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Second Circuit Determines the Relevant Date for Determining a Chapter 15 Debtor's "COMI"

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A. INTRODUCTION

Courts in the Southern District of New York and elsewhere have issued conflicting decisions regarding the appropriate time period to consider in determining a foreign debtor's "center of its main interests" or "COMI" for the purpose of recognition of a "foreign main proceeding" under Chapter 15 of the Bankruptcy Code. The split in authority that has developed over the past several years can be distilled into a single question: should COMI be measured at the time of the filing of the foreign proceeding for which recognition is being sought under Chapter 15 of the Bankruptcy Code, or, alternatively, at the time of the filing of the Chapter 15 petition? The answer may have a significant impact on the automatic relief a Chapter 15 debtor can obtain upon recognition of the foreign proceeding.

The Second Circuit, in *Morning Mist Holdings Ltd., et al. v. Kenneth Kryz, et al. (In re Fairfield Sentry Ltd.)*, resolved the split and concluded that a foreign debtor's COMI should be determined on the date that the Chapter 15 petition is filed.¹ At the same time, the court left lower courts with some discretion to consider the pre-filing period if there has been an obvious attempt to manipulate a foreign debtor's COMI or indicia of bad faith.

B. CHAPTER 15, COMI, AND SPLIT IN AUTHORITY

To commence a Chapter 15 case in the United States, a duly authorized representative must seek recognition of a foreign insolvency proceeding by filing a petition for relief in a United States Bankruptcy Court. If the requirements for recognition are satisfied, Chapter 15 recognizes two types of "foreign proceedings" – "foreign *main* proceedings" and "foreign *nonmain* proceedings."

A bankruptcy court will recognize a foreign proceeding as a foreign *main* proceeding "if it is pending in the country where the debtor has the center of its main interests."² Certain automatic relief becomes available to the foreign debtor upon entry of an order recognizing a foreign main proceeding, including the imposition of the "automatic stay" on creditors that may preclude creditors from seizing the foreign debtor's United States assets or continuing litigation against the foreign debtor. On the other hand, if a foreign debtor only obtains recognition of a foreign nonmain proceeding, the petitioning foreign debtor must specifically request such relief from the bankruptcy court.³ While the Bankruptcy Code does not define "center of its main interests," it does create a presumption that a debtor's COMI is "the debtor's registered office, or habitual residence in the case of an individual" in

¹ 2013 U.S. App. LEXIS 7608 (2d Cir. Apr. 16, 2013) ("*In re Fairfield Sentry Ltd.*").

² 11 U.S.C. § 1502(4).

³ A "foreign nonmain proceeding" is a proceeding which takes place in a jurisdiction where the non-U.S. debtor has an "establishment," which is defined as "any place of operations where the debtor carries out a nontransitory economic activity." 11 U.S.C. §§ 1502(2), (5).

Client Alert

absence of evidence to the contrary.⁴

Whether a foreign proceeding can be recognized as a foreign main proceeding hinges on a determination that the foreign proceeding is pending in the jurisdiction where the debtor has its COMI. Without clear statutory guidance, the question that has confounded courts in multiple jurisdictions is what reference date the court is supposed to use when determining a foreign debtor's COMI – the date of the filing of the foreign proceeding or the date of the filing of the Chapter 15 petition. One view, expressed by Judge Gropper in *In re Millennium Global Emerging Credit Master Fund Ltd.*, was that the appropriate date to determine a debtor's COMI is the date of commencement of the foreign proceeding.⁵ Taking the contrary view, a majority of the courts addressing this issue, including another bankruptcy court in the Southern District of New York, found that a debtor's COMI should be determined as of the date of the filing of its Chapter 15 petition.⁶ In *In re Fairfield Sentry*, the Second Circuit seized the opportunity to resolve the ambiguity in the statute and the split in the case law.

C. BACKGROUND AND LOWER COURT DECISIONS

By way of background, Fairfield Sentry Limited (“Sentry”) was a corporation organized and incorporated under the law of the British Virgin Islands (“BVI”) and the largest feeder fund that acted as a vehicle for non-U.S. persons to invest with Bernard L. Madoff Investment Securities LLC (“BLMIS”). Sentry had approximately 95% of its assets (approximately \$7 billion) invested in BLMIS and operations, employees, and directors all over the world. Sentry was immediately forced to cease operations when it was revealed that BLMIS had been operating a massive Ponzi scheme. As a result of the fraud, Sentry's independent directors became the target of significant lawsuits. Morning Mist Holdings, Ltd. (“Morning Mist”) commenced a shareholder derivative suit in New York state court in May 2009.

