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Expanding Jurisdiction of U.S. Bankruptcy Courts

Two recent appellate decisions of the United States District Court for the Southern District of New York (the district court) have the potential for altering the jurisdictional landscape of bankruptcy courts in the United States.

Recent Case Facts

In *In re Globo Comunicacoes e Participacoes S.A.*, 317 BR 235 (SDNY 2004) (*Globopar*), the district court established a road map for domestic creditors to commence an involuntary proceeding against a foreign debtor under Bankruptcy Code §303(b)(1), thereby opening potential avenues of recovery for domestic creditors who are unable to recover in a foreign jurisdiction.

In *In re Agency for Deposit Insurance Rehabilitation, Bankruptcy and Liquidation of Banks v. Superintendent of Banks of the State of New York*, 310 BR 793 (SDNY 2004), appeal docketed, No. 04-4997-bk (2d Cir. Oct. 18, 2004) (the *Yugoslavian Liquidators* case), under the rationale of providing a “helping hand” in aid of foreign proceedings, the district court held that the eligibility restrictions of Bankruptcy Code §109 are inapplicable to foreign banks commencing ancillary proceedings and, in the process, shut out a domestic creditor who had been unable to recover in the foreign proceeding.

Of related interest is the extraterritorial reach of the U.S. Bankruptcy Court for the Southern District of Texas in the *Yukos Oil Co.* case (*Yukos*), where several parties were enjoined from participating in a Russian auction of Yukos’ main asset.¹ Whether the *Yukos* court’s ability to enjoin extraterritorial participation in an auction nine time zones away will have any effect on the final outcome of the *Globopar* and *Yugoslavian Liquidators* cases will be of particular significance to those

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Although there is no specific provision in Bankruptcy Code §303, or its legislative

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history, that would prohibit domestic creditors from filing an involuntary petition against a foreign debtor, the *Globopar* court appears to be the first court to openly allow the practice.² This will undoubtedly give hope to many domestic creditors who have suffered at the hands of foreign companies, seeking to take advantage of U.S. capital markets and later avoiding accountability to U.S. creditors.³

In *Globopar*, certain U.S. creditors, displeased with the restructuring efforts in *Globopar*’s home country of Brazil, filed an involuntary petition in the U.S. Bankruptcy Court for the Southern District of New York, pursuant to Bankruptcy Code §303(b)(1), which permits the filing of an involuntary case against a person by “three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute ...

if such claims aggregate at least \$11,625 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims.”⁴

‘No Action’ Clauses in Contracts

The bankruptcy court dismissed the petition, pursuant to Bankruptcy Code §105(a), finding that (i) certain “no action” clauses in contracts between the petitioning creditors and *Globopar* prohibited the filing by those creditors, (ii) *Globopar* did not have sufficient assets in the United States to be an eligible debtor under code §109 and (iii) any order issued by the bankruptcy court would be unenforceable in Brazil, thereby making it “impossible for the bankruptcy court to marshal *Globopar*’s Brazilian assets in support of court-managed restructuring.”⁵

Despite the bankruptcy court’s limited findings of fact, the district court held that, on its face, the “no action” clause at issue did not prohibit the petitioners from filing the involuntary petition.⁶ Further, with respect to due process considerations, the district court held that *Globopar* would clearly be an eligible debtor under code §109 if the alleged ownership of a Delaware corporation and a U.S. bank account could be established.⁷ The district court remanded the case to the bankruptcy court with a direction to make specific findings on whether (i) *Globopar*’s use of the U.S. capital markets constituted sufficient contacts (absent the Delaware corporation and bank account) to satisfy due process requirements, (ii) the debt was held mainly by U.S. creditors, so as to provide the court with personal jurisdiction over *Globopar* and thus have extraterritorial effect over its non-U.S. assets, (iii) the bankruptcy court should abstain under code §305, based upon the factors listed in code §304(c) and (iv) the petition should be dismissed under the doctrine of *forum non conveniens*.⁸

