

April 23, 2013

## **Recognizing Foreign Liquidations Under Chapter 15: The Second Circuit Weighs In**

The United States Court of Appeals for the Second Circuit, the court with jurisdiction over New York, issued an important decision last week concerning the recognition of foreign insolvency proceedings by the United States courts. Chapter 15 of the United States Bankruptcy Code provides the mechanism for representatives of insolvent foreign debtors to seek U.S. recognition, comity, and judicial assistance. Recognition of a foreign representative under Chapter 15 is not automatic; the bankruptcy court must make certain findings, including that the debtor has sufficient connections with the situs of the foreign insolvency proceedings to warrant recognition of that jurisdiction's appointee.

Recognition is vital to foreign liquidators if they are to obtain full access to the U.S. courts, but courts had diverged on a key component of the Chapter 15 analysis: the relevant timeframe for analyzing the debtor's contacts with the foreign country hosting the insolvency proceeding. While most courts considering the issue have focused on the debtor's activities in the foreign country as of the time the Chapter 15 petition is filed – thus including post-insolvency, liquidation-related activities in the analysis – at least one recent decision from the Bankruptcy Court for the Southern District of New York had focused on the debtor's activities as of the time when the foreign insolvency proceeding commenced (thus excluding post-insolvency-petition activity).

This split among the country's federal courts had raised concerns and generated considerable critical commentary, because the minority view made it likely that foreign court appointees would not gain recognition where there had been insufficient brick-and-mortar business activity prior to insolvency in the foreign court's jurisdiction, even when there was extensive post-insolvency liquidation activity in that jurisdiction. Last week's decision from the Second Circuit resolves the issue squarely in favor of the majority view, concluding that the relevant timeframe for analyzing a debtor's contacts with the foreign country is at the time of the filing of the Chapter 15 petition.

### **Background to the Decision**

Chapter 15 provides for recognition of foreign insolvency proceedings if they are found to be "main" or "non-main" proceedings, with the most generous protections available for "main" proceedings. Chapter 15 provides only limited guidance as to what this term means, defining a "main proceeding" as "a foreign proceeding pending in the country where the debtor has the center of its main interests," or COMI. There is a rebuttable presumption that a debtor's registered office is its COMI, but courts have made it clear that this presumption does not relieve the petitioner of its burden of proof. Moreover, the determination of the debtor's COMI is required even where the relevant foreign liquidation is the only one pending – *i.e.*, where there is no competing liquidation that has been launched in another jurisdiction.

It is not unusual for a debtor's principal business activities to occur in one country and its insolvency proceedings in another – typically, the country of incorporation. In some cases, as with the Chapter 15 petition considered by the Second Circuit last week, months or even years may pass between the foreign insolvency petition and the Chapter 15 petition, and the period of the liquidation activity may exceed the life of the insolvent company as a going concern. In these cases, the equities may strongly favor the recognition of the foreign court appointee. The minority approach, however, seems to compel non-recognition in these circumstances where there was insufficient pre-insolvency activity in the jurisdiction hosting the insolvency proceeding. This would be the case even in the absence of a competing insolvency process, raising the possibility that *no one* would be in a position to secure assets and otherwise address the legal interests of the debtor effectively in the United States.

### **The Second Circuit's Decision**

In *In re Fairfield Sentry Ltd.*, Appeal No. 11-4376-cv (2d Cir. Apr. 16, 2013), the Second Circuit affirmed two lower court proceedings, upholding U.S. recognition of a British Virgin Islands (“BVI”) insolvency proceeding involving the largest of the feeder funds that invested with Bernard Madoff Investment Securities LLC. The feeder fund, Fairfield Sentry Limited (“Sentry”), which operated from 1990 until Madoff's arrest in 2008, administered its business interests from the BVI, where its registered office, registered agent, registered secretary, and corporate documents (among other things) were located. Sentry's Board of Directors oversaw the management of the company, and day-to-day operations were handled by an investment manager based in New York. Sentry's three directors were located in New York, Oslo, and Geneva. Liquidation proceedings were commenced in the BVI in 2009. At the time of filing of the Chapter 15 petition, Sentry's assets were located in Ireland, the UK, and the BVI.

Morning Mist, a Sentry shareholder, opposed recognition, arguing that Sentry's COMI was not in the BVI, but rather in New York. Morning Mist argued that the lower court should have focused on Sentry's operational history in determining its COMI and that liquidation activities are not the type of business activities that should be considered as part of the COMI analysis. Morning Mist also argued that inclusion of post-insolvency activity invites strategic behavior and forum shopping. Finally, Morning Mist argued that the confidentiality of the BVI proceeding offends U.S. public policy, requiring denial of recognition.

Sentry's liquidator argued that, as a matter of statutory construction, the court should focus on Sentry's activities at the time of filing of the Chapter 15 petition. The operative provision of Chapter 15 requires recognition where the foreign proceeding “is pending in the country where the debtor has the center of its main interests.” The tense of the verbs “is” and “has” suggests a focus on the present, and that focus best ensures recognition of the person(s) presently controlling the insolvent estate.

The Second Circuit's *Sentry* decision squarely adopts the majority approach, concluding that a debtor's COMI is determined as of the time of the filing of the Chapter 15 petition, that liquidation activities may be considered in the COMI analysis, and that Sentry's COMI is

therefore in the BVI. The court makes it clear that, in appropriate cases, the lower courts may consider the time period between the foreign insolvency petition and the Chapter 15 petition in order to address any strategic behavior in respect of forum. The Second Circuit's decision also rejects the argument that the sealing of the BVI proceedings offends U.S. public policy and requires non-recognition, dismissing Morning Mist's assertion that the proceedings were "shrouded in secrecy" as "overwrought."

The Second Circuit's decision not only overrules the bankruptcy court decision that had been the primary authority for the minority approach, but also puts the weight of the nation's preeminent intermediate-appellate court for business issues behind the majority approach (along with the only other circuit court to decide the issue), making it highly likely that other circuits will follow suit. In practice, this means that, where the center of main interests at the time of the Chapter 15 petition is in the jurisdiction of the insolvency proceedings, the representative(s) of those proceedings will have good prospects of obtaining main recognition from the U.S. courts.

---

For further information please contact:

H. Bradford Glassman at [brad.glassman@lewisbaach.com](mailto:brad.glassman@lewisbaach.com) or +1.202.659.7210

Chiara Spector-Naranjo at [chiara.spector-naranjo@lewisbaach.com](mailto:chiara.spector-naranjo@lewisbaach.com) +1.202.659.6753

*The foregoing is for informational purposes only. It is not intended as legal advice and no attorney-client relationship is formed by the provision of this information.*