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Second Circuit Decides Key Issue of Statutory Interpretation Under Chapter 15 of the Bankruptcy Code



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In *In re Fairfield Sentry Ltd.*,¹ the Court of Appeals for the Second Circuit affirmed that a Chapter 15 debtor's "center of main interests" ("COMI") is determined as of its Chapter 15 petition date, rather than as of the foreign proceeding commencement date, resolving a split of authority between a significant body of cases, including the lower courts' decisions in *Fairfield*,² and the bankruptcy court's decision in *In re Millennium Global Emerging Credit Master Fund Ltd.*³ The Second Circuit also held that courts may consider

¹ *Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*, 2013 BL 102426 (2d Cir. April 13, 2013) (25 BBLR 564, 4/25/13).

² *In re Fairfield Sentry Ltd.*, 440 B.R. 60 (Bankr. S.D.N.Y. 2010); *In re Fairfield Sentry Ltd.*, 2011 BL 339338 (S.D.N.Y. Sept. 16, 2011).

³ *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). The authors previously examined this split in a related article titled "The Timing is Off: The Definitional Gap Between Plain Language and Legislative Intent in the Recognition of Foreign Proceedings" published in *Bloomberg BNA's*

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whether a debtor's COMI was manipulated in bad faith and may take into account the situs of liquidation activities carried out on behalf of the debtor in determining the debtor's COMI.

Recognition Under Chapter 15

Recognition by a U.S. court pursuant to Chapter 15 extends a wide array of rights and protections to a foreign debtor's representative within the territorial jurisdiction of the United States. To obtain recognition of a foreign proceeding, a foreign representative must prove that the foreign proceeding is either a "foreign main proceeding or foreign nonmain proceeding," and the recognition and other relief sought must not be manifestly contrary to any fundamental U.S. public policy.⁴ A foreign main proceeding is a judicial or administrative proceeding relating to insolvency located "in the country where the debtor has the center of its main interests," while a foreign nonmain proceeding is a judicial or administrative proceeding relating to insolvency that does not constitute a foreign main proceeding but is located "in a country where the debtor has an establishment."⁵ If a foreign proceeding is pending in a country that is not the debtor's COMI and in which the debtor has no establishment, the debtor is "simply ineligible" for ancillary relief under Chapter 15.⁶

Bankruptcy Law Reporter on April 11, 2013 (25 BBLR 501, 4/11/13).

⁴ 11 U.S.C. § 1506 (2005); 11 U.S.C. § 1517(a)(1) (2005).

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

⁶ See *In re Chiang*, 437 B.R. 397, 402 (Bankr. C.D. Cal. 2010); *In re Bear Stearns High-Grade Structured Credit Strat-*

A debtor's COMI may shift over time. Therefore, the temporal focus of a U.S. court's recognition analysis is often key to determining whether a foreign proceeding may be recognized as a foreign main proceeding. The majority of courts that have considered the issue have held, based on the text of Chapter 15, that they must determine the location of a debtor's COMI as of its Chapter 15 petition date. In the context of a liquidation proceeding, courts have also held that a debtor's COMI may become lodged with the liquidator carrying out economic activities on its behalf.⁷ This means that if a liquidation proceeding is commenced for a debtor in a jurisdiction that is not its COMI, and where it maintains no establishment, after some amount of time a U.S. court may recognize that liquidation proceeding as a foreign main proceeding based solely on the activities of the foreign liquidator. The *Millennium* court disagreed with this reasoning, holding instead that the location of a debtor's COMI and establishments should be determined as of the date that its foreign proceeding commenced.⁸ This view would preclude liquidation activities from being used as the basis for establishing COMI in any jurisdiction. In its holding, the *Millennium* court noted its concern that allowing COMI to become lodged with a foreign liquidator creates the potential for bad faith manipulation by debtors or creditors that wish to commence liquidation proceedings in a favorable jurisdiction where the debtor maintains minimal connections, and still obtain the benefits of a Chapter 15 foreign main proceeding in the U.S.⁹

Facts

The *Fairfield* debtor was the largest of the Bernard L. Madoff Investment Securities LLC "feeder funds."¹⁰ It was incorporated in the British Virgin Islands ("B.V.I.") in 1990, and certain of its corporate administrative functions were carried out there.¹¹ A New York-based investment manager handled the debtor's day-to-day operations. In December 2008, after the Madoff fraud was discovered, the debtor's two independent directors, who were both based in Europe, began winding-up the debtor's business.¹² On July 21, 2009, certain of the debtor's shareholders forced it into a B.V.I. liquidation proceeding and a B.V.I. liquidator was appointed to manage its assets and affairs.¹³ Nearly one year later, on June 14, 2010, the liquidator petitioned the U.S. Bankruptcy Court for the Southern District of New York for recognition of the B.V.I. proceeding under Chapter 15 as a foreign main or, alternatively, as a foreign non-main proceeding.¹⁴

Morning Mist Holdings Limited ("Morning Mist"), a shareholder that had filed a derivative action in New