In discussing due process and abstention considerations, the district court made clear that the bankruptcy court should abstain even if the foregoing satisfies due process minimum contacts requirements for personal jurisdiction

but does not satisfy the factors contained in code §304(c).⁹

In the *Multicanal* case, two factors weighed heavily by the court were the lack of substantial assets in the United States and the little likelihood that a bankruptcy court judgment would be enforced in the foreign jurisdiction, a concern that the *Globopar* case touched upon briefly but left for the bankruptcy court to examine on remand.¹⁰ If there are insignificant assets in the United States, or if the foreign jurisdiction is not likely to recognize the extraterritorial judgment of a U.S. bankruptcy court, as was the case in *Multicanal* and as may well be the case in *Globopar*, the bankruptcy court, on remand, is likely to dismiss the petition. Otherwise, the court would be wasting considerable judicial resources where it would be highly likely that domestic creditors would see no benefit.

'Piecemeal Distribution'

Of particular interest is the *Globopar* court's seeming indifference to the policies behind Bankruptcy Code §304, which sets forth the factors a court must consider when evaluating whether a U.S. bankruptcy court is an appropriate forum for adjudicating proceedings ancillary to a foreign plenary case. Specifically, rather than lend a helping hand to a foreign plenary case to avoid "piecemeal distribution," the district court seemed to prefer aiding domestic creditors who incurred losses as a result of the openness of U.S. capital markets and the laws of the foreign debtor's country — whose laws, if substantially unfavorable to U.S. creditors, would mandate abstention under considerations of code §304(c). Given the strong possibility that the bankruptcy court, on remand, will decide to abstain on similar grounds as in *Multicanal*, it may be some time before the road map for filing an involuntary proceeding against a foreign debtor is successfully tested.

Abstention on similar grounds may also be the final outcome in the *Yugoslavian Liquidators* case, although the district court clearly recognized the right of foreign banks to file ancillary proceedings under code §304, which permits a foreign representative of a debtor in a foreign proceeding to commence an ancillary proceeding in the United States.¹¹ As explained in several cases, and in the legislative history, the principal policy reason behind the enactment of code §304 was to facilitate the administration of foreign plenary proceedings and thereby avoid piecemeal distribution of the foreign debtor's assets in the United States.¹²

As a result, courts have taken a very broad view of what constitutes a foreign proceeding and have often stated that a foreign debtor need not have a place of business or any identifiable assets in the United States in order to commence an ancillary proceeding.¹³

Since code §109 expressly prohibits a

foreign bank from becoming a debtor under the Bankruptcy Code, the bankruptcy court denied the ancillary petition filed by the *Yugoslavian Liquidators*.¹⁴ Following the analysis contained in other Southern District of New York bankruptcy cases, the district court examined the plain language of code §304 and noted that it permits a "foreign representa-

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begin an ancillary proceeding
and such a representative is
not a "debtor" under the
Bankruptcy Code.*

tive" to commence an ancillary proceeding, and that a foreign representative is not a "debtor" for definitional purposes under the Bankruptcy Code.

Coordinated Distribution

The court also reiterated Congress' intent to aid "foreign debtors in marshaling their assets to allow for a single, coordinated foreign distribution" and pointed out that an ancillary case does not provide the full panoply of rights, such as the automatic stay and U.S. avoidance powers, that a trustee or debtor-in-possession has in a plenary case.¹⁵ Not only has this case caused a national uproar within the bank regulatory sector by the district court's making short shrift of the arguments of the superintendent of banks of the state of New York regarding federal preemption and sovereign immunity, but it has had the curious effect of prejudicing a domestic creditor who was denied relief in the foreign jurisdiction to the tune of \$4.1 million.¹⁶

Both cases appear to have established clear precedent that expands the jurisdiction of the bankruptcy court, or validate heretofore untried areas of jurisdiction. The ability of domestic creditors to file an involuntary petition against a foreign debtor, subject to due process considerations, is now firmly recognized in the Southern District of New York, as is the right of a foreign representative of a foreign bank to commence an ancillary bankruptcy proceeding.

