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Chapter 15: International Bankruptcy: Foreign Debtors Get Green Light to Sue U.S. Companies

Recent court decisions, in the context of Chapter 15 of the U.S. Bankruptcy Code, signal the U.S.'s "open door" policy to lawsuits by foreign debtors.

Chapter 15 of the U.S. Bankruptcy Code relates to international insolvency proceedings. Specifically, Chapter 15 regulates bankruptcy proceedings filed in the U.S. that are "ancillary" to an insolvency proceeding in another country. The need for Chapter 15 arises from the reality that many insolvent companies have assets, liabilities and claims in multiple countries, including in the U.S. Based on the United Nations' Model Law on Cross-Border Insolvencies, Chapter 15 was enacted to promote cooperation between U.S. courts and foreign courts during international insolvency proceedings and to promote greater legal certainty for trade and investment.

As an ancillary proceeding, Chapter 15 is not intended as a plenary or "full blown" bankruptcy proceeding as in a Chapter 11 or Chapter 7 proceeding. Thus, Chapter 15 does not grant the Chapter 15 debtor the same powers as a Chapter 11 or Chapter 7 debtor. However, in furtherance of international cooperation, Chapter 15 gives the "foreign debtor" (a debtor in an insolvency proceeding in another jurisdiction) some of the rights of a Chapter 11 debtor. Reasons why companies choose Chapter 11 as a business strategy include:

- Automatic stay – the ability to enjoin actions against the debtor.
- Sale of assets – the ability to sell assets free and clear of liens.
- Assumption of rejection of contracts – the right of a debtor to pick and choose which contracts to assume or reject.
- DIP financing – the ability of the debtor to borrow money on a priority basis.
- Avoidance actions – the ability of the debtor to recover assets and on claims from third parties.

Whether or not a foreign debtor may utilize some of these rights or remedies in a Chapter 15 proceeding depends primarily on whether the foreign insolvency proceeding is considered by the U.S. Bankruptcy Court to be a “foreign main proceeding” or a “foreign non-main proceeding”. While the difference between these two is beyond the scope of this article, if the foreign debtor’s “center of main interest” or COMI, is in the country where the foreign insolvency case is pending, the U.S. Bankruptcy Court will conclude that the foreign proceeding is a “foreign main proceeding”. COMI is analogous to a company’s principal place of business.

Once the Chapter 15 is determined to be an ancillary to a “foreign main proceeding”, the foreign debtor has certain rights and powers available to it in the Chapter 15 case. Chapter 15 became law in 2005 as part of the most recent amendments to the U.S. Bankruptcy Code. Since then, Bankruptcy Courts have issued rulings in Chapter 15 cases that have clarified the rights and powers of Chapter 15 debtors, and what the impact will be on creditors who do business with Chapter 15 debtors.

Right to Pursue Avoidance Actions in Chapter 15

Chapter 15 specifically provides that a foreign debtor may NOT pursue recovery actions in a Chapter 15 proceeding under Sections 547 (preferences) and 548 (fraudulent conveyances) of the Bankruptcy Code. To gain those rights, a foreign debtor would have to file a Chapter 11 or Chapter 7 proceeding in U.S. Bankruptcy Court.

However, in the Condor Insurance Ltd. case, the U.S. Fifth Circuit Court of Appeals ruled that a foreign debtor could sue third parties in a Chapter 15 case, using the avoidance provisions under the laws of the foreign country where the “foreign main proceeding” is pending. Condor Insurance was a Caribbean corporation organized under the laws of Nevis that operated an insurance and surety bond business. A creditor of Condor initiated “winding up” proceedings (similar to a Chapter 7 proceeding) against it in Nevis. The Nevis liquidators in turn commenced a Chapter 15 proceeding in the U.S. Bankruptcy Court for the Southern District of Mississippi, based on the Nevis proceeding being the “foreign main proceeding.”

