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The Timing Is Off: The Definitional Gap Between Plain Language and Legislative Intent in the Recognition of Foreign Proceedings

By Douglas P. Bartner and Robert A. Britton

The Second Circuit is currently considering an appeal arising from the decisions of the bankruptcy and district courts in *Fairfield Sentry*.[1] Its opinion is likely to resolve a split of authority between the *Fairfield Sentry* and *Millennium*[2] courts within the Southern District of New York, and could create a split with the Fifth Circuit's decision in the *Ran* case.[3] Whatever the outcome, the Second Circuit's *Fairfield Sentry* decision will highlight a peculiar problem with the language of Chapter 15 of the United States Bankruptcy Code (the ''Bankruptcy Code'') that, if interpreted literally (as it usually is), often leads to results that were almost certainly unintended by Congress, including potential forum shopping by corporate debtors seeking to liquidate in countries that have favorable laws but bear little connection to their prepetition operations. Most courts that have recognized the problem have determined that they are unable to rectify it given the plain language of Chapter 15. While the *Millennium* court interpreted the statute in a way that seems to be in line with the intent of both Congress and the United Nations Commission on International Trade Law (''UNCITRAL''), which drafted the model law that Chapter 15 is based upon (the ''U.N. Model Law''), that court's interpretation of Chapter 15 is difficult to square with the plain language of the statute. To fully resolve the problem, Congress should amend Chapter 15 to make its intent clear. Fortuitously, UNCITRAL is already considering such an amendment to the U.N. Model Law.

Recognition of a Foreign Proceeding

Chapter 15 of the Bankruptcy Code is designed to create ''effective mechanisms for dealing with cases of cross-border insolvency.''[4] Once a foreign proceeding has been recognized by a United States bankruptcy court, Chapter 15 extends a wide-array of rights and protections that a foreign debtor's representative may use to protect and represent the debtor and its assets within the territorial jurisdiction of the United States. To obtain recognition of a foreign proceeding, however, a foreign representative must prove that the foreign proceeding fulfills a rigid set of requirements. These requirements are designed, among other things, to ensure that the foreign proceeding is based in a country with a sufficient nexus to the debtor.[5] Recognition under Chapter 15 ''is not to be rubber stamped by the courts,'' and it has been denied to foreign representatives that failed to meet the statutory requirements, even in the absence of any objection.[6]

[1] *In re Fairfield Sentry Ltd.*, 2011 BL 339338 (S.D.N.Y. Sept. 16, 2011), *appeal docketed*, No. 11-4376 (2d Cir. Oct. 19, 2011).

[2] *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011), *aff'd*, 474 B.R. 88 (S.D.N.Y. 2012).

[3] *Lavie v. Ran (In re Ran)*, 607 F.3d 1017 (5th Cir. 2010).

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[4] 11 U.S.C. § 1501 (2005).

[5] *See, e.g.*, H.R. Rep. 109-31(I), at 106 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 169 (''Cases brought under chapter 15 are intended to be ancillary to cases brought in a debtor's home country.''); *In re British Am. Ins. Co. Ltd.*, 425 B.R. 884, 899 (Bankr. S.D. Fla. 2010) (stating that Chapter 15's ''recognition procedure . . . reflects a policy determination by UNCITRAL and Congress that this Court should not assist a representative of a foreign action unless the debtor has sufficient presence in the country in which the foreign action is taking place.'').

[6] *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122, 126 (Bankr. S.D.N.Y.

One of the requirements for recognition of a foreign proceeding is that it must be a ''foreign main proceeding or foreign nonmain proceeding.''[7] A foreign main proceeding is an insolvency proceeding located ''in the country where the debtor *has* the center of its main interests,'' while a foreign nonmain proceeding is an insolvency proceeding that does not constitute a foreign main proceeding but is located ''in a country where the debtor *has* an establishment.''[8] The term ''center of main interests,'' or ''CoMI,'' is not defined by the Bankruptcy Code. [9] In the case of corporate debtors, United States courts have likened the concept to a principal place of business, and the Bankruptcy Code creates a rebuttable presumption that a debtor's CoMI is in the place of its ''registered office, or habitual residence.''[10]

Every foreign debtor has only one CoMI, and therefore can have just one foreign main proceeding.[11] Insolvency proceedings pending in jurisdictions that are not a debtor's CoMI may qualify as foreign nonmain proceedings if the debtor has an establishment in that country. The term ''establishment'' is defined by the Bankruptcy Code to mean ''any place of operations where the debtor carries out a nontransitory economic activity.''[12] Therefore, before it recognizes a foreign insolvency proceeding, a bankruptcy court must be satisfied that the proceeding is occurring in a country that is the debtor's principal place of business, a place where it performs nontransitory economic activity, or in the case of an individual debtor, his or her habitual residence.