Curiously, while the first case may assist domestic creditors, at the expense of promoting the policy of assisting foreign jurisdictions in the orderly distribution of assets, the other holding has caused outright harm to a U.S. creditor by adhering to that policy. Further, it seems likely from the factors to be considered on remand in both cases that the bankruptcy court will abstain and dismiss both cases.¹⁷

Broad Jurisdiction Coming?

The recently exercised extraterritorial reach of the U.S. Bankruptcy Court in *Yukos*, as discussed above, may alter what previously seemed to be a likely conclusion for both the *Globopar* and *Yugoslavian Liquidators* cases. Although the Russian government clearly dismissed any authority of the bankruptcy court to enjoin a Russian auction of *Yukos'* most valuable asset and ignored the urgings of the United States to forego the auction, none of the entities directly restrained from bidding by the bankruptcy court actually participated, including the Russian Federation-operated Gazprom. Thus, the U.S. Bankruptcy Court exercised extraterritorial jurisdiction over foreign entities having significant business interests in the United States, as many of the enjoined parties were large financial institutions or corporations. To the extent that such entities continue operating in and enjoying the benefits of the U.S. marketplace, the U.S. Bankruptcy Court may wind up exercising broadened jurisdiction with greater frequency.

1. *Yukos Oil Co.* filed for voluntary Chapter 11 relief in Houston on Dec. 14, 2004, Case No. 04-47742-H3-11.

2. One of the first reported cases to permit a plenary case to be commenced by a foreign representative of a foreign debtor, as contemplated by Bankruptcy Code §303(b)(4), was *In re Axona Int'l Credit & Commerce Ltd.*, 88 BR 597 (Bankr. SDNY 1988), aff'd., 115 BR 442 (S.D.N.Y. 1990), appeal dismissed, 924 F.2d 31 (2d Cir. 1991). However, that case did not involve an attempt by domestic creditors to commence plenary proceedings.

3. In *In re Board of Directors of Multicanal S.A.*, 314 BR 486 (Bankr. S.D.N.Y. 2004) ("*Multicanal*"), the court dismissed a petition filed by domestic creditors against a foreign debtor on grounds with which the *Globopar* court disagreed. However, the *Multicanal* case was initially dismissed on abstention grounds, which, as discussed below, is also likely to be the final outcome of *Globopar*. On Jan. 6, 2005, the court in *Multicanal* conditionally granted the Debtor's Code §304 petition for ancillary relief and dismissed, with prejudice, the involuntary petition under code §303.

4. *Globopar*, 317 B.R. at 242; 11 U.S.C. §303(b)(1).

5. *Globopar*, 317 B.R. at 244.

6. *Id.*

7. *Id.* at 249.

8. *Id.* at 255-58.

9. *Id.* at 253-54.

10. *Id.* at 253; *Multicanal*, 314 B.R. at 522-23.

11. *Yugoslavian Liquidators*, 310 B.R. at 794.

12. *Id.* at 795; *In re Board of Directors of Hopewell Int'l Ins. Ltd.*, 238 B.R. 25, 54 (Bankr. S.D.N.Y. 1999).

13. *Haarhuis v. Kunnan Enterp., Ltd.*, 177 F.3d 1007, 1012 (DC Cir. 1999); *In re Manning*, 236 B.R. 14, 20 (BAP 9th Cir. 1999).

14. *Yugoslavian Liquidators*, 310 B.R. at 794-95.

15. *Id.* at 795.

16. Michael Bobelian, "Ruling on Assets of Bankrupt Foreign Banks Causes Stir," N.Y. Law Journal, Aug. 11, 2004, at 1.

17. It is conceivable that the *Yugoslavian Liquidators* case will, like *Multicanal*, be dismissed unless the U.S. creditor who was unable to find relief in the foreign forum receives fair treatment.