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United States Bankruptcy Court for the Southern District of New York Identifies New Jurisdictional Hook to Provide Chapter 15 Relief to Foreign Debtors

On October 28, 2015, the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") issued a decision that significantly expands the jurisdictional bases that foreign issuers can rely upon to obtain relief in the United States under Chapter 15 of the Bankruptcy Code. In its decision, the Bankruptcy Court held that a New York choice of law provision and consent to New York court jurisdiction in the bond indenture of a foreign issuer was a sufficient property interest to establish jurisdiction for purposes of obtaining Chapter 15 relief in the Southern District of New York.

Background

Chapter 15 of the Bankruptcy Code and UNCITRAL

Chapter 15 of the Bankruptcy Code, which governs bankruptcy cases that are ancillary to insolvency proceedings brought in a foreign country, is designed to protect the US interests of foreign debtors and to promote fairness for both local and foreign creditors. Chapter 15 seeks to accomplish these goals through (i) recognition of, and assistance in support of, foreign insolvency proceedings, (ii) access to judicial proceedings in the United States by a duly authorized foreign representative[1] of foreign proceedings,[2] and (iii) availability of specified relief (including a stay of litigation and other enforcement actions within the territorial jurisdiction of the United States) upon recognition of the foreign proceeding (or, in extraordinary circumstances, upon the filing of the Chapter 15 proceeding).

Chapter 15 was added to the Bankruptcy Code as a part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 to encourage cooperation between the United States and foreign countries with respect to international insolvency cases. Chapter 15 incorporates a modified version of the Model Law on Cross-Border Insolvency (the "Model Law") promulgated by the United Nations Commission on International Trade in 1997, in recognition of the increasing incidence of cross-border insolvencies and the need for uniform domestic insolvency

[1] The term "foreign representative" is defined as a person or body 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 such foreign proceeding. 11 USC § 101(24). It is the foreign representative, and not the debtor itself, that commences and prosecutes a Chapter 15 case on the debtor's behalf.

[2] The term "foreign proceeding" is defined as a collective judicial or administrative proceeding in a foreign country, under a 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. 11 USC § 101(23).

laws to deal with cross-border cases. The Model Law is intended to serve as a basis to fairly, effectively and predictably address cross-border insolvency proceedings across jurisdictions.

The Debate: Whether Section 109(a) of the Bankruptcy Code is Applicable to Chapter 15 Cases

Section 109(a) of the Bankruptcy Code provides 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 the Bankruptcy Code, which includes Chapter 15.[3] The Model Law, on the other hand, contains no similar jurisdictional limitation. Courts have expressed differing views as to whether Section 109(a) applies to Chapter 15 proceedings, in which the debtor's foreign representative, not the foreign debtor itself, is the party that appears.

In 2013, the Second Circuit Court of Appeals held that Section 109's jurisdictional requirement is applicable to Chapter 15 cases. Referring to its statutory interpretation as "straightforward," the Court of Appeals went through a step-by-step justification of its conclusion: Section 103(a) makes all of Chapter 1 applicable to Chapter 15; Section 109(a)—within Chapter 1—creates a requirement that must be met by any debtor; and Chapter 15 governs the recognition of a foreign debtor's foreign proceedings.[4] The Court of Appeals found that "the presence of a debtor is inextricably intertwined with the very nature of a Chapter 15 proceeding," and that it "stretches credulity to argue that the ubiquitous references to a debtor in both Chapter 15 and the relevant definitions of Chapter 1 do not refer to a debtor under the title that contains both chapters."[5] The Court of Appeals further observed that if Congress had wished to exclude Chapter 15 from the reach of Section 109(a), it could have done so, but it did not. As a result, the Court of Appeals held that Section 109 is applicable to Chapter 15 cases and that, to file for relief under Chapter 15, a foreign debtor must have property in the United States (or otherwise meet the requirements of Section 109(a)).[6]

In the same month that the *Barnet* decision was issued, the United States Bankruptcy Court for the District of Delaware reached the opposite conclusion and refused to apply Section 109(a) to the recognition of a foreign proceeding.[7] The *Bemarmara* court stated that "Section 109(a) provides for Debtors under this title, and it is a Foreign Representative who is petitioning the Court, not the Debtor in the foreign proceeding. The Foreign Representative is asking for recognition in aid of that foreign proceeding. And the requirements of Section 109(a) do not control."[8]

[3] 11 USC § 109(a).

[4] *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238, 247 (2d Cir. 2013).

[5] *Id*. at 248.

[6] The international reaction to the *Barnet* decision has been largely negative. Among other things, commentators have noted that the decision "confuses the foreign debtor with the foreign insolvency representative," and creates "serious confusion and a potential obstacle to full international recognition." *See, e.g.*, Daniel M. Glosband and Jay Lawrence Westbrook, *Chapter 15 Recognition in the United States: Is a Debtor "Presence" Required?*, 24 Int'l Insolv. Rev. 28 (2015).