If a foreign proceeding is pending in a country that is not the debtor's CoMI and in which the debtor has no establishment, it is part of a ''more nebulous category of proceedings that are neither foreign main nor foreign nonmain.''[13] Foreign proceedings that fall into this definitional gap are ''simply ineligible'' for ancillary relief under Chapter 15.[14] As a result, the only way for a debtor in such a foreign proceeding to, among other things, protect its assets in the United States is by filing a plenary case under Chapter 11 or Chapter 7 of the Bankruptcy Code.

Problems Arising from the Plain Meaning of the Recognition Rules

Chapter 15 states that a foreign main proceeding occurs in a country where a debtor *has* its CoMI, and a foreign nonmain proceeding occurs in a country where a debtor *has* an establishment. Because these definitions are drafted in the present tense, nearly every court to examine the issue has analyzed whether a foreign proceeding is a qualifying main or nonmain proceeding as of the date the Chapter 15 petition was filed or soon thereafter.[15] Debtors, however, may be under administration in a foreign proceeding for months, or years, before a Chapter 15 proceeding is commenced. If the debtor is liquidating (as is not uncommon in many foreign jurisdictions) and has been under administration for a significant amount of time, it will very likely no longer have a principal place of business or an establishment in any country. In that case, the debtor's foreign proceeding would seemingly fall into the definitional gap and be ineligible for ancillary relief under Chapter 15.

Courts have granted recognition to foreign proceedings in such situations by determining that, in a liquidation proceeding, a debtor's CoMI may become lodged with the liquidators who carry out economic activities on the debtor's behalf.[16] This has been the case even when the liquidation proceeding is pending in a country that was neither the debtor's CoMI nor a place where it maintained a statutory establishment prior to commencement of its foreign proceeding. For example, debtors have obtained recognition of foreign proceedings pending in countries where they had no prepetition connection other than that they incorporated there, a basis that would have been insufficient to support recognition on the first day of their foreign insolvency proceedings.[17] Courts have recognized that this interpretation of the Bankruptcy Code creates the potential for foreign debtors to forum shop the location of their main proceeding simply by delaying the filing of their Chapter 15 petition. This result is contrary to the policy determinations made by the United Nations and Congress in drafting and adopting the U.N. Model Law.[18] A brief examination of the *Bear Stearns* and *Fairfield Sentry* cases illustrates the dilemma.

The *Bear Stearns* debtors were investment funds formed in the Cayman Islands. In 2007, the debtors' assets were significantly devalued, and counterparties made margin calls that the debtors were unable to meet. This led to the debtors' commencing winding-up proceedings in the Cayman Islands. On the same day that they commenced the Cayman proceedings, the debtors' Cayman liquidators filed a Chapter 15 petition

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2007) (denying recognition of a foreign proceeding in the absence of any objection).

[7] 11 U.S.C. § 1517(a)(1) (2005).

[8] 11 U.S.C. §§ 1502(4)-(5) (2005) (emphasis added).

[9] The term is borrowed from the U.N. Model Law, and was included in the Bankruptcy Code ''to promote international uniformity'' in the adoption of the U.N. Model Law. *In re Tri-Continental Exch. Ltd.*, 349 B.R. 627, 633 (Bankr. E.D. Cal. 2006) (citing Jay Lawrence Westbrook, *Chapter 15 at Last*, 79 AM. BANKR. L.J. 713, 719-20 (2005)).

[10] *Lavie v. Ran*, 406 B.R. 277, 283 (S.D. Tex. 2009); *aff'd*, 607 F.3d 1017 (5th Cir. 2011); 11 U.S.C. § 1516(c) (2005).

[11] *In re Chiang*, 437 B.R. 397, 399 (Bankr. C.D. Cal. 2010).

[12] 11. U.S.C. § 1502(2) (2005).

