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Bruce Nathan, Esq.
and Eric Horn, Esq.

Demystifying Chapter 15 of the Bankruptcy Code

It has been nearly three-and-a-half years since the enactment of the cross-border provisions of Chapter 15 of the Bankruptcy Code. Since then, many Chapter 15 cases have been commenced in the United States Bankruptcy Courts. However, despite the large number of Chapter 15 filings, there remains a level of uncertainty as to what exactly Chapter 15 does and how it impacts trade creditors. This uncertainty is fed by the dearth of literature discussing the practical import and impact of Chapter 15 on trade creditors. This article attempts to demystify Chapter 15 by not only providing a general overview of its provisions, but also providing brief case studies exemplifying Chapter 15's practical uses and how such uses have impacted trade creditors.

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General Overview

In an effort to modernize and harmonize cross-border insolvencies throughout the world, in 1997, the United Nations Commission on International Trade Law adopted the Model Law on Cross-Border Insolvency (the "Model Law"). The Model Law offers guidance and solutions for foreign insolvency proceedings through their recognition by other countries' courts, cross-border cooperation and coordination of concurrent insolvency proceedings in various countries. As of April 2009, the following counties have adopted the Model Law: Australia, the British Virgin Islands, Colombia, Eritrea, Great Britain, Japan, Mexico, Montenegro, New Zealand, Poland, the Republic of Korea, Romania, Serbia, South Africa and the United States.

Chapter 15 adopted and implemented virtually all of the substantive provisions of the Model Law. Chapter 15's main objectives are to advance:

(i) cooperation between United States and foreign courts;
(ii) greater legal certainty for trade and investment;

(iii) efficient administration of cross-border insolvencies that protect the interests of stakeholders;
(iv) protection and maximization of the value of foreign debtors' assets; and
(v) protection of investment, preservation of employment and facilitation of the reorganization of troubled foreign debtors.

How Does Chapter 15 Work?

The threshold requirement for commencing a Chapter 15 case is the existence of a pending foreign insolvency proceeding and a duly authorized representative of that foreign proceeding seeking recognition of that proceeding in the United States. Often, the authorized foreign representative is a critical player (i.e, a receiver, liquidator, etc.) in the foreign insolvency proceeding or the foreign representative could be one of the foreign debtor entities.

Chapter 15 broadly defines a "foreign proceeding" as follows:

> 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.

A foreign representative must obtain *recognition* of the foreign proceeding in order to obtain the rights and benefits of Chapter 15, including protecting the foreign debtor's United States assets from creditor action and obtaining access to and relief from the United States courts on most matters. Chapter 15 recognizes two types of "foreign proceedings" pending in another country—namely "foreign main proceedings" and "foreign nonmain proceedings." While these proceedings may appear somewhat identical to an untrained eye, there is an important distinction which is critical to note. If a bankruptcy court recognizes a foreign proceeding as a foreign main proceeding, certain relief becomes automatically available. For instance, the "automatic stay" that trade creditors deal with in Chapter 7, 11 and other bankruptcy cases is immediately available upon the bankruptcy court's recognition of a foreign main proceeding. The stay precludes creditors from seizing the foreign debtor's United States assets or otherwise continuing their litigation and other collection efforts against the debtor. No such stay automatically arises in a foreign nonmain proceeding. If a Chapter 15 petitioner wishes to obtain a stay of creditor actions in a foreign nonmain proceeding, the petitioning party must specifically request such relief from the bankruptcy court and the bankruptcy judge has the discretion of deciding whether or not to grant such relief.

Upon the filing of a Chapter 15 petition, certain parties are notified of the Chapter 15 filing and the relief sought in the case (more on "notice" appears below). The bankruptcy court will typically hold a hearing within 30 days of the Chapter 15 filing to determine whether the foreign proceeding should be recognized as a "foreign main" or "foreign nonmain" proceeding. This hearing is usually referred to as the "recognition hearing."

During the time period between the filing of the Chapter 15 petition and the recognition hearing—frequently referred to as the "Chapter 15 gap period"—the foreign debtor is not protected by any provisions of the Bankruptcy Code, such as the automatic stay. Thus, absent the intervention of the bankruptcy court, creditors are able to take action against the foreign debtor's United States assets, but don't start collecting so fast! In cases where a foreign debtor believes that a stakeholder may take action against the debtor or its U.S. assets, a foreign representative may seek protection by requesting "provisional relief" (usually in the form of injunctive relief) from the bankruptcy court, pending a determination of recognition. For instance, a foreign representative may request immediate implementation of the automatic stay to protect against any attack on the foreign debtor's U.S. assets. "Provisional relief" is not granted without the foreign representative satisfying the usual standards for injunctive relief: (i) a reasonable probability of success on the merits; (ii) irreparable injury by denial of the relief; (iii) whether granting preliminary relief will result in even greater harm to the nonmoving party; and (iv) whether granting the preliminary relief will be in the public interest.

