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Constraints on Stay Relief Afforded to Chapter 15 Debtors

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At one time, insolvency proceedings were primarily confined to one jurisdiction. However, in the age of expanding globalization, corporate insolvencies may now involve businesses and assets in multiple jurisdictions. Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) and a new chapter of the Bankruptcy Code, chapter 15, entitled, "Ancillary and Other Cross-Border Cases."[1] Chapter 15 is based on the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"), a body whose "business is the modernization and harmonization of rules on international business."[2] Chapter 15 repealed § 304 of the Bankruptcy Code which, prior to chapter 15, provided the method by which foreign trustees and liquidators could seek relief from U.S. bankruptcy courts in order to prevent piecemeal distribution of assets in the U.S. and obtain other assistance from the bankruptcy courts.

Chapter 15 is intended "to provide effective mechanisms for dealing with cases of cross-border insolvency."[3] Section 1501 of the Code enumerates the objectives delineated in the Model Law, which include fostering cooperation among U.S. courts,

trustees and debtors, and foreign courts involved in cross-border insolvencies, "fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor...protection and maximization of the value of the debtor's assets; and facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment."[4]

Chapter 15 provides the framework by which U.S. bankruptcy courts are available to companies in insolvency proceedings outside the country. Section 1502(1) defines a chapter 15 debtor as "an entity that is the subject of a foreign proceeding," and thus places chapter 15 on an international stage. However, where the debtor's primary assets and business are located in another jurisdiction, the U.S. proceeding is typically not the center-stage performer. A debtor's foreign representative seeks recognition under chapter 15. If the bankruptcy court enters a recognition order, the chapter 15 becomes an *ancillary proceeding*.[5] Chapter 15 debtors in ancillary proceedings typically have their business centers outside the U.S. but maintain either businesses or assets in the U.S. or are the subject of litigation within the U.S. The foreign proceeding is recognized as the primary proceeding.[6] The ancillary proceeding under chapter 15 allows the debtor and its foreign representative to avail themselves of certain protections and powers under the Bankruptcy Code, subject to certain limitations.[7] Notably, in contrast to other cases initiated under chapters in the Code, filing a petition seeking recognition and obtaining it does not create a debtor's "estate."[8]

A court can only recognize a foreign proceeding if it finds that the foreign proceeding is either pending in a country where the debtor has the "center of its main interests," (such foreign proceedings are denoted as the "main" case) or in the case of a "non-main" proceeding, the foreign proceeding is pending in a country where the debtor has an "establishment."[9] In other words, a U.S. bankruptcy court can only recognize foreign proceedings where the foreign representative meets the requirement of chapter 15 and demonstrates the proper nexus to the foreign jurisdiction.[10]

In contrast to ancillary proceedings, international corporate conglomerates may initiate full, plenary bankruptcy proceedings in multiple jurisdictions.[11] Where there are concurrent U.S. and foreign cases, chapter 15 provides a framework for cooperation and coordination between the U.S. and the foreign court(s) and enables the courts to establish procedures to manage in tandem, co-equal cross-border insolvencies. In a number of cross-border insolvency proceedings, courts and counsel for debtors in each jurisdiction often agree to protocols, which are intended to enable the courts in co-equal, multi-jurisdictional proceedings to work together.[12]

Automatic Stay: In and Out of Chapter 15

The automatic stay in a plenary case under the Bankruptcy Code has an expansive, broad territorial reach, protecting all property encompassed in a debtor's estate under § 541(a) "wherever located and by whomever held."[13] Section 362 provides that the filing of a petition under the Code, "operates as a stay, applicable to all entities" for actions taken against a debtor and his or her estate, including, among others, commencing or continuing a legal or administrative proceeding, attempts to enforce judgments against a debtor or his or her property or attempts to collect or recover on a claim against the debtor.[14] It is well recognized that the stay comes into effect immediately upon filing a petition, without further application for relief.

