

## US BANKRUPTCY CODE—CHAPTER 15: THE EARLY RETURNS

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**LT** Bankruptcy proceedings; Centre of main interests; Cross-border insolvency; Relief; United States

On April 20, 2005, the US Bankruptcy Code was amended by the Bankruptcy Abuse Prevention and Consumer Protection Act 2005. While the amendments are primarily focused on consumer issues, they include a new c.15 to the Bankruptcy Code. Chapter 15, which replaces former s.304, is based upon the model law on cross-border insolvencies proposed by the United Nations Commission on International Trade Law and applies to cases filed on or after October 17, 2005. After a brief review of the statute, this article discusses important decisions rendered in those c.15 cases filed in the first year of its application.

Much like s.304, one of the key features of c.15 is the grant of authority to bankruptcy courts to assist in the administration of insolvency, bankruptcy or debt restructuring proceedings pending in foreign courts. There are, however, significant differences. For example, relief under s.304 was dependent upon a court's analysis of the so-called s.304(c) factors, which included comity. Under c.15, those factors play less of a role, if any, in a court's determination of whether to grant relief. Furthermore, under c.15, recognition of a foreign proceeding is relatively automatic provided certain procedural requirements are satisfied. In general, a debtor's foreign proceeding is entitled to automatic recognition under c.15, unless recognition would be "manifestly contrary to the public policy of the United States".

Under c.15, the definition of a foreign proceeding has been amended, but remains broad. Foreign proceedings are now divided into two types: "foreign main" and "foreign non-main". A foreign main proceeding is one that is pending in the debtor's "center of main interests". Recognition of a foreign main proceeding has certain immediate and automatic effects. For example, the automatic stay generally applicable to US bankruptcy cases applies with respect to the debtor and its property located in the United States upon recognition of a foreign main proceeding. A foreign non-main proceeding is one that is pending where the debtor has a place of operations where it carries out nontransitory economic activity (i.e. an "establishment"). Recognition of a foreign non-main proceeding does not have any immediate injunctive effect.

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Upon recognition of a debtor's foreign proceeding, whether foreign main or foreign non-main, a court may grant "any appropriate relief". Appropriate relief includes: (i) injunctions broader than the automatic stay; (ii) discovery concerning the debtor's assets, liabilities, and affairs; and (iii) relief available to a trustee under other chapters of the Bankruptcy Code. A court may grant immediate relief upon the filing of a c.15 case, even before formal recognition, such as a temporary restraining order, if it is urgently needed to protect the debtor's assets or creditors' interests. Furthermore, c.15 expressly authorizes US courts, trustees and other persons authorised by a US court to co-operate and communicate directly with foreign courts. Such co-operation can be accomplished by, inter alia: (i) co-ordinating the administration and supervision of the debtor's assets and affairs; (ii) implementing agreements relating to the co-ordination of proceedings; and (iii) co-ordinating concurrent proceedings.

There have been several cases filed under c.15 during its first year of application. This article highlights the key rulings, organised by subject matter, that will certainly influence later decisions by the courts. While these decisions are significant, prior decisions under former s.304 will continue to serve as guidance to US courts considering whether assistance should be given to insolvency proceedings pending elsewhere.

### Exclusive avenue for relief

Unlike s.304, c.15 is intended to be the exclusive avenue for relief for a foreign representative. Prior to the enactment of c.15, a foreign representative could, for example, request that a district or state court enforce an injunction issued in a foreign proceeding to enjoin a lawsuit pending before it under principles of comity. By virtue of the enactment of c.15, however, a foreign representative's discretion to select from different alternatives has been significantly limited. The US District Court for the Eastern District of New York confirmed this key feature of c.15 in *United States v J. A. Jones Construction Group LLC*,<sup>1</sup> which involved litigation commenced by the US Government against, among others, LBL Systems (U.S.A.) Inc (LBL).

During the course of the lawsuit, the District Court received a letter from the Canadian Interim Receiver of LBL informing the District Court that a Canadian court had appointed a trustee in connection with bankruptcy proceedings in Canada. The Interim Receiver requested a stay of the lawsuit in accordance with Canadian law. The District Court concluded that s.1509 prevented it from considering the foreign representative's request until recognition was granted to the Canadian proceeding. Accordingly, the District Court held that the Interim Receiver should first seek recognition of the Canadian proceeding under c.15 and if recognition were to be granted and a stay still necessary, the Interim Receiver should then seek a stay from the District Court. Given that recognition of the Canadian Proceeding as a foreign main proceeding would trigger an automatic stay of actions against LBL, the District Court noted that recognition could obviate the need for a separate stay.

