

Canada's "Northern Lights" Could Dispel Shadow of *Bear Stearns* over Ch. 15 Practice

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The *Bear Stearns* decision made waves several years ago when the court refused to recognize two hedge funds' offshore insolvency cases,¹ an outcome that I previously argued would confound chapter 15 and the cross-border cooperation it was meant to facilitate.² The statutory problem that became evident was that, by its unduly strict application of the key provisions pertaining to the recognition of foreign proceedings,³ the *Bear Stearns* court had "added a dimension to [the] statutory analysis that many practitioners had not previously considered" (*i.e.*, one that could possibly result in nonrecognition).⁴ Post-*Bear Stearns*, in addition to "foreign main" (for a case pending where a debtor has its center of main interests (COMI))⁵ and "foreign non-main" (for any ancillary case pending where a debtor has an "establishment")⁶ proceedings, foreign representatives now faced a frightening "black box" of no recognition whatsoever, and a bar to meaningful relief from U.S. courts.⁷

I propose quieting these troubled legal waters by adopting the enlightened approach of Canada, which has made "foreign non-main" the default minimum for foreign proceedings.⁸ Although closing the "black

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box" would widen the variety of potential foreign non-main proceedings faced by U.S. bankruptcy courts,⁹ the latter will wisely exercise the particular discretion that chapter 15 vests in them over such proceedings. After all, it was through the prior exercise of that discretion that a valuable and hopefully still-viable case law evolved concerning recognition of foreign proceedings under the old § 304.¹⁰

Problems in the Code

Admittedly, certain recent precedents have curtailed the width of the "black box." The *In re Betcorp* court, citing a case for an individual (*In re Ran*) held that a corporate debtor's COMI is to be determined on the date that its chapter 15 petition was filed, not when its underlying foreign proceeding was commenced or at some other pre-petition date.¹¹ The *Betcorp* rule thus allows a U.S. bankruptcy court to predicate COMI on the pendency of the foreign proceeding, the commencement of which may have caused COMI to shift, likely to the debtor's jurisdiction of registration.¹² Although *Betcorp* opens the door to certain forum-shopping, its rule better avoids the "potential greater evil" enhanced by determining COMI as

of a pre-petition date: nonrecognition and "depriv[ing] the foreign representative of meaningful access to American courts."¹³

The *Bear Stearns* court subsequently recognized an offshore foreign proceeding in *In re Fairfield Sentry*. While refusing to set a bright-line rule as to when COMI determinations are to be made, that court found that the facts showed that the debtor's COMI had shifted to the British Virgin Islands during the "extended period" prior to the chapter 15 petition date, essentially holding that the pendency of a foreign proceeding can itself provide a debtor with the requisite presence in a jurisdiction for COMI to be found there.¹⁴ It appeared that a "new dawn" for chapter 15 practice had then arisen because, although primarily pitched to COMI, *Fairfield Sentry's* reasoning could allow offshore debtors to avoid nonrecognition as "the same [COMI] analysis would seem critical to

determining whether an 'establishment' existed, thereby making [its] analysis applicable to determining 'non-main' qualifications as well. Importantly, this seemingly would make *Bear Stearns'* outcome (*i.e.*, no recognition at all) less likely to occur."¹⁵

And yet, the *Bear Stearns* "black box" remains, raising the stakes and the evidentiary bar set for foreign representatives.¹⁶ By overturning *sua sponte* the statutory presumption that a debtor's COMI is in its jurisdiction of registration,¹⁷ the *Bear Stearns* court acted on a "serious controversy"¹⁸ where none had been perceived by the parties-in-interest.¹⁹ *Bear Stearns* and its progeny have thus converted recognition from its intended streamlined process into an evidence-heavy threshold factual deter-

¹ *In re Bear Stearns High Grade Structured Credit Strategies Master Fund Ltd.*, 374 B.R. 122, 126 (Bankr. S.D.N.Y. 2007), *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008) (*Bear Stearns*). The title for this article is derived from Prof. Janis Sarra's "Northern Lights, Canada's Version of the UNCITRAL Model Law on Cross-Border Insolvency," 16 *Int'l Insolvency Rev.* 19 (2007).