Section 1520 of the Code provides that once the bankruptcy court grants an order of recognition to a foreign proceeding, certain Code sections become operative, including, § 362, which will "apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States."[15] Although § 362 is understood to have a global reach because it encompasses all of the debtor's property in the estate "wherever located and by whomever held,"[16] the breadth of that reach in an ancillary chapter 15, where an "estate" is not created, appears to be narrower than some foreign debtors may have hoped.

In *In re JSC BTA Bank*,[17] the Bankruptcy Court for the Southern District of New York was asked to define the scope of the automatic stay in a chapter 15 ancillary proceeding. The specific issue before the court was whether the automatic stay "applicable to 'the debtor and the property of the debtor that is within the territorial jurisdiction of the United States' operates as a bar to the continuation of a pending arbitration proceeding brought against the debtor...in a foreign jurisdiction."[18]

On Oct. 16, 2009, JSC BTA Bank (BTA) initiated a reorganization proceeding in the Republic of Kazakhstan (the "Kazakh proceeding"). Shortly thereafter, on Oct. 28, 2009, the Geneva branch of a French bank, Banque Internationale de Commerce-BRED, Paris, (BIC-BRED), initiated arbitration proceedings in Switzerland (the "Swiss arbitration") against BTA for a determination as to liability and damages for BTA's alleged breach of a loan agreement. The loan documents contained a Swiss choice of law provision and an arbitration clause requiring a Swiss-arbitration forum.[19]

BTA's foreign representative, Anvar Galimullaevich Saidenov (the representative), sought recognition of the Kazakh proceeding in various jurisdictions, including the U.S. The court granted recognition on March 2, 2010 (the "recognition order").[20] The chapter 15 was "uneventful" until July 2, 2010, when the representative filed a motion seeking to hold BIC-BRED in contempt for violating the automatic stay by refusing to stay the Swiss arbitration and requesting that the court enter an order to

formally stay the Swiss arbitration.[21] In support for his arguments, the representative relied on the expansive breadth of the automatic stay in plenary cases and specific language in the recognition order, which it asserted granted BTA and the representative "all of the relief set forth in section 1520...including, without limitation, the application of the protection afforded by the automatic stay under 362(a)...to the Bank worldwide and to the Bank's property that is within the territorial jurisdiction of the United States."[22]

BIC-BRED opposed the motion for contempt and request to stay the Swiss arbitration asserting that BIC-BRED was beyond the court's jurisdiction and challenging the representative's interpretation of the scope and breadth of the automatic stay in ancillary proceedings. BIC-BRED asserted that the court's jurisdiction neither reached it nor the Swiss arbitration because BIC-BRED (1) did not have any offices in New York or the U.S.; (2) did not have any employees in New York or the U.S.; (3) did not own any property in New York or the U.S.; and (4) did not maintain any deposit accounts in New York or the U.S. and that the Swiss arbitration involved a foreign contract and foreign parties.[23] BIC-BRED and BTA's only connections to New York or the U.S. were through certain correspondent bank accounts maintained through unrelated banking entities in New York.[24]

Ultimately, the court declined to adopt the representative's broad interpretation and refused to find that the recognition order triggered a stay of all proceedings against the debtor, wherever located. Chief among the court's concerns was: (1) chapter 15's international focus, (2) the ancillary—as opposed to plenary—nature of this bankruptcy, and (3) that, unlike typical cases under other chapters in the Code, obtaining recognition under chapter 15 does not create a "debtor's estate" under § 541.[25]

The representative asserted that the language of § 1520 supported enjoining the Swiss arbitration because it was an action against the debtor. Section 1520(a)(1) provides that "[u]pon recognition of a...foreign main proceeding (1) sections 361 and 362 apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States."[26] The representative asserted that part one of § 1520(a)(1) provided a debtor with the protections of a worldwide automatic stay as to actions against the debtor, while the "limitation" that narrowed the scope of § 362 in this provision to "property within the United States" was a limitation applying only to tangible property of the debtor. The court found that such a construction was contrary to the aims of chapter 15 and ignored the "in rem nature of jurisdiction in a chapter 15 case."[27] Moreover, the court rejected the assertion that the Recognition Order could be read to grant more protection than that provided under § 1520.