Consistent with US policies of encouraging co-operation between courts, the District Court did not immediately deny the request for a stay. Rather, the

District Court granted a 60-day stay to give the Interim Receiver an opportunity to seek appropriate relief under c.15.

### "Manifestly Contrary to Public Policy"

Section 1506 of the Bankruptcy Code provides that a court may refuse:

*"to take an action governed by [Chapter 15] if the action would be manifestly contrary to the public policy of the United States."*

The legislative history of c.15 states that this exception should be limited to the most fundamental public policies of the United States. Aside from the brief legislative history, however, there is little guidance as to what would fall into the exception.

In the case of *Ephedra Products Liability Litigation, Re*,<sup>2</sup> the US District Court for the Southern District of New York was asked to recognise and enforce a claims resolution procedure approved by a Canadian Court in the insolvency proceeding of Muscletech Research and Development Inc. Certain claimants opposed the request, which the District Court granted subject to the Canadian court's approval of certain amendments to the procedure designed to ensure greater clarity and fairness.

One of the key features of the claims resolution procedure, as amended, was a provision for mandatory mediation. Certain claimants objected to recognition of the claims resolution procedure because it denied them a trial by jury and was thus, according to the claimants, manifestly contrary to US public policy. The District Court noted that "manifestly" should be interpreted as emphasising that the public policy exception should be interpreted:

*"restrictively and . . . is only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting state."*

The District Court concluded that the right to jury trial, while important, does not rise to that level. The District Court limited its analysis to whether the claims resolution process was a "fair and impartial proceeding". According to the District Court, the lack of a jury trial did not necessarily result in unfairness. Moreover, other US courts have recognised judgments issued by foreign courts "for whom the very idea of a jury trial is foreign". After the Canadian court approved the amended procedures, the District Court issued an order recognising and enforcing the claims resolution procedure in the United States because it provided claimants with a fair and impartial proceeding.

### Centre of main interests

As previously noted, c.15 draws a distinction between "foreign main" and "foreign non-main" proceedings. A proceeding will qualify as a foreign main proceeding and its recognition will have certain injunctive effects if the proceeding is pending where the debtor's "centre of main interests" is located. Chapter 15 presumes that the location of a debtor's registered office is its centre of

main interests, but otherwise does not define the term. Given the lack of a definition, the courts have been left to decide what qualifies as a debtor's centre of main interests. Prior to c.15's first anniversary, two US courts adopted different tests to determine a debtor's centre of main interests.

In *Tri-Continental Exchange Ltd, Re*,<sup>3</sup> the US Bankruptcy Court for the Eastern District of California was asked to recognise liquidation proceedings pending in St Vincent and the Grenadines as foreign main proceedings because the debtor insurance companies, TCE, were legally domiciled and had their only offices there. A judgment creditor, however, objected to recognition as such and argued that the United States was TCE's centre of main interest because most of its creditors and policyholders were located in the United States. Noting the Bankruptcy Code's mandate to interpret c.15 in a manner consistent with the application of similar statutes adopted by foreign jurisdictions, the bankruptcy court considered the EU Convention on Insolvency Proceedings (hereinafter the EU Convention) in analysing centre of main interests. The EU Convention states that a debtor's centre of main interests:

*"should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties."*

The bankruptcy court equated this statement with a debtor's "principal place of business" under US law. As a result, given that TCE had registered offices and conducted regular business in St Vincent and the Grenadines, the bankruptcy court held that the liquidation proceedings pending in St Vincent and the Grenadines qualified as foreign main proceedings.

In *SPhinX Ltd, Re*,<sup>4</sup> the US Bankruptcy Court for the Southern District of New York considered the effect of recognition in analysing a debtor's centre of main interests. The SPhinX Funds were hedge funds incorporated in the Cayman Islands engaged in the business of buying and selling securities and commodities to investors located throughout the world. Although they were registered in the Cayman Islands, the SPhinX Funds did not conduct any trade or business or have any employees or offices in the Cayman Islands.

