

**The New Chapter 15**

**August 2005**

**William H. Schrag  
Wendy S. Walker  
Amanda R. Waller**

**Morgan, Lewis & Bockius LLP**

## **The New Chapter 15**

**By William H. Schrag, Wendy S. Walker and Amanda R. Waller<sup>1</sup>**

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “Act”) codifies significant changes with respect to the relief available to foreign debtors in the United States by creating a new chapter – Chapter 15, Ancillary and Other Cross Border Cases (“Chapter 15”).

### **Purpose/Interpretation:**

The purpose of Chapter 15 is to “incorporate the Model Law on Cross-Border Insolvency so as to provide effective mechanisms for dealing with cases of cross-border insolvency.” 11 U.S.C. §1501(a).<sup>2</sup> Specifically, the new statute is intended to accomplish several objectives, including:

- promoting cooperation between (a) courts, trustees, United States trustees, examiners, debtors and debtors-in-possession in the United States and (b) courts and other “competent authorities of foreign countries in cross-border insolvency cases;”
- fostering “greater legal certainty for trade and investment;”
- providing guidance designed to encourage “fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor;”
- protecting and maximizing the value of the debtor’s assets; and

---

<sup>1</sup> William H. Schrag and Wendy S. Walker are partners and Amanda R. Waller is an associate in the Finance and Restructuring Group of the New York office of Morgan, Lewis & Bockius LLP.

<sup>2</sup> As with most of the changes made by the Act, new Chapter 15 will be effective with respect to cases commenced on or after October 17, 2005.

- facilitating the “rescue of financially troubled businesses, thereby protecting investment and preserving employment.”

11 U.S.C. §§1501(a)(1)-(5).

The promotion of cooperation between U.S. and foreign entities involved in cross-border insolvencies is not new to the Bankruptcy Code. Current Code §304 (repealed by the Act) permits foreign debtors to invoke U.S. bankruptcy laws in a limited way and its primary goal is to assist foreign proceedings, albeit while protecting U.S. creditors and assets.

New Chapter 15 continues and reinforces this policy of cooperation by enunciating the foregoing objectives, as well as including other provisions, such as 11 U.S.C. §1508, which provides that, in interpreting Chapter 15, courts “*shall* consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions.” 11 U.S.C. §1508 (emphasis added).<sup>3</sup> In addition, Subchapter IV of Chapter 15 provides that bankruptcy courts and persons authorized by the courts in cross-border cases “*shall* cooperate to the maximum extent possible with a foreign court or a foreign representative.” 11 U.S.C. §1525 (emphasis added).

Further, §§1526 and 1527 set forth ways in which bankruptcy courts may cooperate with foreign courts, including the following: (i) bankruptcy judges are authorized to appoint persons to act in cross-border cases and both they and the courts may communicate directly with and request information or assistance from foreign

---

<sup>3</sup> The Model Law on Cross Border Insolvency, promulgated by the United Nations Commission on International Trade Law, has been adopted by the British Virgin Islands, Eritrea, Japan, Mexico, Montenegro, Poland, Romania and South Africa. *Status 1997 – Model Law on Cross-border Insolvency* (July 19, 2005), [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html).

courts or representatives; (ii) sharing information; (iii) “coordination of the administration and supervision of debtor’s assets and affairs,” (iv) “approval or implementation of agreements concerning the coordination of proceedings;” and (v) coordination of concurrent proceedings. As with the philosophy behind Chapter 15, these approved forms of cooperation are not new. Rather, the designation of representatives, the use of protocols and direct communication between foreign and U.S. judges are practices that have evolved and are now accepted practices through their use in numerous cross-border cases. *See, e.g., In re Board of Directors of Hopewell Int’l Ins. Ltd.*, 238 B.R. 25, 53-54 (Bankr. S.D.N.Y. 2002), *aff’d*, 275 B.R. 699 (S.D.N.Y. 2002) (appointing “duly selected” foreign representative over objection by creditor); *In re Maxwell Comm. Corp. plc*, 170 B.R. 800, 802 (Bankr. S.D.N.Y. 1994), *aff’d*, 186 B.R. 807 (S.D.N.Y. 1995) (“*Maxwell II*”), *aff’d*, 93 F.3d 1036 (2d Cir. 1996) (“*Maxwell III*”) (establishing protocol to harmonize insolvency proceedings in the United Kingdom with Chapter 11 proceedings in the United States).