[13] *Ran*, 406 B.R. at 287.

[14] *Chiang*, 437 B.R. at 402; *see also In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 389 B.R. 325, 334 (S.D.N.Y. 2008); *British Am. Ins. Co. Ltd.*, 425 B.R. at 899-900 (Bankr. S.D. Fla. 2010).

[15] *See, e.g., In re Betcorp Ltd.*, 400 B.R. 266, 290-91 (Bankr. D. Nev. 2009) (finding that taking a debtor's operational history into account would ''make the determination of CoMI imprecise and often incorrect.''); *British Am. Ins. Co. Ltd.*, 425 B.R. at 910, 915 (finding that the proper date of examination is the date that the court rules on the Chapter 15 petition and that in any case the determination could ''be no earlier than the date the chapter 15 petition was filed.''); *In re Fairfield Sentry Ltd.*, 440 B.R. 60, 64; *see also* Mark Lightner, *Determining the Center of Main Interests Under Chapter 15*, 18 J. Bankr. L. & Prac. 5, art. 2 (2009).

[16] *See, e.g., Betcorp Ltd.*, 400 B.R. at 292; *British Am. Ins. Co.*, 425 B.R. at 914; *In re Fairfield Sentry Ltd.*, 440 B.R. at 64.

[17] *See British Am. Ins. Co.*, 425 B.R. at 914; *In re Fairfield Sentry Ltd.*, 440 B.R. at 64.

[18] *Fairfield Sentry Ltd.*, 440 B.R. at 65-66. The drafting of the recognition requirements in the present tense has also led to the result that individual debtors may be able to escape their foreign creditors by changing the nation of their habitual residence. *Lavie v. Ran*, 406 B.R. at 288 (S.D. Tex. 2009), *aff'd*, 607 F.3d 1017 (5th Cir. 2010).

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for recognition as a foreign main or, in the alternative, foreign nonmain proceeding in the United States. The Chapter 15 petitions were not objected to by any party.[19] Nonetheless, the bankruptcy court determined that the debtors' CoMI was actually in the United States, because the funds' asset manager, administrator, books and records, and liquid assets were all located there.[20] The court also found that the debtors had no assets and no economic activities in the Cayman Islands.[21] Therefore, the court denied recognition of the Cayman proceedings as either foreign main or nonmain proceedings.

In *Fairfield Sentry*, the essential facts were similar, but the court's decision was different. The debtor in that case was a feeder fund of Bernard L. Madoff Investment Securities, Inc. It was incorporated in the British Virgin Islands, but nearly all of its business activities, including its management, took place in New York.[22] When the Madoff funds were revealed to be Ponzi schemes, the *Fairfield Sentry* debtor ceased operations, and joint liquidators were appointed to administer its estate by a British Virgin Islands court. From that point, the joint liquidators managed all of the debtor's affairs from the British Virgin Islands and were its sole representatives.[23] More than a year later, the liquidators filed a Chapter 15 petition for recognition of the British Virgin Islands insolvency proceeding as a foreign main proceeding. In contrast to the decision in *Bear Stearns*, the *Fairfield Sentry* court recognized the British Virgin Islands proceeding, finding that the recent business activities carried out on behalf of the debtor by the liquidators were sufficient to establish the debtor's CoMI in the British Virgin Islands and discounting a history of nearly two decades carrying on activity almost exclusively in the United States.[24] In reaching this conclusion, the court relied on the fact that ''courts . . . have consistently held that the relevant time for determining a debtor's CoMI is when the chapter 15 petition was filed.''[25] The decision in *Fairfield Sentry* leads to the conclusion that the *Bear Stearns* foreign representatives would have received recognition of the Cayman liquidation as a foreign main proceeding if they could have commenced liquidation activities and waited an indeterminate amount of time before filing a Chapter 15 petition.