[7] *In re Bemarmara Consulting A.S.*, Case No. 13-13037 (Bankr. D. Del. Dec. 17, 2013).

[8] *Id*.

The debate is far from academic. Many foreign issuers of US debt have no other connection to the United States, including any tangible property in the United States. If Section 109(a) applies to these issuers, they could effectively be barred from seeking Chapter 15 relief in the US that would be necessary to, for example, enforce foreign court judgments compromising their bonds on anything other than a fully consensual basis, and to provide third parties such as indenture trustees the certainty and legal protection required in order to facilitate such a restructuring. One practical way that bankruptcy courts have tried to avoid addressing this issue was by finding that the requirements of Section 109(a) may be satisfied by the debtor depositing a retainer into its bankruptcy counsel's US client trust account.[9]

Berau Capital Resources – Indenture Provisions Satisfied Section 109(a) Jurisdictional Requirement

Berau Capital Resources Pte Ltd ("Berau") filed an insolvency proceeding in Singapore in July of 2015, and subsequently filed a petition for Chapter 15 recognition in the Southern District of New York. In determining whether to recognize Berau's foreign proceeding and grant relief in the United States, the Bankruptcy Court stated that it is bound by the holding in *Barnet*, meaning that Section 109(a) required that Berau must reside, have a domicile or place of business, or property in the United States to be eligible for Chapter 15 relief.

The Bankruptcy Court started its analysis by finding that a retainer held by the foreign representative's New York counsel constituted "property in the United States" for purposes of establishing Chapter 15 eligibility under Section 109(a).[10] Rather than stopping there, as the Bankruptcy Court has done in previous decisions, it went on to hold that Berau's contractual rights under the indenture governing its bonds served as an independent basis to establish the requisite jurisdiction. According to the Bankruptcy Court's analysis, the indenture was a contract that created intangible contractual property rights for all of the parties thereto, including the debtor.[11] The Bankruptcy Court noted that New York law expressly governed the indenture (which also included a New York choice of forum clause), Berau appointed an authorized agent for service of process in New York, and numerous other acts addressed in the indenture could only be performed in New York. Stating that "it would be ironic if a foreign debtor's creditors could sue to enforce the debt in New York, but in the event of a foreign insolvency proceeding, the foreign representative could not file and obtain protection under [c]hapter 15 from a New York bankruptcy court," the Bankruptcy Court found that Section 109(a)'s jurisdictional requirement was independently satisfied by the Debtor's contractual property rights derived from the bond indenture.

Discussion

Prior to *Berau*, the jurisdictional requirement of Section 109(a) could be met by the foreign debtor transferring a retainer to its attorney's US trust account. However, this "workaround" is imperfect for several reasons. For example, in a case with multiple affiliated debtors, it may be necessary for each debtor (including debtors without access to cash) to transfer a retainer to their US attorney or risk having recognition of their case denied for lack of

[9] *See, e.g., In re Lupatech, et al.*, Bk. No. 14-11559-SMB (Bankr. S.D.N.Y. 2014).

[10] *In re Berau Capital Resources Pte Ltd (In re Berau)*, Bk. No. 15-11804-MG, 2015 WL 6507871 (Bankr. S.D.N.Y. Oct. 28, 2015).

[11] *Id.*

proper jurisdiction.[12] Many foreign entities are parties to contracts that contain choice of law and forum selection clauses for New York or other states in respect of debt issued outside of the United States. The *Berau* decision's reliance on intangible contractual rights, therefore, creates "another substantial (and frequently recurring) basis for [C]hapter 15 eligibility."[13]

In order to reconcile his position with the Court of Appeals' decision in *Barnet*, Judge Glenn's ruling is grounded in the conclusion that intangible property rights constitute property for purposes of Section 109(a) of the Bankruptcy Code. Because Section 109(a) applies in Chapter 11 and Chapter 7 cases as well as Chapter 15 cases, there is no reason that the logic of the *Berau* decision would not apply to allow a foreign debtor to file under Chapter 11 on the basis of New York (or some other US state's) choice of law and forum selection clauses. In that regard, the jurisdictional perspective would be similar to the view of English courts, which view choice of law as an appropriate basis to obtain jurisdiction over an English scheme of arrangement.[14] Judge Glenn's ultimate ruling that choice of law or consent to jurisdiction provisions, by themselves, are enough to create situs of a contract within the United States is somewhat novel, and, therefore, it is unclear whether the decision will be followed in other jurisdictions or would be upheld on appeal. What is clear is that the *Berau* decision may have far reaching impacts at the intersection of US bankruptcy practice in the Southern District of New York and international commerce.

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[12] *In re Berau*, 2015 WL 6507871 at *1.

[13] Another risk and potential cost to relying on a retainer is that creditors sometimes challenge such filings as being in bad faith by virtue of purportedly manufactured jurisdiction.

[14] *Re Rodenstock GmbH [2011] EWHC 1104 (Ch)*

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