### **Who May Be a Debtor Under Chapter 15:**

Having been given no guidance under the provisions of the current Bankruptcy Code, courts have generally held that the requirements of Code §109 regarding eligibility to be a debtor are inapplicable to ancillary cases involving foreign debtors. *See, e.g., In re Goerg*, 844 F.2d 1562, 1568 (11th Cir. 1988), *cert. denied sub nom, Parungao v. Goerg*, 488 U.S. 1034 (1989); *In re Saleh*, 175 B.R. 422, 425 (Bankr. S.D. Fla. 1994); *In re Brierley*, 145 B.R. 151, 159 (Bankr. S.D.N.Y. 1992).

Chapter 15 clarifies this issue and sets out specifically the types of entities and proceedings to which it does, and does not, apply. Pursuant to §1501(b), Chapter 15

applies to (i) a foreign court or representative seeking assistance in the United States in connection with a foreign proceeding, (ii) an entity seeking assistance in a foreign country with respect to a case under Title 11, (iii) concurrently pending foreign and U.S. Title 11 cases and (iv) interested parties in a foreign country who wish to commence or participate in a Title 11 case. 11 U.S.C. §1501(b). Chapter 15 expressly does not apply to, among others, entities prohibited from being debtors pursuant to amended Code §109(b).<sup>4</sup>

**Venue:**

Whereas the prior statute contained requirements with respect to the venue of an ancillary proceeding based on the relief sought, pursuant to 28 U.S.C. §1410 (as amended by the Act), a case under Chapter 15 may be commenced in the district where the foreign debtor's principal assets or principal place of business in the United States are located, or, if none, in the district where an action in state or federal court is pending against the foreign debtor, or, if there are no assets, business or pending actions, in the district "in which venue will be consistent with the interests of justice and the convenience of the parties, having regard to the relief sought by the foreign representative." 28 U.S.C. §1410(3).

---

<sup>4</sup> This includes foreign banks, savings banks, cooperative banks, savings and loan associations, building and loan associations and credit unions which have a branch or agency (as defined in §1(b) of the International Banking Act of 1978) in the United States. This provision thus effectively overrules the district court's decision *In re Agency for Deposit Insurance, Rehabilitation, Bankruptcy and Liquidation of Banks v. Superintendent of Banks of the State of New York*, 310 B.R. 793 (S.D.N.Y. 2004), *appeal docketed*, Nos. 04-4997, 04-4999 (2d Cir. Sept. 17, 2004), holding that the exclusion of foreign banks from eligibility to be a debtor under Code §109 is irrelevant to the analysis of whether an entity is qualified to commence an ancillary case under §304. *Id.* Pursuant to amended Code § 109, foreign insurance companies engaged in such business in the United States are similarly ineligible to be debtors and are thus ineligible to be debtors under Chapter 15. 11 U.S.C. §109(b)(3)(A).

## **Commencement of a Case Under Chapter 15:**

A case is commenced under 11 U.S.C. §§1504 and 1515 by the filing with the bankruptcy court by a foreign representative<sup>5</sup> of a petition for “recognition” of a foreign proceeding.<sup>6</sup> The recognition petition must be accompanied by evidence of the commencement of a foreign proceeding and of the appointment of the foreign representative and a statement identifying all of the pending foreign proceedings. 11 U.S.C. §1515. To the extent that such documents are issued by a foreign entity, they need not be supported by authenticating affidavits; rather, the court is permitted to presume their authenticity. 11 U.S.C. §1516. The recognition petition will be granted if the foregoing requirements are met and the foreign proceeding meets the definition of a “foreign main proceeding” or a “foreign nonmain proceeding.”<sup>7</sup>

---

<sup>5</sup> The definition of the term “foreign representative” has been changed to mean “a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding *to administer the reorganization or the liquidation of the debtor’s assets* or affairs or to act as a representative of such foreign proceeding.” (11 U.S.C. §101(24) (as amended) (emphasis added). *Cf. In re Goerg*, 844 F2d 1562 (11th Cir. 1988), *cert denied sub nom, Parungao v. Goerg*, 488 U.S. 1034 (1989) (holding that foreign representative of foreign insolvent decedent’s estate was qualified to commence ancillary proceeding under Code §304, even though a decedent’s estate would not qualify as a “debtor” under Code §109).