As further support for his argument, the representative claimed that § 1520 must apply to stay actions beyond U.S. borders because § 1520(a) specifically "does not affect the right to commence an individual action or proceeding in a foreign country to the extent necessary to preserve a claim against the debtor."[28] He reasoned that the foregoing language would be unnecessary if § 1520(a) did not already extend the stay worldwide.[29] The Court found that this argument did "support...an alternative interpretation that would extend the automatic stay to the debtor in other jurisdictions *in appropriate circumstances*."[30] This, however, was not an "appropriate circumstance," particularly given the fact that neither BTA nor BIC-BRED had sufficient contacts with the U.S., the Swiss arbitration was not connected to the chapter 15 and the stay was not being sought to protect property of the debtor within U.S. territorial jurisdiction. The court also observed the dearth of any case law applying the automatic stay in a chapter 15 to stay a foreign proceeding.[31] The representative's reliance on the "global" scope of the automatic stay in plenary cases was not supported by the court because it failed to account for the limited in rem jurisdiction of a U.S. bankruptcy court in an ancillary chapter 15.[32]

The court held that "at least in the setting of an ancillary chapter 15 case, [the bankruptcy court] should not stand in the way of a foreign arbitration process when the outcome will have no foreseeable impact on any property of the foreign debtor in the United States."[33] It held that, because the Swiss arbitration had already resulted in a judgment by the time the court heard the motion, there was no proceeding to stay. The court further declined to hold BIC-BRED in contempt given its conclusion that the stay did not apply to the Swiss arbitration.

The *JSC* decision may be a cautionary tale for foreign debtors seeking to use a chapter 15 to avail themselves of the automatic stay. While the automatic stay applies once a recognition order is entered, debtor's foreign representatives and their counsel should examine the proceeding or property in question that they are seeking to protect to first confirm that it is within the jurisdictional reach of the chapter 15.

In *JSC*, the court recognized the limitations of the reach of the automatic stay consistent with the limited nexus of the foreign debtor to the U.S. The court was unwilling to overreach where U.S. interests were limited. In *In re Bear Sterns High-Grade Structured Credit Strategies Master Fund Ltd.* and *In re Bear Sterns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd.*[34] the court refused to recognize a foreign proceeding where it found that the foreign jurisdiction was not the "center of the debtors' main interests" and the debtors did not have an "establishment" in that jurisdiction. The court found the debtors' nexus to the U.S. far greater than their limited connections with the Cayman Islands. The court concluded that granting recognition to the foreign proceeding in these

circumstances would improperly afford the debtors all the protections of the automatic stay without commencing a full, plenary proceeding under Chapter 11. The court denied the representatives' request for recognition without prejudice to file a Chapter 11 case.[35]

The *JSC* and *Bear Sterns* decisions both reflect the ongoing development of the appropriate scope of a chapter 15 proceeding and the extent of protections of the automatic stay in cross-border proceedings involving multinational conglomerates. They represent applications of chapter 15 to establish the appropriate role for the U.S. bankruptcy courts in cases involving multinational debtors.

1. U.S.C. §§ 1501, *et seq.*

2. *See* the UNCITRAL website, available at www.uncitral.org/uncitral/en/index.html. UNCITRAL also published the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency (the "Guide") to assist courts and legislatures in interpreting the Model Law. The Guide is available at www.uncitral.org/pdf/english/texts/insolven /insolvency-e.pdf.

3. Preamble of the Guide, Part One.

4. 11 U.S.C. § 1501(a)(1)-(5).

5. Section 101(24) defines a "foreign representative" as "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."

6. *See* 11 U.S.C. § 1502(4).

7. *See, e.g.*, 11 U.S.C. § 1509; 8 *Collier on Bankruptcy*, ¶ 1509.02 at 1509-4 (16th ed).

8. *See, e.g., In re JSC BTA Bank*, --- B.R ---, 2010 WL 3306885 (Bankr. S.D.N.Y. Aug. 23, 2010), No. 10-10638 (JMP).

