

INDEPTH

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# CHAPTER 15 BANKRUPTCIES



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Since Chapter 15 was enacted in 2005, the number of such cases has increased year on year from around 76 in 2006 to 147 last year. Part of the reason for this increase has been a growing awareness and familiarity among foreign representatives and their advisers about the benefits and burdens associated with the Chapter 15 process. Furthermore, greater clarity from US courts on Chapter 15 has given foreign representatives more assurance that cases will be handled in a predictable manner. Part of the reason for heightened Chapter 15 activity is the global financial crisis. Recent cases have caused concern among offshore insolvency practitioners and their ability to obtain recognition of liquidation proceedings for hedge funds and asset holding vehicles. But there are signs that foreign representatives may increase their prospects of recognition through their own activities as officeholders of the debtor, encouraging more Chapter 15 petitions.

Chapter 15 can be invaluable to foreign investors of offshore companies with operations, creditors, assets and potential claims in the US. "Foreign representatives are given or may apply for the main rights and powers which would be advantageous to them in a plenary bankruptcy case to gather and deal with the debtor's property and to run the debtor's business," says Jeremy Walton, head of the Cayman litigation and insolvency practice group at Appleby. "They also have a direct right of access to US Courts to assist them to administer their home proceeding without having to commence a plenary bankruptcy case and incur the associated costs and burdens, including the requirement to have a creditors' committee whose professional advisers are paid

by the insolvent estate." Further, Chapter 15 cases may result in more favourable tax treatment for the debtor. Ultimately, the process encourages cooperation and communication between US and overseas courts when a debtor is engaged in cross-border activity.

When US courts approve a Chapter 15 application by a foreign representative, the proceeding is recognised and given comity, and certain provisions of the US bankruptcy code apply to the case. Given the avoidance of plenary actions, Chapter 15 is often considered a more efficient and cost effective alternative to initiating an independent US Chapter 11 proceeding. "In a Chapter 15 proceeding, where the foreign proceeding is recognised as a foreign main proceeding, an automatic stay is entered, protecting assets located in the United States," explains Christopher J. Redmond, a partner at Husch Blackwell Sanders LLP. "In a foreign non-main proceeding, the US court can still enter an automatic stay for the benefit of the foreign representative if the Court deems that relief is necessary and proper. Chapter 15 debtors can also initiate adversary proceedings for fraudulent conveyance actions if it is a foreign main proceeding and is based on the law of foreign jurisdiction and not on the US Bankruptcy Code."

#### Metcalfe and Mansfield significance

One case in particular, Metcalfe and Mansfield, did illustrate both the flexibility and unpredictability of the bankruptcy court's jurisdiction. "In Metcalfe, the US bankruptcy court overseeing a Chapter 15 proceeding of a Canadian debtor recognised and gave comity to a third party release provision in the debtor's CCAA plan, even though the US

bankruptcy court stated that it might not approve that provision in a standalone Chapter 11 plan of reorganisation, because the court found that the provision was not manifestly contrary to US public policy," explains James H.M. Sprayregen, a partner at Kirkland & Ellis LLP. "Central to the US court's ruling was that the Canadian proceeding was fair and impartial and maintained procedural safeguards similar to US insolvency proceedings." The case has given foreign representatives and their advisers the additional comfort that decisions of a foreign court, even if not entirely consistent with US law, will be given a fair hearing in the US, where parties in interest are then afforded an impartial legal process.

Similar to Metcalfe, the US district court decided in Ephedra Products to recognise Canadian claims resolution procedures that did not provide for a right to a jury trial. "This case further underscores that US courts are willing to recognise and enforce foreign orders that would not necessarily be entered in a standalone US Chapter 11 case, provided that the foreign proceeding is fair and that the foreign order is not manifestly against US public policy," says Mr Sprayregen. "However, courts are still required to make actual determination as to the fairness of the foreign proceeding and whether the foreign order is grossly against US policy," he adds. For example, in the recent Qimonda Chapter 15 filing, US district courts partially reversed the bankruptcy court's order recognising a foreign proceeding as there was a lack of factual findings to justify the ruling.

Indeed, cases that most influence the development of Chapter 15 are those which address the fundamentals and clarify issues open to interpretation. Besides the Metcalfe and Mansfield case, other cases have touched on these areas. "One such case is Bear Stearns, in which Judge Lifland found the Court must independently determine if the threshold requirements have been met even if not opposed by another party to the proceedings. Issue of the independence of the court and on appeal was upheld by the United States District Court. In the Bear Stearns case, the court also found the debtor did not have an establishment in the Cayman Islands and as such no relief could be granted," says Mr Redmond. In another case in Condor, the Fifth Circuit Court of Appeals found and approved of Chapter 15 and its legislative structure and permitted relief consistent to the legislative grant. Cases such as these set out and interpret the law at appellate levels. ▶▶

Due to its relative infancy, there are still challenges associated with Chapter 15. For example, foreign representatives have looked for pragmatic solutions to increase their prospects of recognition. Determining the centre of main interests (COMI) can be the root cause of issues. Accepting that a company's COMI can change even after it goes into liquidation can create a risk for manipulation or 'gaming the system'. "Until the test for establishing COMI is clarified, probably by legislative amendment, foreign representatives of offshore entities will remain uncertain of obtaining the recognition they need when there are assets of the debtor located in the US," notes Mr Walton. "Furthermore, there is uncertainty as to the extent to which the US Courts will enforce orders made in foreign courts based on principles of comity, as demonstrated by

the different outcomes in the Mansfield and Lehman cases." Some offshore practitioners have artificially tried to create COMI after commencement of the foreign proceeding in order to improve prospects of Chapter 15 recognition. This could require further legislative review, perhaps requiring the COMI of a foreign debtor to be determined at the date of commencement of the foreign proceeding. Despite these issues, and the lack of reported cases available as precedent, especially when compared to Chapter 11, Chapter 15 continues to mature. And where issues are left uncontested, the Chapter 15 process tends to run very smoothly.

Chapter 15 has added a sense of certainty to international insolvency by providing a standardised framework for such cases, although cases involving offshore jurisdiction have

shown there is room for improvement. "Adding the recognition requirement as a precursor to relief was supposed to add a layer of certainty to the regime which was not present under § 304 and its international equivalents, though this has not been entirely successful. UNCITRAL needs to clarify the process and test for determining COMI, including a proper definition and confirming the time at which COMI is to be determined," asserts Mr Walton. "The enforcement of foreign orders under the Chapter 15 regime will always be a matter of uncertainty as long as it relies on assessments of comity." However, the discretionary nature of the process allows the bankruptcy court to be flexible and address the needs of individual cases, so the introduction of a strict procedure could have unintended consequences. ■

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