<sup>6</sup> Section 1502 contains the following new definitions: (i) recognition “means the entry of an order granting recognition of a foreign main proceeding or a foreign nonmain proceeding under this chapter”; (ii) foreign main proceeding “means a foreign proceeding pending in the country where the debtor has the center of its main interests” (pursuant to §1516(c), a debtor’s registered office is presumed to be the center of its main interests; however, the presumption is rebuttable and is therefore an area ripe for litigation); (iii) foreign nonmain proceeding “means a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment” and (iv) establishment “means any place of operations where the debtor carries out a nontransitory economic activity.” In addition, the definition of “foreign proceeding” has been amended to mean “a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation.” 11 U.S.C. §101(23) (as amended). Thus, the Bankruptcy Code recognizes ancillary as well as plenary foreign proceedings. In addition, in contrast to the Model Law, the commencement of a plenary case outside the U.S. does not preclude a foreign debtor from seeking plenary relief in the U.S.

<sup>7</sup> The filing of a recognition petition does not subject the foreign representative to the jurisdiction of any U.S. court for any other purpose. 11 U.S.C. §1510.

The court must make a determination with respect to the petition for recognition “at the earliest possible time” and may modify or terminate such determination upon a change of circumstances, giving “due weight to possible prejudice to parties that have relied upon the order granting recognition.” 11 U.S.C. §§1517(c) and (d). Pursuant to §1518, a foreign representative is obligated to file a notice with the court of any “substantial change” in the status of the foreign proceeding or the foreign representative and of any additional foreign proceedings. The court has an obligation following subsequent filings to coordinate the relief granted in such proceedings so as to be consistent with each other and with any pending foreign main proceeding.

Thus, as with the current system under Code §304, prerequisites for the commencement of an ancillary proceeding are minimal and, although the automatic stay does not apply upon the *filing* of the petition (as distinguished from its new applicability, discussed below, upon the *recognition* of a foreign main proceeding), a request for provisional relief may be filed with the petition. *See, e.g., In re Manning*, 236 B.R. 14, 20 (B.A.P. 9th Cir. 1999) (the debtor’s ownership of property in the United States is not the “sine qua non” of subject matter jurisdiction under Code §304); *Hopewell*, 238 B.R. at 49-51 (broadly construing the term “foreign proceeding”); *In re Evans*, 177 B.R. 193, 196-97 (Bankr. S.D.N.Y. 1995) (allowing turnover proceeding commenced by foreign representative under Code §304).

**Relief Available Between Petition Filing and Recognition of Foreign Proceeding:**

While the provisional relief typically requested on the first day of a case under Code §304 could be very broad and would remain in place, subject to periodic review, throughout the life of the ancillary proceeding, under Chapter 15, relief granted in

conjunction with the filing of the petition is limited to that which is “urgently needed” and terminates (without prejudice) once the petition is granted. Thereafter, the foreign representative will likely seek post-recognition relief. *See* 11 U.S.C. §1507.