In July 2009, the High Court of Justice of the Eastern Caribbean Supreme Court entered an order commencing Sentry's liquidation proceedings and appointing BVI-based liquidators to administer the wind-down of Sentry's operations. Thereafter, in June 2010, the liquidators sought recognition of the BVI proceeding under Chapter 15 of the Bankruptcy Code in the Southern District of New York. The liquidators' stated purpose for commencement of the Chapter 15 proceeding was to facilitate the liquidators' access to U.S. courts in connection with the pursuit of Sentry's claims, and to afford the liquidators certain discovery rights. The liquidators asserted that Sentry's COMI was in the BVI and sought recognition of the BVI proceeding as a foreign main proceeding.

After examining Sentry's operations between December 2008, when Sentry ceased operating, and June 2010, when the Chapter 15 petition was filed, the bankruptcy court determined that Sentry's COMI was in the BVIs and

⁴ 11 U.S.C. § 1516(c).

⁵ 48 B.R. 63, 72 (Bankr. S.D.N.Y. 2011) (Gropper, J.) (“The substantive date for the determination of the COMI issue is at the date of the opening of the foreign proceeding for which recognition is sought.”).

⁶ See *In re Fairfield Sentry Ltd.*, 440 B.R. 60, 64-67 (Bankr. S.D.N.Y. 2011) (Lifland, J.) (granting foreign main proceeding recognition of a foreign proceeding and examining COMI following appointment of joint liquidators), *aff'd In re Fairfield Sentry Ltd.*, 2011 WL 4357421, at *6 (S.D.N.Y. 2011) (affirming Judge Lifland's decision to consider the time at and around Sentry's chapter 15 filing in determining its COMI and recognizing that “courts . . . have consistently held that the relevant time for determining a debtor's COMI is when the Chapter 15 petition was filed.”); *In re Ran*, 607 F.3d 1017, 1025 (5th Cir. 2010) (concluding, in an individual case, that COMI should be determined as of the date of the filing of the chapter 15 petition since “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” and “examining a debtor's COMI at the time the petition for recognition is filed fulfills Congress's purpose for implementing Chapter 15”); *In re Betcorp Ltd.*, 400 B.R. 266, 290-92 (Bankr. D. Nev. 2009) (holding that the review of operational history of a debtor in connection with a COMI determination “would frustrate the goals of using COMI to ‘harmonize’ insolvency proceeding recognition transnationally, and it would make the determination of COMI imprecise and often incorrect”).

Client Alert

entered an order recognizing the BVI proceeding as a foreign main proceeding. By virtue of recognition as a “main” proceeding, Morning Mist’s derivative action was automatically stayed by section 362 of the Bankruptcy Code. Morning Mist appealed, arguing that “the bankruptcy court should have looked at Sentry’s entire operational history” and not just the period between December 2008 and June 2010 in reaching a COMI determination.⁷ The district court disagreed with Morning Mist’s assertion and affirmed. Undeterred and further entrenched by Judge Gropper’s *Millennium Global* decision, which was issued in the interim, Morning Mist argued to the Second Circuit that the debtor’s “entire operational history” should have been considered in connection with the COMI determination.

D. SECOND CIRCUIT DECISION

As a strong rebuke to the arguments made by Morning Mist on appeal, the Second Circuit largely ignored Morning Mist’s contention that the “entire operational history” should be considered and framed the relevant inquiry as whether a court should determine a foreign debtor’s COMI as of the date of the filing of the foreign proceeding or the date of the filing of the Chapter 15 petition. In conducting its analysis, the Second Circuit relied upon (a) the text of the relevant statutes; (b) guidance provided by other federal courts; and (c) international sources.⁸ These three factors combined convinced the court that “a debtor’s COMI should be determined based on its activities at or around the time the Chapter 15 petition is filed.”⁹

1. Statutory Construction

The court began its analysis by assessing the plain language of section 1517(b) of the Bankruptcy Code. As noted, Chapter 15 does define COMI, but does provide that a “foreign proceeding shall be recognized . . . as a foreign main proceeding if it *is pending* in the country where the debtor *has* the center of its main interests.”¹⁰ The court placed significant weight on the fact that the applicable statutory language was drafted in present tense, thereby indicating that Congress had no intent to consider the debtor’s entire operational history.¹¹ Furthermore, in light of the plain language of the statute, the court found that “a COMI determination based on the date of the *initiation* of the foreign proceeding is not compelled by the statute.”¹² The present tense used in the statute was the pivotal driver of the court’s decision to use the date of filing of the Chapter 15 petition as the COMI reference date.

2. Other Federal Court Decisions

Next, the Second Circuit was guided by other federal court decisions that considered the same question and concluded that “[n]early every federal court to address this question has determined that COMI should be considered as of the time that the Chapter 15 petition is filed.”¹³ In particular, the court relied heavily on the only

⁷ *In re Fairfield Sentry Ltd.*, 2013 U.S. App. LEXIS 7608, at *8, citing 11 U.S.C. § 1517(b)(1).