² Timothy T. Brock, "How the Assault on Offshore Havens in *Bear Stearns* Undermines New Chapter 15" Part I and II, *ABI Journal*, Vol. XXVI, No. 10, December/January 2008, and Vol. XXVII, No. 1, February 2008 (Brock on *Bear Stearns*); see also 11 U.S.C. § 1501(a) (purposes of chapter 15).

³ "Foreign proceeding" is defined at 11 U.S.C. § 101(23).

⁴ William H. Schrag and William C. Heuer, "Cross-Border Insolvencies and Chapter 15: Recent U.S. Case Law Determining Whether Foreign Proceeding Is Main, Nonmain or Neither," *NYSBA Int'l Law Practicum*, Spring 2010, Vol. 23, No. 1, 37 at 38.

⁵ 11 U.S.C. §§ 1502(4); 1517(b)(1).

⁶ 11 U.S.C. §§ 1502(5); 1517(b)(2). Whereas § 1502(2) defines "establishment" as "any place of operations where the debtor carries out a nontransitory economic activity," chapter 15 does not define COMI. A recognized foreign representative for a foreign main proceeding, however, automatically receives certain relief under § 1520 (including the § 362 stay) that a representative for a foreign non-main proceeding does not, and who can only receive such and other relief at the discretion of the bankruptcy court via § 1521.

⁷ "Black box" was the term ascribed to this outcome by Bankruptcy Judge Charles Case during a panel presentation at the 84th Annual Meeting of the National Conference of Bankruptcy Judges in New Orleans on Oct. 14, 2010.

⁸ *Northern Lights* at 43 (citing Andrew Kent, et al., "UNCITRAL, eh? The Model Law and Its Implications for Canadian Stakeholders," in J. Sarra, ed., *Annual Rev. of Insolvency Law* 2005 at 187 (2006) ("Canada's Chapter 47 does not require an establishment in order to recognize foreign non-main proceedings and will not be faced with [the Model Law's] problem [of foreign proceedings other than "main" or "non-main."]).

⁹ *Id.* at 42 ("In Canada, [because there is no "establishment" requirement], one could have different kinds of foreign non-main proceedings than anticipated by the Model Law or U.S. Chapter 15.").

¹⁰ 11 U.S.C. § 304 (2004), repealed by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, title VIII, § 802(d) (3), April 20, 2005, 119 Stat. 146. Prior to repeal, old § 304 was the U.S. Bankruptcy Code provision pursuant to which foreign representatives could access (or not) U.S. bankruptcy courts and open ancillary proceedings.

¹¹ See Mark A. Lightner, "Determining the Center of Main Interests under Chapter 15," 18 *Norton J. Bankr. L. & Prac.* 5, Art. 2, Page 519 (2009) (citing *In re Betcorp*, 400 B.R. 266 (Bankr. D. Nev. 2009), and *In re Ran*, 390 B.R. 257 (Bankr. S.D. Tex. 2008); *aff'd*, 2009 U.S. Dist. LEXIS 26269 (S.D. Tex. 2009) (Lightner article)). The lower courts in *Ran* were later affirmed by the Fifth Circuit. See 607 F.3d 1017 (5th Cir. 2010).

¹² Had the *Bear Stearns* court applied the (later) *Betcorp* rule, "COMI would...have probably pointed to the Cayman Islands in light of the control over the Fund's management exerted by the liquidators." See Lightner article at 529. The liquidation at least constituted an "establishment" there. *Id.* at n. 80.

¹³ Lightner article at 527.

¹⁴ *In re Fairfield Sentry Ltd.*, 440 B.R. 60, 64 (Bankr. S.D.N.Y. 2010).