Upon the filing of the petition for recognition but prior to the court’s determination of whether the petition should be granted, the foreign representative may seek and the court may grant provisional relief “urgently needed to protect the debtor’s assets or the interests of creditors,” including (i) a stay of execution against the debtor’s assets; (ii) turnover of the responsibility for administering or realizing on assets of the debtor in the U.S. to the foreign representative or other person authorized by the court for the purpose of protecting and preserving perishable, devaluing or otherwise jeopardized assets;<sup>8</sup> (iii) freezing the debtor’s assets; (iv) discovery and (v) other relief available to a trustee (except for relief available under Code §§522, 544, 545, 547, 548, 550 and 724(a)). 11 U.S.C. §1519(a).<sup>9</sup>

**Effect of Recognition:**

Upon the grant by a court of a petition for recognition, (i) “a court in the United States *shall* grant comity or cooperation to the foreign representative;” (ii) a foreign representative may, in the case of a foreign main proceeding, commence a voluntary or

---

<sup>8</sup> Code §1104(d) (appointment of disinterested person as trustee or examiner) applies in Chapter 15. 11 U.S.C. §1522(d).

<sup>9</sup> The standard for a grant of relief under 11 U.S.C. §1519 is an injunction standard. 11 U.S.C. §1519(e). Such relief must be denied where it would interfere with a foreign main proceeding and terminates when the recognition petition is granted. 11 U.S.C. §§1519(b) and (c). The relief under this section cannot be used to enjoin a police or regulatory act of a governmental unit or to stay rights not subject to the automatic stay under Code §§362(b)(6), (7), (17) or (27) or 362(n). 11 U.S.C. §§ 1519(d) and (f).

involuntary case under Code §§301, 302 or 303;<sup>10</sup> (iii) the foreign representative automatically becomes a party in interest in any case pending against the debtor under Title 11; (iv) the foreign representative may sue and be sued in the United States; (v) the foreign representative may “apply directly to a court in the United States for appropriate relief;” and (vi) the foreign representative may intervene in any proceeding in state or federal court where the debtor is a party. 11 U.S.C. §§1509, 1511, 1512, 1524 (emphasis added).<sup>11</sup>

In addition, in a change that is important to U.S. creditors of foreign debtors, pursuant to 11 U.S.C. §1520, upon the recognition of a foreign main proceeding, (i) Bankruptcy Code §§361 (adequate protection) and 362 (automatic stay) apply with respect to any property of the debtor located in the U.S.; (ii) Code §§363 (sale or use of property), 549 (post-petition transfers) and 552 (liens on after-acquired property) apply to transfers of property of the debtor in the U.S.; (iii) the foreign representative is empowered to operate the debtor and take action under Code §§363 and 552 and (iv) Code §552 applies to property of the debtor in the U.S.<sup>12</sup>

U.S. creditors of foreign debtors should be particularly mindful of these provisions given the consequences of violating the automatic stay, which may include

---

<sup>10</sup> Recognition of a foreign main proceeding constitutes proof that the debtor is insolvent for purposes of Code §303. 11 U.S.C. §1531. A voluntary case may only be commenced by the foreign representative if the foreign proceeding is a foreign main proceeding. 11 U.S.C. §1511(a)(2).

<sup>11</sup> Irrespective of whether recognition is granted, a foreign representative is always subject to applicable non-bankruptcy law. Irrespective of whether a foreign representative seeks recognition, a foreign representative may exercise any available right to collect or recover a claim which is property of the debtor. 11 U.S.C. §§1509(e) and (f).

<sup>12</sup> This section does not prevent the commencement of an action in a foreign country to preserve a claim against the debtor or the ability of a foreign representative to commence a case under Title 11 or the right of other parties in interest to file claims and take permitted actions in such a case. 11 U.S.C. §§ 1520(b) and (c).

sanctions and contempt orders for repeated violations. The application of Bankruptcy Code §§361, 363, 549 and 552 to foreign debtors, however, should provide significant protections to U.S. creditors in that the use or sale of a debtor's property located in the U.S. will be subject to the protection of the interests of creditors with interests in such property.

**Additional Relief Available Post-Recognition:**

Pursuant to 11 U.S.C. §1507, if recognition is granted, the foreign representative may seek “additional assistance” from the bankruptcy court. In determining whether to provide such assistance, the bankruptcy court must “consider whether such additional assistance, consistent with principles of comity,” is also consistent with the principles listed in current Code §304, including just treatment of holders of claims, protection of U.S. creditors from prejudice and inconvenience of prosecuting claims in a foreign proceeding, preventing fraudulent and preferential transfers, distribution of proceeds substantially in accordance with the Bankruptcy Code priorities and an opportunity for a fresh start. In addition, a court may always refuse to act if to do so would be “manifestly contrary” to U.S. public policy. 11 U.S.C. §1506.

