By George W. Shuster, Jr. and Benjamin W. Loveland

At the Edge of the Universe

Are Chapter 15's Principles of "Universalism" Too Parochial for the Realities of Today's Global Economy?

George W. Shuster, Jr.
WilmerHale; Boston and New York

Benjamin W. Loveland
WilmerHale; Boston and New York

George Shuster and Benjamin Loveland are partners in WilmerHale's Boston and New York offices.

Two recent bankruptcy court decisions — *In re Serviços de Petróleo Constellation SA*[1] and *In re Agrokor d.d.*[2] — demonstrate the increasing complexity of applying basic chapter 15 principles of "universalism" to global insolvency cases that span many jurisdictions. These decisions cast doubt on the meaning of the "universalism's" approach to cross-border insolvency in multinational cases. As a theory of international insolvency, universalism envisions that a "main" court in the debtor's "home" jurisdiction would administer the debtor's insolvency proceeding, while "ancillary" courts in other jurisdictions where the debtor has assets or liabilities would assist by recognizing the main court's orders and otherwise cooperating in aid of the main proceeding.

Previous chapter 15 decisions have grappled with whether the "center of main interests" (COMI) of a debtor company is in one country or another. Yet the *Serviços de Petróleo* decision addresses next-order questions: Should the COMI of a parent company be imputed to its subsidiaries, and should each entity within a corporate family have its COMI evaluated on a stand-alone basis? These questions invite further inquiry as to whether determining COMI independently for each entity within a global corporate enterprise serves the "universalism" goals under which chapter 15 emerged, or whether such a determination invites a new type of "territorialism" that focuses heavily on the "home" jurisdiction of an entity and its assets, to the exclusion of the entity's, or the entity's corporate family's, multinational status.

Likewise, the *Agrokor* decision addresses the extent to which the court in a chapter 15 case should recognize a settlement agreement approved by the Croatian court overseeing the "main" foreign proceeding of the debtor, where the settlement agreement purported to deal with debt claims governed by English (and New York) law. While the *Agrokor* court cited principles of "universalism" in recognizing the Croatian settlement agreement in the U.S., the court also made clear that its decision has strict limits. The court emphasized that the effect of its recognition order would not extend beyond the territory of the U.S., and that English creditors would still be free — at least from a U.S. perspective — to press for a "home" court determination of their claims under English law.

In this way, the *Agrokor* decision, like the *Serviços de Petróleo* decision, uses a window of "universalism" to enter a room where "territorialism" still has a place to sit. These decisions challenge whether cross-border universalism has an outer limit of utility and whether, at that outer limit, certain issues must still be resolved in, and on the basis of, a specific country and legal system.

Underpinnings of Universalism and Recognition Framework

When enacted in 2005, chapter 15 of the Bankruptcy Code — which governs the treatment afforded to international insolvency proceedings by U.S. bankruptcy courts — was widely viewed as a significant move toward more of a "universalism" theory of international insolvency. Universalism favors the centralized administration of a multinational debtor's insolvency proceedings in a court in a single "hub" jurisdiction, with the cooperation of courts in ancillary or "spoke" jurisdictions where the debtor might have other assets.

Universalism is generally understood to be in contrast to "territorialism," a theory under which each country where the debtor has assets would administer them independently and make distributions according to that country's local law — a system in which every country's insolvency proceeding is its own "hub." Proponents of universalism tout its benefits in the form of increased predictability regarding applicable law, greater efficiency and reduced costs, among other advantages.

Chapter 15 expressly adopts universalism's objectives[3] and fosters the goals of universalism by implementing a procedure by which U.S. courts will recognize a chapter 15 debtor's foreign insolvency proceedings as either "main" or "non-main" proceedings. A "main" proceeding is one that is pending in the debtor's "home" jurisdiction, where the debtor has its COMI. A proceeding pending where the debtor does not have its COMI, but nevertheless

1 600 B.R. 237 (Bankr. S.D.N.Y. 2019).
2 591 B.R. 163 (Bankr. S.D.N.Y. 2018).

3 Chapter 15 is often said to reflect a "modified universalism" rather than a "pure universalism," because it yields to the practical limitations inherent in relying on the courts and local laws of different jurisdictions. Jay Lawrence Westbrook, "Universalism and Choice of Law," 23 *Penn St. Int'l L. Rev.* 625 (2005).

maintains an "establishment," can be recognized as a "non-main" proceeding.