9. Section 1502 defines a "foreign main proceeding" as "a foreign proceeding pending in the country where the debtor has the *center of its main interests*" and a "foreign non main proceeding" as "a foreign proceeding, other than a foreign main proceeding, pending a country where the debtor has an *establishment*." 11 U.S.C. § 1502(4), (5) (emphasis added). See also, *In re Bear Sterns High-Grade Structured Credit Strategies Master Fund Ltd.* and *In re Bear Sterns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd.*, 374 B.R. 122, 124, 126-33 (Bankr. S.D.N.Y. 2007), *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008).

10. *See Bear Sterns*, 374 B.R. at 124, 126-33.

11. *See* 11 U.S.C. §§ 1529, 1530 32.

12. *See, e.g., In re Lehman Bros. Holdings Inc.,* No. 08-13555 (Bankr. S.D.N.Y. 2008); *In re Nortel Networks Inc.*, No. 09-10138 (KG) (Bankr. D. Del. Jan. 14, 2009); *In re Progressive Molded Prods.*, No. 08-11253 (KJC) (Bankr. D. Del. July 14, 2008); *In re Quebecor World (USA) Inc.*, No. 08-10152 (Bankr. S.D.N.Y. Apr. 8, 2008); *In re Pope & Talbot Inc.*, No. 07-11738 (CSS) (Bankr. D. Del. Dec. 14, 2007); *In re Calpine Corp.*, Case No. 05-60200 (BRL) (Bankr. S.D.N.Y. Apr. 12, 2007); *In re Systech Retail Sys. (U.S.A.) Inc.*, No. 03-00142 (Bankr. E.D.N.C. 2003); *In re Federal Mogul Global Inc.*, No. 01-10578 (JKF) (Bankr. D. Del. Feb. 7, 2002); *see also* 8 *Collier on Bankruptcy*, ¶ 1501.4 at 1501-11.

13. *See* 11 U.S.C. §§ 362(a), 541(a).

14. *See* 11 U.S.C. § 362(a).

15. 11 U.S.C. § 1520(a)(1).

16. *See* 11 U.S.C. §§ 541(a), 362(a).

17. *In re JSC BTA Bank*, --- B.R ---, 2010 WL 3306885 (Bankr. S.D.N.Y. Aug. 23, 2010), No. 10-10638 (JMP).

18. *See JSC, supra*, at *2 (citing 11 U.S.C. § 1520).

19. *Id.* at *3.

20. *See* Docket No. 9.

21. *See* Docket No. 19, Motion for Contempt and Stay of Arbitration Proceeding. BTA Bank separately requested on July 5, 2010, that the Swiss arbitration recognize that the automatic stay imposed by reason of the entry of the recognition order. *See* Docket No. 30, Attachment 1, Swiss Arbitration Award at p. 18.

22. *See JSC*, 2010 WL 3306885, * 2; Recognition Order at Docket No. 9.

23. *See* Docket No. 24, ¶¶ 1, 22, 27.

24. *See* JSC, 2010 WL 3306885, *3.

25. *Id.* at *2.

26. 11 U.S.C. § 1520(a)(1).

27. *JSC*, 2010 WL 3306885 at*6; *see also* 11 U.S.C. § 1502(8), defining "within the territorial jurisdiction of the United States."

28. *JSC*, 2010 WL 3306885 at *7 (citing 11 U.S.C. § 1520(b)).

29. *Id.*

30. *Id.* (emphasis added).

31. *Id.* at *8.

32. *Id.* at *9.

33. *Id.* at *4.

34. 374 B.R. 122 (Bankr. S.D.N.Y. 2007), *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008), *supra*.

35. The court noted that the representative could file an involuntary petition under 11 U.S.C. § 303(b)(4) and stayed its ruling to allow the representative to do just that. *Id.* at 132. Instead, the representative appealed. The district court affirmed the court's decision. *See generally Bear Sterns,* 389 B.R. 325. (S.D.N.Y. 2008)