It is also important to note that relief under either 11 U.S.C. §1519 (relief available post-filing, but pre-recognition) or 11 U.S.C. §1520 (Code provisions applicable upon recognition of foreign main proceeding) may be (i) granted, modified or terminated sua sponte upon the request of the foreign representative or an affected entity “only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected” or (ii) subjected to conditions, including the posting of a bond or other security. 11 U.S.C. §§1522(a) and (b).

More specifically, upon the recognition of a foreign proceeding, main or nonmain, “where necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interests of creditors,” the foreign representative may request and the court may grant additional relief, including (i) a stay of any action or proceeding; (ii) a stay of execution against the debtor’s assets; (iii) suspension of the right to transfer, encumber or dispose of any assets; (iv) discovery; (v) turnover of the administration or realization of the debtor’s assets to the foreign representative or other authorized person; (vi) the extension of any relief previously granted under 11 U.S.C. §1519 during the interim period between the filing and granting of the recognition petition; (vii) other relief available to a trustee (other than under Code §§522, 544, 545, 547, 548, 550 and 724(a)) and (viii) authorization to distribute the debtor’s assets located in the U.S., which may be granted only if “the court is satisfied that the interests of creditors in the United States are sufficiently protected.” 11 U.S.C. §§1521(a) and (b).<sup>13</sup>

**Concurrent Plenary Cases:**

Concurrent plenary cases, previously unmentioned in the Bankruptcy Code, are now the subject of Subchapter V of Chapter 15. Section 1528 provides that following recognition of a foreign main proceeding, a case under another chapter of Title 11 may

---

<sup>13</sup> In granting relief under 11 U.S.C. §1521 with respect to a foreign nonmain proceeding, the court must be “satisfied that the relief relates to assets that, under the law of the United States, should be administered in the foreign nonmain proceeding or concerns information required in that proceeding.” 11 U.S.C. §1521(c). The standard for a grant of relief under §1521 is an injunction standard. 11 U.S.C. §1521(e). The relief under this section (as under §1519) cannot be used to enjoin a police or regulatory act of a governmental unit or to stay rights not subject to the automatic stay under Code §§362(b)(6), (7), (17) or (27) or 362(n). 11 U.S.C. §§1521(d) and (f).

be commenced only if the debtor has assets in the United States.<sup>14</sup> Section 1528 further provides:

The effects of such case shall be restricted to the assets of the debtor that are within the territorial jurisdiction of the United States and, to the extent necessary to implement cooperation and coordination under sections 1525, 1526 and 1527, to other assets of the debtor that are within the jurisdiction of the court under section 541(a) of this title and section 1334(e) of title 28, to the extent that such other assets are not subject to the jurisdiction and control of a foreign proceeding that has been recognized under this chapter.<sup>15</sup>

In concurrent cross-border insolvency proceedings under the current Bankruptcy Code, U.S. courts have no restrictions on their exercise of jurisdiction over the debtor's statutory property. The new limitations imposed by Chapter 15, designed to further its goals of cooperation and coordination, may limit the discretion and power of U.S. courts in concurrent cross-border cases.<sup>16</sup>

Subchapter V further provides that (i) to the extent that a concurrent plenary case is filed, relief granted under 11 U.S.C. §§1519 or 1521 must be consistent (or modified

---

<sup>14</sup> Section 1528 does not distinguish between voluntary plenary cases under Bankruptcy Code §301 and involuntary plenary cases under §303(b)(4), each of which may be commenced by a foreign representative in accordance with 11 U.S.C. §1528 and so long as the other eligibility requirements are met. Further, under current Code §305, a plenary case may be dismissed or the court may abstain from hearing the case if, among other things, there is a foreign proceeding pending or based on the factors set forth in §304. *See In re Globo Comunicacoes E Participacoes S.A.*, 317 B.R. 235 (S.D.N.Y. 2004) (bankruptcy court dismissal of involuntary case filed against debtor in foreign proceeding vacated and remanded by district court, with instructions to make specific findings whether, among other things, abstention warranted under Code §305 based upon factors listed in §304(c)). Code §305 has been amended by the Act to provide that a case may be dismissed or a court may abstain if a recognition petition has been granted or if the purposes of Chapter 15 would be best served.