Prior to being placed in liquidation, certain of the SPhinX Funds were named as defendants in an adversary proceeding commenced on behalf of the estate of Refco Capital Markets Ltd, a debtor in US bankruptcy proceedings before the US Bankruptcy Court for the Southern District of New York. The SPhinX Funds and the Refco Capital Markets Ltd estate subsequently reached a settlement of the adversary proceeding. Notwithstanding the objection of a number of the SPhinX Funds investors, the bankruptcy court approved the settlement in accordance with the US Bankruptcy Rules. The investors appealed the bankruptcy court's order approving the settlement.

While the settlement was on appeal, the SPhinX Funds were put into voluntary liquidation in the Cayman Islands. The liquidators of the SPhinX Funds filed a petition under c.15 seeking recognition of the Cayman Islands proceedings as foreign main proceedings. The

c.15 case was assigned to the same judge assigned to the *Refco Capital Markets* bankruptcy case.

Notwithstanding that the SPhinX Funds were registered in (and therefore their centre of main interests presumed to be) the Cayman Islands, the bankruptcy court held that the proceedings pending in the Cayman Islands did not qualify as foreign main proceedings. While the bankruptcy court acknowledged that it would "normally" conclude that the Cayman Islands was the debtors' centre of main interests, it refused to do so in this instance given the effect of such recognition. Recognition of the Cayman Islands proceedings as foreign main proceedings would trigger a stay of all actions, which, according to the bankruptcy court, could prevent the appellate court from considering the appeal of the SPhinX Fund settlement with Refco Capital Markets Ltd. Given that the settlement agreement could not by its terms become effective until resolution of the appeal, a delay of the appeal would, according to the bankruptcy court, effectively constitute success on the appeal without consideration of the merits. The bankruptcy court was hesitant to permit such a result, especially given that it previously dismissed prior attempts to derail the settlement. Thus, the bankruptcy court refused to grant recognition to the proceedings as foreign main proceedings, but granted recognition to the Cayman Islands proceedings as foreign non-main proceedings.

### Flexible approach

Under c.15, courts retain the flexibility, short of recognition, to grant relief that might assist in the administration of the foreign proceeding. The bankruptcy court emphasised such flexibility in the c.15 case of *Yukos Oil Co, Re*.<sup>5</sup>

Yukos is a Russian company that was the subject of a bankruptcy application filed against it in Russia. In the Russian bankruptcy case, a Russian court appointed a receiver (the Russian Receiver) to perform certain duties, including preserving Yukos's assets. Consistent with his duties, the Russian Receiver sought and obtained orders from the Russian court enjoining Yukos and its management from engaging in certain transactions, including the sale of certain assets, without the consent of the Russian Receiver (the Russian Orders).

At the time of the commencement of the Russian bankruptcy case, Yukos through its managers, several of whom were US citizens and none of whom were in Russia, was in the process of selling significant assets of a Dutch subsidiary. Notwithstanding the terms of the Russian Orders, Yukos continued to proceed with a sale of these significant assets without the Russian Receiver's consent. In order to preserve Yukos's estate, the Russian Receiver commenced a case under c.15 in the United States to obtain recognition of the Russian proceeding and the Russian Orders. Consistent therewith, the Russian Receiver sought and obtained a temporary restraining order from the US Bankruptcy Court for the Southern District of New York enjoining Yukos and its managers from proceeding with the proposed sale.

Yukos and a major creditor objected to the issuance of a further injunction enjoining the sale, given that, among other things, the proceeds of the sale would be used to pay certain creditors with attachments in the

Netherlands in accordance with Dutch law. Ultimately, the Russian Receiver determined that while the purchase price for the asset was fair, he could not consent to the proposed sale because under Dutch law the proceeds would benefit only those creditors with attachments in the Netherlands—to the detriment of other creditors.

As a result, the US bankruptcy court was faced with a tough choice: it could: (i) permit Yukos to sell a significant asset to the detriment of creditors without attachments in the Netherlands; or (ii) enjoin the sale. Given that the proposed sale was for a fair price, the bankruptcy court was not inclined to permanently enjoin the sale. However, the court recognised the need to preserve the proceeds for the benefit of all creditors. Consistent with its authority under c.15, the bankruptcy court issued an order, prior to recognition of the

Russian bankruptcy case, that permitted the sale to proceed, and made recommendations to the Dutch Court to adopt certain procedures to safeguard the proceeds for the benefit of all creditors.