¹⁵ Tally Wiener and Timothy T. Brock, "Fairfield Sentry Ltd. and the New Dawn for Cross-Border Recognition in Manhattan," No. 6 ABI Int'l Committee Newsletter (November 2010), available at www.abiworld.org/committees/newsletters/international/vol7num6/fairfield.html.

¹⁶ See Brock on *Bear Stearns*, Part I at 36 and n. 34-41, and Part II at 26 and n. 68-74; see also *infra* n. 20 and accompanying text.

¹⁷ "In the absence of evidence to the contrary, the debtor's registered office...is presumed to be the center of the debtor's main interests." 11 U.S.C. § 1516(c).

¹⁸ "The presumption that the place of the registered office is also the center of the debtor's main interest is included for speed and convenience of proof where there is no serious controversy." H.R. Rep. 109-31, pt. 1, 109th Cong. 1st Sess. at 112-13 (2005).

mination,²⁰ even for foreign non-main proceedings.²¹

More importantly, the “black box” undermines cross-border cooperation. As *Bear Stearns*’ sister bankruptcy court recently recognized in *In re Millennium Global*, nonrecognition means that a “foreign representative cannot be heard by any court in the United States.”²² Given nonrecognition’s stark effects, that court observed that “[a]ny exclusionary rule would be contrary to U.S. interests”²³ and refused to apply *Bear Stearns* broadly, reasoning that “the COMI requirement should not be applied in a manner that would effectively establish a presumption *against* recognition of cases from offshore jurisdictions,” abrogating years of precedent of U.S. bankruptcy courts recognizing offshore foreign proceedings under the old § 304 where Congress had not clearly so intended.²⁴

Millennium Global goes a long way toward reviving the § 304 precedents and, implicitly, of the comity-centered approach that had engendered them. Moreover, by advocating a more lenient (or at least more flexible) standard for finding “establishment” (*i.e.*, “evidence of some management of an asset through a nominee” in the subject jurisdiction as being sufficient),²⁵ that court has also usefully bolstered the “foreign non-main” proceeding as either the “floor” for recognition, or has at least reduced the “black box” to lesser significance.²⁶ *Millennium Global* has also restored the notion that another bankruptcy court had earlier evinced in likewise considering “equitable” considerations at the recognition stage of chapter 15,²⁷ (*i.e.*, that “someone needs to manage the Debtors’ winding up”).²⁸ The *Bear Stearns* “black box” requiring nonrecognition for lack of a showing of an “establishment” ignores this latter truth and is precisely the type of inequitable and self-defeating “exclusionary rule” against which *Millennium Global* inveighed, as it serves only potentially to deny perhaps the only persons in the world who may be practically and legally able to act on behalf of certain debtors (*i.e.*, foreign representatives appointed pursuant to a foreign non-main proceeding where a foreign proceeding in the COMI jurisdiction is, for whatever valid reasons, untenable or impossible).²⁹ Such foreign representatives may simply

be between a jurisdictional rock and a hard place, unable to proceed with any meaningful restructuring or winding-up in the debtor’s COMI jurisdiction, yet also obliged by the relevant laws of its jurisdiction of registration to conduct its foreign proceeding there, “establishment” or no.

The *Millennium Global* approach could partially achieve through case law what Canada has completely accomplished at the statutory level. Of course, there is no guarantee that this new precedent will be universally followed, which is why a statutory fix remains in order. As noted, in adapting the UNCITRAL Model Law, Canada dropped the requirement of “establishment” for “non-main” recognition: any foreign proceeding not attaining main status would be non-main.³⁰

Conclusion

The United States should follow Canada’s lead and close the “black box” via statute by striking the § 1502(2) definition of “establishment” and § 1517(b)’s requirement of same for recognition of a “foreign non-main” proceeding, and adjusting the definition of foreign non-main proceeding at § 1505(5). So long as a foreign proceeding otherwise met chapter 15’s requisite criteria—primarily those set forth in §§ 101(23) and 1515—it would qualify for recognition as at least an ancillary, “foreign non-main” proceeding. The lingering *Bear Stearns* spectre of nonrecognition would thereby be dispelled and the purposes of chapter 15 commensurately advanced. ■