<sup>15</sup> Section 541(a) provides that the commencement of a case creates an estate comprised of all property of the debtor "wherever located and by whomever held." 11 U.S.C. §541(a). Pursuant to 28 U.S.C. §1334(e), the district court in which a case is commenced has exclusive jurisdiction over all such property.

<sup>16</sup> Although there are no statutory restrictions, practical limitations may exist. *See In re Yukos Oil Co.*, 321 B.R. 396, 410-11 (Bankr. S.D. Tex. 2005) (dismissing case based on inability to grant relief due to lack of participation of Russian government, questionable exercise of U.S. jurisdiction and proceedings pending in other countries).

so as to be consistent) with such plenary case and 11 U.S.C. §1520 (regarding the applicability of the automatic stay and other sections) no longer applies; and (ii) to the extent that a foreign nonmain case is filed, the court must ensure that any relief granted relates to assets which, under U.S. law, should be administered in the foreign nonmain proceeding. 11 U.S.C. §1529. In a concurrent plenary case commenced in the U.S., the court may also authorize a person or entity to act in the foreign proceeding and such person may act in any way permitted by foreign law. 11 U.S.C. §1505.

**Avoidance Actions Under Chapter 15:**

Although the foreign representative is not authorized to pursue avoidance actions under Bankruptcy Code §§522, 544, 545, 547, 548, 550 or 724(a) in an ancillary proceeding under Chapter 15, the foreign representative may do so in any case involving the debtor under another chapter of Title 11 so long as, in the case of a foreign nonmain proceeding, the court is satisfied that such an action relates to assets which, under U.S. law, should be administered in the foreign nonmain proceeding. 11 U.S.C. §1523.

As set forth above, after recognition of a foreign main proceeding, a foreign representative may only commence a plenary action in the U.S. if the debtor has assets in the United States; and the U.S. court's jurisdiction only reaches those assets and other assets not within the jurisdiction of the foreign court. 11 U.S.C. §1528. Thus, Chapter 15 states clearly that avoidance actions are available to foreign debtors; and it resolves the choice of law issue that arises when U.S. and foreign plenary proceedings are commenced and avoidance actions exist. This is consistent with more recent case law on these issues. *See, e.g., Maxwell III*, 93 F.3d at 1051-52; *cf. In re Axona Int'l Credit & Commerce Ltd.*, 88 B.R. 597, 613-615.

### **Rights of Foreign Creditors in U.S. Cases:**

Foreign creditors, heretofore unmentioned in the Bankruptcy Code, now have recognized rights under §§1513 and 1514. These rights include the following: (i) “the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors;” (ii) foreign creditors with priority claims under Code §§507 or 726 “shall not be given a lower priority than that of general unsecured claims without priority solely because the holder of such claim is a foreign creditor;” (iii) any notice that must be given to creditors generally must also be given to foreign creditors; (iv) such notice must be individual notice unless the court otherwise directs; (v) notice of the commencement of the case must give information regarding the mechanism and timing for filing proofs of claim and (vi) a reasonable amount of additional time to file proofs of claim must be provided to foreign creditors.

### **Conclusion:**

Although much of Chapter 15 represents the codification of standards and practices which have evolved through case law under current §304, there are certain important new changes, including (i) the applicability of the automatic stay and other provisions with respect to cases commenced in the U.S. which are ancillary to foreign main proceedings; (ii) the limitations on the extent of jurisdiction of U.S. courts in concurrent plenary cases and (iii) the recognition of the rights of foreign creditors.

*This Article is provided as a general informational service and should not be construed as imparting legal advice on any specific matter.*