same debtor are taking place, the court shall seek coordination and cooperation. The Section also addresses treatment of inconsistencies between cases in the United States and foreign jurisdictions, and provides for the applicability of relief under specific circumstances. Similarly, Section 1530 provides that a court shall seek cooperation and coordination if the debtor is involved in more than one foreign proceeding. Furthermore, for the purpose of facilitating coordination of the proceedings, any relief granted must be consistent and such relief may be modified or terminated.

Section 1531 provides that for the purpose of commencing a proceeding under § 303, "recognition of a foreign main proceeding is...proof that the debtor is generally not paying its debts as such debts become due."

Section 1532 sets forth a rule of payment in concurrent proceedings. The section states that, without prejudice to secured claims or rights in rem, once a creditor has received payment of an insolvency claim in a foreign proceeding, such creditor may not receive another payment for the same claim if the payments made to other creditors in the same class are proportionally less than the payment received.

VI. Conclusion

Due to the globalization of businesses, foreign business insolvencies with implications in the United States have and will continue to become more prevalent. Petitions for bankruptcy relief are likely to increase as foreign representatives seek to protect the foreign debtor's assets in the United States. Consequently, banking professionals would be wise to understand the options that are available to foreign debtors under current and future United States bankruptcy laws and principles.

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