The Nevis liquidators sought to recover \$313 million in assets that allegedly were transferred to third parties in the U.S. and to this end commenced an adversary proceeding in the Chapter 15 case to recover the assets that were fraudulently transferred. The defendant in this action argued that the Nevis liquidators were prohibited from pursuing avoidance actions in Chapter 15. Both the Bankruptcy Court and the District Court agreed and dismissed Condor’s recovery actions for \$313 million. On appeal, however, the Fifth Circuit Court of Appeals ruled that Condor could pursue the avoidance actions to recover transferred assets. In so ruling, the Court agreed that the Nevis liquidators could not use the avoidance powers in the U.S. Bankruptcy Code (including Sections 547 and 548). However, the Court ruled that Chapter 15 did NOT preclude the Nevis liquidators’ use the avoidance provisions of Nevis law. Accordingly, Condor Insurance was able to pursue the avoidance actions in the Chapter 15 proceeding, based on application of Nevis law.

As a result of the Condor Insurance ruling, debtors in foreign insolvency proceedings will be able to utilize Chapter 15 in the U.S. as a vehicle to file avoidance actions against third parties in the U.S. These suits will seek recovery based on the laws of the foreign jurisdictions of where the foreign debtors are located.

Tolling of Statutes of Limitation

On a related topic, in the Fairfield Sentry Ltd. 1 case, the United States Bankruptcy Court for the Southern District of New York recently ruled that the tolling provisions of Chapter 11 and Chapter 7 that allow a debtor an additional two years to sue third parties also apply to Chapter 15 debtors. Fairfield Sentry and related entities were the leading “feeder funds” to Bernard L. Madoff Investment Securities, LLC. After Madoff’s fraud was exposed, the Fairfield Sentry funds entered liquidation proceedings under the laws of the British Virgin Islands, where the funds were organized and operated. In connection with the BVI proceeding, the BVI liquidators filed more than 200 “redeemer actions” to recover almost \$6 billion.

In addition, the BVI liquidators filed a Chapter 15 in the U.S. Bankruptcy Court for the Southern District of New York seeking recognition of the BVI proceedings as a “foreign main proceeding”. The BVI liquidators’ strategy was to utilize the Chapter 15 proceeding to commence additional lawsuits in the Chapter 15 case against various third parties, arising from the Madoff fraudulent activities. Given the magnitude and complexity of such potential claims and lawsuits, the BVI liquidators needed more time to investigate and initiate such claims. However, there was a concern that the statute of limitations on such claims would expire, thus barring recovery against third parties. Accordingly, the BVI liquidators sought to take advantage of the two year tolling provisions of Chapter 11. These provisions provide that if a Chapter 11 or Chapter 7 is filed prior to the expiration of any applicable statute of limitation, the debtor or trustee has an additional two year period after the filing to initiate claims.

The question presented by Fairfield Sentry is whether a foreign debtor could take advantage of the tolling provisions in a Chapter 15 case. The Bankruptcy Court in Fairfield Sentry ruled that in fact the tolling provisions do apply in a Chapter 15 case, thus giving the BVI liquidators until July, 2012 to investigate and file additional claims or lawsuits.

With the Condor Insurance and Fairfield Sentry cases, it is clear U.S. Bankruptcy Courts are interpreting Chapter 15 in favor of foreign debtors, particularly in connection with their pursuit of claims against third parties. The rulings in these cases will no doubt encourage foreign debtors to pursue claims against third parties in the U.S., and to utilize Chapter 15 for this purpose. Parties that do business with foreign companies now face the prospect that their foreign business partners file insolvency proceedings in their “home” jurisdictions, then commence Chapter 15 proceedings in the U.S. Moreover, such parties face the possibility that they will be sued by such Chapter 15 debtors under the laws of a foreign jurisdiction.

We hope you found this information helpful. If you have any questions regarding the foregoing, or any other matter, please feel free to contact us.

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