Relying on activities carried on as part of a debtor's liquidation to determine its CoMI opens the door to forum shopping by debtors that wish to liquidate under the laws of a business-friendly jurisdiction with no other connection to their operations than, perhaps, that it or an affiliate was incorporated there. The *Fairfield* bankruptcy court noted this potential for abuse, stating ''[i]n any proceeding for foreign recognition, of great concern to the Court is the potential for mischief and CoMI manipulation,'' but it found no such abuse in that case.[26]

Reinterpreting Chapter 15

The *Fairfield* case is currently on appeal to the Second Circuit. This appeal is timely because another recent decision from the Southern District of New York broke from the significant body of authority and held that the proper temporal focus of a recognition analysis is the date of the commencement of a foreign proceeding, rather than the date of commencement of the Chapter 15 proceeding.[27]

In *Millennium,* the court was faced with petitions for recognition from two investment vehicles incorporated in Bermuda. Those entities were managed from Guernsey and London, and their investment activities occurred primarily in Europe and the United States.[28] The funds failed to meet a margin call in 2008, and their liquidation promptly commenced in Bermuda. In 2011, the Bermudan liquidators filed a Chapter 15 proceeding seeking recognition of the Bermudan proceedings as foreign main proceedings, arguing that the debtors' CoMI had always been in Bermuda or, alternatively, that it had become lodged there as a result of the liquidators' winding-up activities.[29] In examining the issue, the bankruptcy court agreed that the definitions of ''foreign main proceeding'' and ''foreign nonmain proceeding'' are written in the present tense. Nonetheless, it went on to conclude that the present tense refers back to the time that the foreign proceeding was commenced. The *Millennium* court supported this reading by noting that a debtor in liquidation has no CoMI, since it has no place of business, and by analyzing analogous provisions under a previous version of the Bankruptcy Code and in foreign law. [30] It is not clear how an event that occurred in the past – the commencement of the foreign proceeding – can be analyzed as though it occurred in the present, as is required by the plain language of Chapter 15.

Nonetheless, the *Millennium* court's interpretation appears to be in line with the intent of UNCITRAL and Congress that a foreign proceeding be recognized only if the debtor bears a sufficient connection to the locale of that proceeding. Moreover, the *Millennium* court's reading of Chapter 15 would prevent the forum shopping concerns identified by other courts while still relying on an identifiable point in time to use in the recognition analysis.[31] Notably, the drafters of the U.N. Model Law appear to agree with the *Millennium* court's view and are preparing proposed revisions to clarify the issue.[32] In their report, the drafters note that ''a proposal was made to provide a clear rule'' that ''[t]he date of commencement of the foreign insolvency proceeding

[19] *Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 389 B.R. at 328-29.
[20] *Id.* at 330.
[21] *Id.* at 339.
[22] *In re Fairfield Sentry Ltd.*, 2011 BL 339338 (S.D.N.Y. Sept. 16, 2011).
[23] *Id.* at *2.
[24] *Id.* at **4, 6.
[25] *Id.* at *6.
[26] *In re Fairfield Sentry Ltd.*, 440 B.R. 60, 65-66 (Bankr. S.D.N.Y. 2010).
[27] *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63, 87 (Bankr. S.D.N.Y. 2011).
[28] *Id.* at 66.
[29] *Id.* at 68.
[30] *Id.* at 72-73. The court drew a distinction between the debtor's estate and any reorganizing entity, which is separate from that estate.
[31] *Id.*
[32] UNCITRAL, *Report of Working Group V (Insolvency Law) on the work of its forty-first session*, U.N. Pub. Sales No. A/CN.9/742 at ¶¶ 4, 60.

should be used as the date to determine the CoMI of the debtor.''[33] A subsequent report notes that the drafters adopted the proposal with minor revisions, and that they determined that the same timing determination ''should also apply to establishment.''[34]

Conclusion

The plain language of Chapter 15 of the Bankruptcy Code – in its use of the present tense – seems to require courts to determine whether a foreign proceeding qualifies for recognition as of the date of filing of the Chapter 15 petition. This leads to the unintended consequence that a foreign debtor may manufacture the jurisdiction of its foreign main proceeding, a result at odds with the stated intent of Congress and UNCITRAL in drafting Chapter 15 and the U.N. Model Law, respectively. The optimal resolution of the issue would be for Congress to amend Chapter 15 by enacting the amendments to the Model Law that UNCITRAL is currently drafting. In the meantime, the Second Circuit's decision in *Fairfield Sentry* should provide guidance to other courts and practitioners on balancing Congress's apparent intent with the plain meaning of the statute that it enacted.

[33] *Id.* at 60.

[34] UNCITRAL, *Report of Working Group V (Insolvency Law) on the work of its forty-second session*, U.N. Pub. Sales No. A/CN.9/763 at ¶ ¶ 50-52.

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