York state court on behalf of the debtor,¹⁵ objected to the debtor's request for recognition, arguing that: (1) the court should review the entire operational history of the debtor in determining the proper COMI, rather than focusing only on the location of its liquidation activities as of the date it filed for Chapter 15 relief; and (2) restricting public access to potentially important documents, as is routinely done in B.V.I. liquidation proceedings, is manifestly contrary to U.S. public policy in violation of Section 1506 of the Bankruptcy Code.¹⁶

Lower Fairfield Courts' Decisions

Overruling Morning Mist's objections, the bankruptcy court granted the debtor's Chapter 15 petition as a foreign main proceeding. The bankruptcy court reviewed the debtor's administrative and liquidation-related activities carried out in the B.V.I. between December 2008 and June 2010 and concluded that such activities sufficed to establish COMI in the B.V.I.¹⁷ The district court affirmed the bankruptcy court's decision on appeal.¹⁸ Morning Mist then appealed the district court's decision to the Second Circuit.¹⁹

Second Circuit's Opinion

Addressing the COMI timing determination question on appeal, the Second Circuit noted that Section 1517(b) of the Bankruptcy Code is written in the present tense: "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."²⁰ The Second Circuit found that this present tense construction suggests that Congress intended for courts to examine a debtor's COMI as of the time the Chapter 15 petition is filed.²¹ Thus, it rejected Morning Mist's argument in support of examining the debtor's entire operational history as beyond the plain meaning of the statute.²² The Second Circuit also determined that the words "is pending" in Section 1517 must refer to a foreign proceeding that has already commenced, and therefore rejected arguments for a COMI determination based on the date of the initiation of the foreign proceeding.²³

By rejecting the *Millennium* court's holding that COMI should be determined as of the date of commencement of the foreign proceeding, and finding that "any relevant activities, including liquidation activities and administrative functions, may be considered in the COMI analysis," the Second Circuit resolved a split among lower courts in the Southern District of New York.²⁴ At the same time, the Second Circuit addressed the *Millennium* court's concerns over potential COMI manipulation by stating that "a court may consider the

egies Master Fund, Ltd., 389 B.R. 325, 334 (S.D.N.Y. 2008); *In re British Am. Ins. Co. Ltd.*, 425 B.R. 884, 899-900 (Bankr. S.D. Fla. 2010).

⁷ See, e.g., *In re Betcorp Ltd.*, 400 B.R. 266, 290-92 (Bankr. D. Nev. 2009); *British Am. Ins. Co.*, 425 B.R. at 914; *Fairfield*, 440 B.R. at 64.

⁸ *Millennium*, 458 B.R. at 76.

⁹ *Id.*

¹⁰ *Fairfield*, 2013 BL 102426 at *3.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at *3.

¹⁷ *In re Fairfield Sentry Ltd.*, 440 B.R. 60 (Bankr. S.D.N.Y. 2010).

¹⁸ *In re Fairfield Sentry Ltd.*, 2011 BL 339338 (S.D.N.Y. Sept. 16, 2011).

¹⁹ *Fairfield*, 2013 BL 102426 at *3.

²⁰ *Id.* at *5 (citing 11 U.S.C. § 1517 (emphases added)).

²¹ *Id.* at *5.

²² *Id.*

²³ *Id.*

²⁴ *Id.* at *9.

period between the commencement of the foreign proceeding and the filing of the Chapter 15 petition to ensure that a debtor has not manipulated its COMI in bad faith.”²⁵

Finally, the Second Circuit dismissed Morning Mist’s public policy argument, finding that the public policy exception should be narrowly read and limited to acts that are manifestly contrary to the most fundamental policies of the U.S.²⁶ Morning Mist argued that the B.V.I. liquidation proceedings were conducted under seal and “shrouded in secrecy” in contravention of public policy.²⁷ However, the Second Circuit determined that unfettered public access to court documents is not a fundamental public policy in the U.S., especially given that certain documents are routinely filed under seal in U.S. courts.²⁸

Conclusion

The Second Circuit’s decision in *Fairfield* resolves a split among lower courts in the Southern District of

²⁵ *Millennium*, 458 B.R. at 72; *Fairfield*, 2013 BL 102426 at *8.

²⁶ *Fairfield*, 2013 BL 102426 at *10.

²⁷ *Id.* at *11.

²⁸ *Id.*

New York regarding an important question of statutory interpretation arising in Chapter 15 cases and offers key guidance in interpreting the meaning of COMI. The Second Circuit acknowledged the differing view held by the *Millennium* court, but ultimately found that the present tense construction of Section 1517(b) of the Bankruptcy Code must refer to the time that the Chapter 15 petition is filed rather than the time that the applicable foreign proceeding was commenced. The Second Circuit also recognized the potential for bad faith COMI manipulation by certain liquidating entities, and stated that courts may consider whether such manipulation has occurred when determining whether to recognize a foreign proceeding. Thus, while the court’s decision clarifies COMI analysis, the Second Circuit clearly is mindful of the tension between the strict statutory reading of Section 1517(b) and the inequities that may arise from COMI manipulation. Applying these rules to the debtor’s case, the Second Circuit held that the debtor’s COMI was in the B.V.I. as of its Chapter 15 petition date, and that the debtor did not manipulate its COMI in bad faith.²⁹

²⁹ *Id.* at *9-10.