⁸ *In re Fairfield Sentry Ltd.*, 2013 U.S. App. LEXIS 7608, at *13.

⁹ *Id.*, at *22.

¹⁰ *Id.*, at *13 quoting 11 U.S.C. § 1517(b) (emphasis added by court).

¹¹ *In re Fairfield Sentry Ltd.*, 2013 U.S. App. LEXIS 7608, at *14.

¹² *Id.*

¹³ *In re Fairfield Sentry Ltd.*, 2013 U.S. App. LEXIS 7608, at *15.

Client Alert

other circuit-level decision that specifically decided the question before the Court, *In re Ran*, 607 F.3d 1017, 1025 (5th Cir. 2010), which responded to the argument that a COMI determination should be made with regard to a debtor's operational history with the following:

Every operative verb is written in the present or present progressive tense. . . . 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. If Congress had, in fact, intended bankruptcy courts to view the COMI determination through a look-back period or on a specific past date, it could have easily said so.¹⁴

The Fifth Circuit also observed that a review of a debtor's full operational history would lead to a "meandering and never-ending inquiry" that "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."¹⁵ However, the court noted that the Fifth Circuit did "leave open the possibility (albeit in dicta) of looking at a broader time frame in order to frustrate possible bad-faith COMI manipulation."¹⁶ The Fifth Circuit's concern about manipulation of COMI was adopted by the Second Circuit.

The Second Circuit also disagreed with Judge Gropper's decision in *Millennium Global*. There, the court analogized COMI to the American jurisdictional concept of "principal place of business" and held that a debtor's COMI should be determined as of the commencement of the foreign proceeding.¹⁷ The Second Circuit was not persuaded by the legal analysis advanced in *Millennium Global*, citing to a law review article regarding Congress's decision to use the term "center of its main interests" instead of "principal place of business," and the plain language of the now-repealed section 304 of the Bankruptcy Code as the predecessor to Chapter 15.

3. International Interpretations

While the Second Circuit was guided by the plain text of Chapter 15, the court also considered Chapter 15's "international origin" and specifically that Chapter 15 courts must "promote an application of similar statutes adopted by foreign jurisdictions."¹⁸ Looking to the UNCITRAL Model Law on Cross-Border Insolvency (the "UNCITRAL Guide") and the European Union Council on Insolvency Proceedings (from which the UNCITRAL Guide originated), the Second Circuit credited the present tense description of COMI which implies that it "should correspond to the place where the debtor *conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.*"¹⁹ However, the court noted that the use of the phrase "on a regular basis" could be read to indicate a broader timeframe.²⁰ On this basis, the court found that the UNCITRAL Guide,

¹⁴ *Id.*, at *14 citing *In re Ran*, 607 F.3d 1017, 1025 (5th Cir. 2010).

¹⁵ *In re Fairfield Sentry Ltd.*, 2013 U.S. App. LEXIS 7608, at *16 citing *In Re Ran* 607 F.3d at 1025-26.

¹⁶ *In re Fairfield Sentry Ltd.*, 2013 U.S. App. LEXIS 7608, at *17.

¹⁷ *In re Millennium*, 458 B.R. at 72.

¹⁸ 11 U.S.C. § 1508.

¹⁹ *In re Fairfield Sentry Ltd.*, 2013 U.S. App. LEXIS 7608, at *20 citing Council Regulation (EC) No 1346/2000 of 29 May 2000, Preamble ¶ 13 (emphasis added).

²⁰ *In re Fairfield Sentry Ltd.*, 2013 U.S. App. LEXIS 7608, at *21.

Client Alert

other EU regulations regarding recognition of foreign insolvency proceedings, and European case law provided the court with little useful guidance.

E. CONCLUSION

Primarily on the basis of statutory interpretation, the Second Circuit held that “a debtor’s COMI should be determined based on its activities at or around the time the Chapter 15 petition is filed.”²¹ Moreover, the Second Circuit adopted the Fifth Circuit’s apprehension about COMI manipulation and left open the possibility that a broader temporal analysis that includes the period between the commencement of a debtor’s liquidation proceeding and the filing of the Chapter 15 petition could be considered if the court suspects that the debtor has manipulated its COMI in bad faith.²² Though it remains to be seen how *Fairfield Sentry* will impact relief available to putative Chapter 15 debtors in the future, all parties—including debtors and creditors alike—will benefit from the resolution of the uncertainty in the law regarding the appropriate reference date for a COMI determination.

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²¹ *Id.*, at *23.

²² *Id.*, at *27.