Chapter 15 defers in many respects to a foreign main proceeding, with the understanding that the proceedings in the main jurisdiction will largely govern the priority of claims and distribution of assets, while the chapter 15 court will assist in the implementation of the decisions reached in the main proceeding. The *Serviços de Petróleo* and *Agrokor* decisions display some of the difficulties of applying chapter 15's principles of universalism and recognition framework in today's global business environment.

Determining the COMI of a Highly Interrelated Enterprise Group

Serviços de Petróleo involved a request by a foreign representative for chapter 15 recognition of insolvency proceedings pending in Brazil with respect to 10 debtors. These debtors were part of an integrated enterprise group involved in oil drilling and production, located primarily in Brazil. The foreign representative sought recognition of the Brazilian proceedings in the U.S. as either foreign main or non-main proceedings.

One of the debtors' creditors objected to recognition of the debtors' Brazilian proceedings as foreign main proceedings on the basis that the debtors could not establish that its COMI was in Brazil, and urged the U.S. court to recognize the Brazilian proceedings as only non-main proceedings. As the court put it, the central issue was "how to apply the Chapter 15 COMI standards to each Chapter 15 Debtor in a highly interrelated enterprise group whose management and operations are increasingly becoming detached from any specific locale as the business aims towards increased globalization."[4]

The U.S. court began with the rebuttable presumption that a debtor's COMI is where the debtor has its "registered office." The chapter 15 debtors for which the Brazilian foreign representative sought recognition consisted of (1) a parent company with its registered office in Luxembourg, (2) an intermediate holding company with its registered office in the British Virgin Islands (BVI), and (3) seven subsidiaries of the BVI holding company, with registered offices in the BVI, Cayman Islands and Brazil, respectively. The BVI-organized debtors were also the subject of separate insolvency proceedings in the BVI in which joint provisional liquidators had been appointed. The U.S. court then applied to each debtor the factors to be considered in determining whether a debtor has rebutted the COMI presumption, including factors such as the location of the debtor's headquarters, management and primary assets; the jurisdiction whose law would apply to most disputes; and the expectations of the debtor's creditors and other third parties.[5]

The U.S. court concluded that the parent debtor's COMI was in Luxembourg, where it had its registered office and headquarters. The parent's board of directors, which appointed the corporate group's executives in London and Brazil, met in Luxembourg. Because the parent company was responsible for making high-level management decisions, the court placed a heavier emphasis on the location where the board conducted its activities than on the location of the enterprise's daily operational staff or the location of its primary assets. Nevertheless, the court concluded that the subsidiary debtors' substantial and ongoing business connections in Brazil were sufficient to support recognition of the parent's Brazilian proceeding as a non-main proceeding.

The U.S. court then analyzed the COMI of the BVI-organized intermediate holding company. The court characterized that COMI analysis as the most difficult of its determinations. The objector argued that because each subsidiary debtor was controlled and managed by the parent, the COMI for each must be the parent's COMI of Luxembourg. While the court recognized that the entities were highly interrelated, it emphasized its statutory obligation to separately determine the COMI of *each debtor*. Although the parent controlled the intermediate holding company from the perspective of "top-down legal control," the court noted that it was "difficult to overlook the fact that its revenues used to pay creditors *and* the day-to-day management of those revenue streams come from Brazil."[6]

Given what the U.S. court characterized as the relatively equal pulls in favor of a Luxembourg and Brazilian COMI, the court declined to hold that the location of the senior management should always be a more important consideration than the location of the management and generation of actual cash flows. Instead, the court determined that when a COMI analysis leads to a "toss-up between locales as the 'ultimate-seat,' the court should allow the weight of the relevant factors in evidence to determine the outcome."[7] The court concluded that it would be "fundamentally improper as a governing rule" to automatically impute the COMI of a parent entity to the entire enterprise.[8]

The strong creditor support for a Brazilian COMI, including the support of the joint official liquidators in the BVI proceedings (combined with the significant management and revenue-generation activities in Brazil), led the U.S. court to find that the weight of the evidence favored a COMI in Brazil for the intermediate holding company, and therefore recognition as a foreign main proceeding. Perhaps obvious following its rationale for the intermediate holding company's COMI, the court concluded that the COMI of the remaining debtors was also in Brazil and also recognized those debtors' proceedings as foreign main proceedings.