Turning to the recognition hearing, the bankruptcy judge is charged with determining whether the foreign proceeding should be recognized as a foreign main or foreign nonmain proceeding. In determining whether a proceeding is a foreign main proceeding, the bankruptcy court must consider whether the proceeding is pending in the country where the debtor has its "center of main interests." While the Bankruptcy Code does not define "center of main interests," it contains a statutory presumption that, in the absence of evidence to the contrary, the country of the debtor's registered office is presumed to be the center of the debtor's main interests.

Bankruptcy courts also examine other factors in determining whether a foreign proceeding is pending in a jurisdiction where the debtor has its center of main interests so as to be recognized as a foreign main proceeding. For instance, Bankruptcy Judge Lifland, presiding over the *Bear Stearns* Chapter 15 cases, noted the following:

> [v]arious factors could be relevant to such a determination, including: the location of the debtor's headquarters; the location of those who actually manage the debtor . . .; the location of the debtor's primary assets; the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes.

A foreign nonmain proceeding is a foreign proceeding that is not a foreign main proceeding and is pending in the country where the foreign debtor has an "establishment." An establishment is any place of operations where the debtor carries out non-transitory economic activity. The presence of a foreign debtor's assets in a jurisdiction, without more, is insufficient to create an establishment that would justify recognizing a foreign proceeding in that jurisdiction as a foreign nonmain proceeding.

Upon a bankruptcy court's recognition of a foreign main or nonmain proceeding in connection with a Chapter 15 filing, the petitioning foreign representative of the debtor is typically authorized to carry out the stated purpose of the debtor's Chapter 15 case. That may include liquidation of the debtor's U.S. assets, giving effect to a foreign plan of liquidation or reorganization or approving a foreign debtor's sale of its assets and/or assignment of its leases located in the United States. Further, to the extent a foreign proceeding is recognized as a foreign main proceeding, the petitioning foreign representative is automatically given many of the powers that a Chapter 11 or 7 debtor/trustee has (other than pursuing avoidance claims, such as preferences), often without further order of the bankruptcy court. The debtor's foreign representative is also often given additional authority, such as the ability to operate the debtor's business, use cash collateral, sell assets, etc. Conversely, to the extent that the proceeding is recognized as a foreign nonmain proceeding, the petitioning foreign representative is granted only those powers as explicitly approved by the bankruptcy court (upon satisfaction of the injunctive relief standard in the case of a continued stay of creditors' actions) and as reflected in the order granting recognition.

> Chapter 15 cases have been commenced to bind creditors to the terms of a restructuring plan approved and implemented in a foreign proceeding.

Practically Speaking — What Are Chapter 15s Used for?

Chapter 15s have been filed for various purposes. They are frequently filed to protect a foreign debtor's assets located in the United States from creditor attack. For example, in the recently filed *In re Innua Canada* case — commenced in the Bankruptcy Court for the District of New Jersey, a receivership proceeding had been previously commenced in Canada. Subsequent to the Canadian court's appointment of a receiver, the receiver filed a Chapter 15 in an effort to protect the foreign debtor's inventory located in warehouse containers in New Jersey and Texas from creditor attack. In order to protect those assets during the "Chapter 15 gap period," prior to entry of a recognition order, the receiver also petitioned the bankruptcy court for provisional injunctive relief. The court ruled that the receiver satisfied the standards for an injunction and granted the provisional injunctive relief. The court subsequently recognized the receivership proceeding as a foreign main proceeding—thus activating the automatic stay of Bankruptcy Code Section 362 during the pendency of the Chapter 15 case.

Chapter 15 cases have also been commenced to establish procedures for U.S. creditors to follow for filing proofs of claim against the foreign debtor. For instance, in *In re Quebecor World Inc.,* a Chapter 15 case was commenced in the Bankruptcy Court for the Southern District of New York to approve a claims procedure order, issued by the Canadian court overseeing Quebecor World's Canadian Companies' Creditors Arrangement Act ("CCAA") case, governing the filing of claims by U.S. creditors of Quebecor against Quebecor World in its CCAA case. Specifically, the claims procedure required the filing of claims in Canada — not the United States. The bankruptcy court recognized the CCAA proceeding as a foreign main proceeding and ordered that "[t]he Claims Procedure Order is hereby given full force and effect in the United States and is binding on all persons subject to this court's jurisdiction..." Thus, to the extent that a creditor did not comply with the claims procedure by properly filing a claim in Quebecor's CCAA proceeding in Canada, the creditor would, among other things, be barred from sharing in any distribution made to creditors in that case. All of this played out against the backdrop of a pending Chapter 11 filed by the U.S. Quebecor entities.

