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# Client Alert: Chapter 15: A Sword and A Shield

## THE RULING: CHAPTER 15 DEBTORS CAN ASSERT AVOIDANCE ACTIONS UNDER STATE LAW

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On March 23, 2017, the United States Bankruptcy Court for the Southern District of Florida, Miami Division, ruled that a foreign debtor could use Chapter 15 to assert "avoidance actions" in the U.S. under state law (in this case New York fraudulent conveyance statutes). In 2010, the United States Fifth Circuit Court of Appeals similarly ruled that a foreign debtor could use Chapter 15 to assert "avoidance actions" in the U.S. based on foreign law. My article in the International Committee Newsletter of the American Bankruptcy Institute ("ABI") dated November 2011 discusses the Fifth Circuit case, *Condor Insurance Ltd.*, in detail. By contrast, the statutory language of Chapter 15 is clear that foreign debtors cannot assert "avoidance actions" based on the provisions set forth in the U.S. Bankruptcy Code, specifically including Sections 547 (preferences) and 548 (fraudulent conveyances).

### CHAPTER 15: BACKGROUND

A U.S. company doing business globally will inevitably encounter issues with its foreign customers or counter-parties in the supply chain. Such issues include a foreign insolvency proceeding of such customer or counter-party in their "home" country. Since there is no uniform global insolvency law, the outcome for the U.S. company is primarily dependent on the insolvency law in the foreign jurisdiction, which will be quite different from Chapter 11, the primary insolvency law in the U.S. If the potential risk to or exposure of the U.S. company is material, participating in the foreign proceeding is advisable.

Global companies are likely to have assets, liabilities, contracts, property or employees throughout the world. If such a company initiates an insolvency proceeding in its home country, it is likely the company will also need to address issues in other countries. In recognition of this, and to promote comity among countries, in 1997, the United Nations Commission on International Trade Law (UNCITRAL) published its Model Law on Cross-Border Insolvency. To date, 43 countries have adopted the Model Law, including the

U.S., which adopted the Model Law in 2005 as Chapter 15.

Chapter 15 is a U.S. proceeding that is ancillary to a foreign main proceeding regarding the debtor company's overall restructuring. As such, Chapter 15 is a powerful tool for foreign debtors to deal with assets and claims in the U.S. Chapter 15 has primarily been utilized by foreign debtors as a sword, and as a shield. As a sword, Chapter 15 allows a foreign debtor to assert claims and to obtain discovery with respect to companies or assets in the U.S. As a shield, Chapter 15 allows a foreign debtor to protect its U.S. assets by invoking the "automatic stay" of Section 362 of the U.S. Bankruptcy Code, which is a broad injunction against any claims or lawsuits against the debtor or its U.S. assets. In fact, some U.S. Bankruptcy Courts have applied the "automatic stay" extraterritorially, to debtors' assets outside the U.S.

## THE BANCO CRUZEIRO DO SUL S.A. BANKRUPTCY RULING

The U.S. Bankruptcy Court in Miami, in the Chapter 15 proceeding of Brazilian bank *Banco Cruzeiro Do Sul S.A.* ("BCSUL"), expanded the "sword" for foreign debtors by allowing BCSUL's trustee to assert a fraudulent conveyance claim under New York law to recover a New York City penthouse apartment. Ownership of BCSUL was controlled by the Indio da Costa family, and managed by Felippe and Octavio Indio da Costa. According to allegations in the trustee's complaint in the Chapter 15 adversary proceeding, Felippe purchased a New York apartment with funds improperly diverted from BCSUL. The apartment was subsequently conveyed to a BVI Company, Alina Corporation ("Alina"), controlled by Felippe.

In response, Alina filed a motion to dismiss the adversary proceeding, in part arguing that Chapter 15 does not permit a foreign debtor to assert "avoidance actions", based on an express exclusion of Sections 547 and 548 in Chapter 15. The Bankruptcy Court rejected this argument, and denied the defendant's motion to dismiss on this issue. The Court concluded that as a matter of statutory construction, Chapter 15 expressly excludes the specified avoidance provisions in the U.S. Bankruptcy Code, and nothing more. Thus, the clear intent of Chapter 15 was to not exclude avoidance actions based on other law. The Bankruptcy Court also noted a Chapter 15 foreign debtor's right to sue and be sued in the U.S.

## TAKEAWAY

The *Condor Insurance* and the *Banco Cruzeiro* cases make clear that foreign debtors in those jurisdictions are entitled to assert avoidance actions in the U.S. based on applicable state law and based on the avoidance laws of the foreign jurisdiction.

Since 2005, U.S. Bankruptcy Courts have broadly interpreted Chapter 15 to allow foreign debtors maximum flexibility in protecting assets and pursuing claims. It is predictable that other courts will follow *Condor Insurance* and *Banco Cruzeiro*, encouraging foreign debtors to assert avoidance actions in Chapter 15 cases under state law in the U.S. and under foreign law, to enhance the value of insolvent debtors' estates.

A company with material risk associated with a customer or counter-party in an overseas insolvency proceeding is advised to participate in the foreign proceeding regarding its claims, contracts, and risks. In addition, the company should monitor any Chapter 15 filing of the foreign debtor in the U.S., which could increase "avoidance action" risk.

We hope that you find this useful and informative. Please contact us if you have any questions about this, or any other matter.

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