Considerations of International Comity in Recognition of Foreign Court Orders

In *Agrokor*, the U.S. court was faced with the inquiry of whether to recognize and enforce a restructuring plan (in the form of a settlement agreement) entered in the Croatian foreign main proceedings of a multinational enterprise consisting of multiple debtors. The settlement agreement for which the foreign representative sought the U.S. court's recognition would result in the discharge or modification of significant debt obligations, the majority of which were governed by

4 *Serviços de Petróleo*, 2019 WL 2051791, at *3.
5 *Id.* at 278-93.
6 *Id.* at 285.
7 *Id.*
8 *Id.* at 286.

continued on page 61

from page 21

English law and the remainder of which were governed by New York law.

The debtors had obtained recognition of their Croatian proceeding in England, but that recognition was the subject of an appeal. Moreover, the English court had not yet been asked to grant recognition to the settlement agreement. However, there was some concern that the English court would not recognize and enforce an agreement entered in the Croatian court that approved a discharge or modification of English law-governed debt.

The U.S. court began by recognizing chapter 15's goal of universalism: allowing a single proceeding to govern the equitable and orderly distribution of a debtor's assets, with the cooperation of courts in other countries in granting assistance to the court overseeing the primary proceeding. The court then turned to whether to recognize and enforce the settlement agreement as a matter of comity, noting that courts generally extend comity when the foreign court has proper jurisdiction and that enforcement would not prejudice the rights of U.S. citizens or violate U.S. policy. The comity determination takes into account the interests of the U.S., the interests of the foreign countries involved and the interest of international cooperation. The court concluded that the Croatian proceedings had been fair, and that the settlement agreement was consistent with U.S. policy.

However, the U.S. court noted that "[b]ecause Chapter 15's principal criterion for recognizing foreign proceedings and recognizing and enforcing a reorganization plan is a comity analysis, it is appropriate for this Court to consider the effects of a decision to extend comity to one nation if doing so could be seen as a refusal to extend comity to the laws of another — particularly where a majority of the debt to be modified is governed by the law of the latter nation."[9] Specifically, the court was concerned with the English law *Gibbs* rule, which notes that the recognition of foreign insolvency proceedings should be settled in the territory whose law governs the applicable contract. Under the *Gibbs* rule, an English court could decline to recognize the settlement agreement on the basis that it purported to discharge obligations governed by English law.[10] The failure by an English court to recognize the settlement agreement would undermine the effectiveness of the entire restructuring.

Despite questioning the *Gibbs* rule's continued applicability in an era of increasing universalism, the court ultimately concluded that it was appropriate to recognize the settlement agreement within the territorial jurisdiction of the U.S., but within that jurisdiction only. The court noted that "though the concept of comity is broad and may require overlapping considerations of the rights of several parties and nations, the Court believes it is appropriate to extend comity within the territorial jurisdiction of the United States to the Croatian Settlement Agreement if it becomes final, even with respect to the modification or discharge of English law governed debt."[11] The court's decision expressly left open the possibility that if the English court did not recognize the settlement agreement, through application of the *Gibbs* rule or otherwise, creditors would be free, from a U.S. perspective, to seek enforcement of their English law-governed claims in the English court.

Conclusion

Serviços de Petróleo and *Agrokor* illustrate the practical difficulties inherent in pursuing pure universalism, even in a country like the U.S., which, through the enactment of chapter 15, has sought to foster universalism's principles. *Serviços de Petróleo* demonstrates that individual COMI determinations for multiple debtors might undermine universalism's goals by failing to recognize a single main proceeding for a multinational enterprise group. In complex multinational cases, this could mean case structures with multiple main proceeding "hubs," each with its own non-main proceeding "spokes," and possibly instances where the one main proceeding "hub" is also a non-main proceeding "spoke" for another main proceeding.

In turn, *Agrokor* shows that even when the U.S. court is willing to grant comity in deference to the orders of a U.S. court in a foreign main proceeding, true universalism will depend on other countries' willingness to do the same, even in spite of its own parochial interests. Where another country's court fails to apply the same level of universalism as the U.S. court, it might become unclear which country's court is the true decision-maker on an issue.

In these types of cases, not only does the idea of "universalism" begin to lose sharp definition, but the goals of universalism (including predictability and efficiency) are at risk. This risk will possibly build pressure to create a new level of cross-border insolvency cooperation that goes beyond what chapter 15 achieved nearly 15 years ago. abi

9 *Agrokor*, 591 B.R. at 192.
10 *Id.* at 192-96.
11 *Id.* at 196.