Chapter 15 cases have also been commenced to bind creditors to the terms of a restructuring plan approved and implemented in a foreign proceeding. In connection with *Tembec Industries,* a Canadian proceeding under the Canada Business Corporation Act ("CBCA"), Tembec's foreign representative commenced a Chapter 15 case in the Bankruptcy Court for the Southern District of New York in order to implement a Canadian-court-approved restructuring plan in the United States and thus, make the plan binding on all United States creditors subject to the plan.

In *Tembec*, prior to the commencement of the CBCA proceeding, Tembec had issued an outstanding unsecured bond debt in the principal amount totaling approximately USD 1.2 billion (the "Old Notes"). In late 2007, the debtor and the holders of approximately 65% of the outstanding principal amount of the Old Notes had agreed to the terms of a recapitalization, which involved, among other things, equity-for-debt exchanges and new loans. The recapitalization was implemented through a plan under the CBCA (the "Tembec Plan"). The debtor gathered the consents of noteholders, as required by Canadian law, and the Canadian court subsequently approved the Tembec Plan and also authorized the debtor to request the assistance of the United States courts to implement the Tembec Plan in the United States.

Subsequently, in September 2008, Tembec's foreign representative commenced a Chapter 15 case to make the Plan binding on all holders of the Old Notes — including those located in the United States. The Bankruptcy Court for the Southern

District of New York subsequently recognized the CBCA proceeding as a foreign main proceeding and made the Tembec Plan—as well as the Canadian order approving the plan—effective in the United States. The court also permanently enjoined the holders of the Old Notes from taking any action against Tembec's United States assets.

Chapter 15 cases have also been commenced to facilitate asset sales approved in a foreign proceeding. For instance, in *In re Maax Corp.,* a Chapter 15 case was filed in the Bankruptcy Court for the District of Delaware, in part, to give effect to a Canadian court order authorizing the sale of Maax Corp.'s assets (and assignment of leases), free and clear of liens and encumbrances, in the United States pursuant to Bankruptcy Code Section 363. Similarly, in *In re Madill Corp.,* a Chapter 15 case was filed in the Bankruptcy Court for the Western District of Washington to implement an asset sale, free and clear of liens and encumbrances, under Bankruptcy Code Section 363, that was previously approved by the Canadian court pursuant to a Liquidation Services Agreement.

Chapter 15 cases have also been commenced to permit a foreign debtor to use the "cash collateral" of its senior lenders in the United States. In *In re Madill Corp.,* the bankruptcy court granted the Chapter 15 petitioner's request to use the cash collateral of the senior lenders. In exchange, the bankruptcy court granted the senior lenders' replacement liens in Madill's post-petition assets for any diminution in the value of their collateral and deemed such liens fully perfected without the need to file UCC financing statements, as would otherwise be required.

Chapter 15 cases have also been commenced to permit discovery of parties subject to U.S. bankruptcy court jurisdiction. In *In re Condor Insurance,* the debtor's court-appointed liquidators commenced a Chapter 15 case in the Southern District of Mississippi for the purpose of, among other things, obtaining discovery from the debtor's asset manager and the debtor's primary secured lender in an effort to determine the location and ownership of certain assets.

Salient Chapter 15 Points for Trade Creditors to Consider

While the prior section certainly illustrates the many practical uses of Chapter 15, a trade creditor may ask "how does Chapter 15 affect me?" This section provides a roadmap of a few of the salient points that trade creditors should keep in mind when faced with a customer that files Chapter 15 in the United States.

How Does a Trade Creditor Become Aware of a Chapter 15 Filing?

The Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") provide guidance on how creditors receive notice of a foreign debtor's Chapter 15 filing here. Under the Bankruptcy Rules, at least 20 days notice of the Chapter 15 filing must be provided to all entities against whom provisional injunctive relief is sought, all persons that are parties to any U.S. litigation with the Chapter 15 debtor and such other parties as the court may direct. Chapter 15 debtors frequently seek to implement court-approved notice procedures. For instance, in *In re Daewoo Corporation,* one of the earlier Chapter 15 filings, the Bankruptcy Court for the Southern District of New York approved procedures that required notice of the Chapter 15 proceeding and a proposed recognition hearing date by U.S. mail or overnight courier to all known creditors and other parties against whom relief is sought, whether they are inside or outside the U.S., and by publication in *The Wall Street Journal.* Today, the most common practice is for the debtor's foreign representative to move the court to approve procedures that give notice to as many parties in interest as possible, at least the ones mentioned in the Bankruptcy Rules. While court-approved notice procedures are aimed at providing notice to all parties in interest, it is conceivable that certain parties may still not receive notice of a Chapter 15 filing—as often happens in Chapter 11 and 7 cases.