¹⁹ “Courts are simply not at liberty to search out their own evidence, or even to tell the parties what evidence to present. Given the [§ 1516] presumption... evidence of the location of [a debtor’s] registered office should be sufficient unless a party in interest contests the application of the presumption.” Hon. Samuel L. Bufford, “Center of Main Interests, International Insolvency Venue and Equality of Arms: The *Eurofood* Decision of the European Court of Justice,” 27 *NW. J. Int’l L. & Bus.* 351, 415.

²⁰ See *In re Millennium Global Emerging Credit Master Fund Ltd., et al.*, No. 11-13171, slip op. at 25 and n. 38 (Bankr. S.D.N.Y. Aug. 26, 2011) (noting the “increasingly heavy burden” and summarizing authorities).

²¹ In the eyes of one commentator, the “establishment” test has numerous facets and seems at least as complicated as that for COMI (if not more so). See, e.g., Travis Wofford, “Comment, The Other Establishment Clause: The Misunderstood Minimum Threshold for Recognition,” 44 *Tex. Int’l L. J.* 665 (2008) (Wofford article). Faced with such a complicated and time-consuming threshold issue of fact, it becomes understandable how a U.S. bankruptcy court might first determine (preliminarily) whether it would exercise discretion to grant the requested § 1521 relief; if “no” as to the requested relief, the court would be tempted—and rightly so—to sidestep the recognition question altogether. Why waste its own and litigants’ time and resources on “establishment” when the court’s ultimate exercise of discretion might result in no relief being granted in any event?

²² *Id.* at 27. The court criticized the *Bear Stearns* court’s *dicta* as to the supposed ability of unrecognized foreign representatives to file an involuntary case under § 303, noting that without a recognition order, § 1511(a) clearly bars a foreign representative from filing a subsequent plenary case. See *id.* at 27 and n. 41.

²³ *Id.* at 27-28.

²⁴ *Id.* at 29 (emphasis in original). By holding that COMI is to be determined, contra *Betcorp* and *Ran*, when the foreign proceeding was commenced, the *Millennium Global* court has (temporarily) widened the “black box” and created a stark split on the COMI timing issue. See *id.* at 12-19.

²⁵ *Id.* at 32 (citing U.K. precedents).

²⁶ *Id.* at 29-32. I had personally taken for granted, prior to *Bear Stearns*, that “foreign non-main” proceedings were to be coterminous with those recognized under § 304. See Brock on *Bear Stearns*, Part II at 26 n. 63. Some bankruptcy judges seem to have previously construed “foreign non-main” as the minimal default for recognition prior to *Bear Stearns*. See *In re Schefenacker Plc*, No. 07-11482, 6-14-07 Recog. Hrg. Tr. at 32 (“At a minimum, this is a non-main proceeding.”).

²⁷ *Id.* at 23 (citing as “equitable factors” relevant to recognition of “the existence of a fair and impartial judicial system and a sophisticated body of law, as aspects of the bona fides of the proceedings”).

²⁸ *In re SPhinx Ltd.*, 351 B.R. 103, 120-22 (Bankr. S.D.N.Y. 2006), *aff’d*, 371 B.R. 10 (S.D.N.Y. 2007).

²⁹ “Granted, there are legitimate situations where a debtor’s COMI may not be a viable place to host an insolvency proceeding.” See Wofford article at 670. I disagree, however, that a “vague, malleable establishment test” would engender an intolerable amount of forum-shopping. *Id.* In any event, tolerating a certain amount of forum gamesmanship appears to be far less of an evil than the anomaly of nonrecognition.

³⁰ *Northern Lights* at 42 and n. 101-3; see also *supra* n. 8-9 and accompanying text.

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