These early cases reflect the court's flexibility which was common in decisions under s.304 and consistent with the legislative history of c.15. It is likely that these cases will influence future decisions in the years to come.

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1 333 B.R. 637 (E.D.N.Y. 2005).

2 349 B.R. 333 (S.D.N.Y. August 11, 2006).

3 349 B.R. 627 (Bankr. E.D. Cal. September 11, 2006).

4 351 B.R.103 (Bankr. S.D.N.Y. September 6, 2006).

5 Case No.06-B-10775 (RDD) (Bankr. S.D.N.Y. May 26, 2006).

## “BUILDING EUROPE”—THE FRENCH CASE LAW ON COMI

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<sup>LT</sup> Centre of main interests; Cross-border insolvency; EC law; France; Groups of companies

### Introduction

At a recent breakfast meeting hosted by Freshfields in London, Judge Drummen, the President of the Tribunal de Commerce<sup>1</sup> of Nanterre surprised the audience of English judges, lawyers and insolvency practitioners by declaring that the French courts were not simply assisting other European courts pursuant to the EC Regulation on insolvency proceedings (1346/2000) but were taking part in the process of “building Europe”. This highlights an important cultural difference between the approach in the United Kingdom and in France. The UK approach tends to be intensely pragmatic, whereas the French are concerned with the underlying philosophy, although in recent years they have also imported British pragmatism into the practicalities of “building Europe”.

### An inauspicious start

It will be recalled that Anglo-French relations in respect of the EC Regulation got off to a bad start in the *Daisytek-ISA Ltd, Re* case.<sup>2</sup> The administration order made in respect of a French registered company on May 16, 2003 in Leeds was greeted with disbelief by the Tribunal de Commerce of Cergy-Pontoise and a conviction that the English court had confused the notion of a separately incorporated subsidiary with a mere branch. Matters improved once the Court of Appeal of Versailles reversed this ruling and recognised the English opening of main proceedings based on the location of the centre of main interests (COMI) being in England.<sup>3</sup> The court acted as first rate Europeans in loyally recognising the findings of the English court as to the COMI. The judgment is a model of the proper approach to international assistance in insolvency matters.

### Subsequent cases

Following the initial shock created by “perfidious Albion” in the *Daisytek* case, the French courts got fully into the spirit of the EC Regulation and the “head office functions” approach developed in England<sup>4</sup> to displacing the presumption of the COMI being in the place of the registered office.

In the case of *Rover France SAS, Re*,<sup>5</sup> the Tribunal de Commerce of Nanterre,<sup>6</sup> on May 19, 2005, recognised the opening of main proceedings for the French registered company in Birmingham on the basis that the centre of main interests was located there. This case also went up on appeal to the Court of Appeal in Versailles, which upheld the recognition. The Court of Appeal in Versailles held that the French courts could not review the finding as to the COMI being located in the other Member State. It held that the Tribunal de Commerce of Nanterre had no power to depart from the finding in Birmingham that the centre of main interest was located there.

It was argued on the appeal that the French courts could invoke the exception to recognition under Art.26 of the Regulation on the basis that the English insolvency proceedings ignored the rights of the employees to be represented in court and that this was incompatible with French public policy. This argument was rejected by the Court of Appeal of Versailles, who confirmed that the public policy exception had to be interpreted strictly in line with Recital (22) of the Regulation. The Court of Appeal held that it had not been demonstrated that English law deprived employees of all means of informing themselves about the proceedings and of intervening in the proceedings. The English administrators maintained that the employees had been kept informed of the progress of the proceedings and that the workers' representatives had been involved and consulted throughout the proceedings. Furthermore, pursuant to Art.10 of the Regulation, which requires the application of French law to the effects of insolvency proceedings in the United Kingdom on French employment contracts, the employees' workers council and staff representatives had to be consulted where insolvency proceedings were to affect contracts of employment and labour relations. Accordingly, the Court of Appeal ruled that neither the recognition nor the implementation of the insolvency