> Chapter 15 claims procedures are quite different than claims procedures trade creditors may be used to in their Chapter 7, 11 or other bankruptcy case experiences.

Where Are Claims Filed?

Trade creditors clearly understand the importance of filing a claim in a bankruptcy proceeding. After all, as a general rule, absent the timely filing of a claim, a creditor is unable to share in any distribution made, or otherwise participate, in the bankruptcy case. Chapter 15 claims procedures are, however, quite different than claims procedures trade creditors may be used to in their Chapter 7, 11 or other bankruptcy case experiences. For the most part, claims must be filed as required in the foreign proceeding, rather than in the U.S. bankruptcy court. For example, in *In re MuscleTech,* the District Court for the Southern District of New York approved and implemented a Canadian claims filing procedure, subject to some adjustment by the bankruptcy court to protect U.S. creditors. Additionally, in *Quebecor World,* claims had to be filed in Canada and not the United States.

The bottom line is that trade creditors must pay careful attention to where claims must be filed. Sending claims to the U.S. bankruptcy court where the Chapter 15 is pending—unless specifically authorized to do so—will likely lead to the disallowance of the claim. Also, trade creditors must follow the procedure for filing claims set by the foreign jurisdiction and check whether any order has been entered in the Chapter 15 that modifies this procedure.

Chapter 15 Debtors Have a Lot of Powers

Upon recognition of a Chapter 15 proceeding as a foreign main proceeding, the foreign debtor's representative has many powers—similar to those granted to a Chapter 11 debtor in possession or trustee. For instance, the debtor's foreign representative is permitted to manage the affairs of the business—including selling assets. Upon recognition of a foreign main or nonmain proceeding, the debtor's foreign representative could also seek court approval to examine witnesses, obtain relief that a bankruptcy trustee could seek, sue or be sued in any United States court, intervene in any lawsuits in which the debtor is a party and obtain relief necessary to protect the debtor's assets or creditors' interests. However, the foreign representative does not have the power to commence most types of avoidance actions, such as preference and fraudulent conveyance actions.

Chapter 15 Debtors May *Not* Commence Avoidance Actions

When faced with a customer that has filed for bankruptcy, one of the first things that comes to a trade creditor's mind is the risk of being sued for recovery of a "preferential payment." In the context of a Chapter 15 case, creditors need not worry—Chapter 15 debtors simply do not have the authority to bring preference and most other avoidance actions, such as fraudulent transfer claims. The Bankruptcy Code specifically prohibits a Chapter 15 debtor from commencing most types of avoidance actions. This prohibition was put to test in *Fogerty v. Condor Guaranty, Inc.*, which was part of the *Condor Insurance* Chapter 15 case commenced in the Bankruptcy Court for the District of Mississippi.

> Chapter 15 debtors simply do not have the authority to bring preference and most other avoidance actions, such as fraudulent transfer claims.

In *Condor Insurance*, a debtor's foreign representatives commenced an adversary proceeding in the bankruptcy court seeking to avoid in excess of $300 million received by Condor affiliates and principals as fraudulent transfers. The defendants moved to dismiss the lawsuit on jurisdictional grounds and the bankruptcy court granted the motion. On appeal to the U.S. District Court, the debtor's liquidators, while conceding that they lacked the power to assert avoidance actions that arise under the Bankruptcy Code, such as a garden variety trade preference claim, argued that they could commence an avoidance action arising under foreign law (as opposed to the Bankruptcy Code). The court rejected that argument and held that under Bankruptcy Code Sections 1521(a)(7) and 1523, a Chapter 15 debtor cannot sue on any preference or fraudulent transfer claim under either United States law or foreign law, unless a Chapter 7 or 11 bankruptcy proceeding is instituted.

Conclusion

As the world's markets become more accessible, cooperation amongst the courts of various nations becomes ever more important. Chapter 15 of the Bankruptcy Code provides a statutory framework for fostering such cooperation in the context of foreign insolvency proceedings. The scope and uses of Chapter 15—as discussed in this article—are being tested on a daily basis and will continue to be so going forward. Thus, credit executives dealing with foreign customers should have a general understanding about how Chapter 15 works and know what to look for when confronted with a Chapter 15. ●

Bruce Nathan, Esq. is a partner in the New York City office of the law firm of Lowenstein Sandler PC. He is a member of NACM and is on the Board of Directors of the American Bankruptcy Institute and is a former co-chair of ABI's Unsecured Trade Creditors Committee. He can be reached via email at bnathan@lowenstein.com.

Eric Horn, Esq. is counsel in the New Jersey office of Lowenstein Sandler PC. He can be reached at ehorn@lowenstein.com.