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RECOGNITION AND ENFORCEMENT OF FOREIGN INSOLVENCY PROCEEDINGS

The US Bankruptcy Code (Title 11, United States Code), as a federal statute, is uniform throughout the United States, except for the application of local law as it applies to liens and exemptions. In addition, some disparity in the law results from the interpretation of the statute by judges in the multiple judicial districts and Federal Circuit Courts of Appeal.

Section 304 of the Code is entitled Cases Ancillary to Foreign Proceedings.² Essentially, the purpose is to prevent piecemeal distribution of assets in the United States by means of local proceedings

¹ Managing Partner, Bernstein Law Firm, P.C., Pittsburgh, Pennsylvania; Board Certified in Business Bankruptcy and Creditors' Rights by the American Board of Certification; Past-President Commercial Law League of America. With thanks for the able assistance of Kirk B. Burkley, Esq. of Bernstein Law Firm, P.C. in the preparation of the underlying materials.

² § 304. Cases ancillary to foreign proceedings.

(a)--A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.

(b)--Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may--

(1)--enjoin the commencement or continuation of--

(A)--any action against--

(i)--a debtor with respect to property involved in such foreign proceeding; or

(ii)--such property; or

(B)--the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;

(2)--order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or

(3)--order other appropriate relief.

(c)--In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with--

(1)--just treatment of all holders of claims against or interests in such estate;

(2)--protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;

(3)--prevention of preferential or fraudulent dispositions of property of such estate;

(4)--distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;

(5)--comity; and

initiated in domestic courts by local creditors. Under §304 there is a deference to the country where the primary insolvency proceeding is pending.

Generally speaking, venue for a §304 Petition is in the federal district where: (a) there is a pending action against the debtor, (b) there is property of the debtor, against which an action is being taken, or (c) where a principal place of business or asset of the debtor is located.

When one seeks to initiate an ancillary proceeding, one files a Petition under §304 requesting relief. The Court will issue a Summons, which needs to be served upon parties against whom relief is sought. Generally speaking, these will be the “active” US creditors or parties involved in pending US actions. Once the Petition and Summons are served, the other parties will have an opportunity to respond and contest the relief. If the relief is ultimately granted, the court then may entertain requests for injunctions or orders to turnover property. It should be kept in mind that a Petition under §304 does not commence a full bankruptcy case, but is created as an aid to a foreign representative to facilitate a proceeding pending abroad.

Among the threshold issues in looking at a possible §304 proceeding, one must meet the definitional requirements of a “foreign representative” and a “foreign proceeding” of a “debtor”. Section 101(23) of the Code defines “foreign proceeding” as a “proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor’s domicile, residence, principal place of business, or principal assets were located...for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization.” In one case, a Cayman Islands liquidation that was not subject to judicial or administrative supervision was held not to qualify as a “foreign proceeding” within the meaning of §101. In re Petition of G.C.K. Tam, 170 B.R. 838 (Bankr.S.D.N.Y., 1994).

Section 101(24) defines a “foreign representative” as a “duly selected trustee, administrator, or other representative of an estate in a foreign proceeding.” The statute is broadly construed to further the

(6)--if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

purpose of §304. Here, members of the Board of Directors of UK and Bahamian companies have been held to constitute foreign representatives, being analogous to a debtor-in-possession in the US.

Finally, one must look to §109 to determine who may be a debtor. While that section excludes certain entities (insurance companies, banks, credit unions) from eligibility to file a plenary proceeding, it appears that the “debtor eligibility requirements” of §109 are not “engrafted onto §304”. This construction allows courts the “maximum flexibility” suggested by §304 and its legislative history. In re Petition of Brierley, 145 B.R. 151 (Bankr.S.D.N.Y., 1992).

The second issue is the choice of what a foreign debtor (or foreign representative) should do when faced with the need to enjoin or “stay” actions in the US. On the one hand, the foreign debtor could commence a full, plenary proceeding (assuming it qualified as a debtor under §109). In so doing, the debtor would be subject to all of the obligations of a debtor under the Code, including possible trustee, examiner, creditors’ committee and the like. Alternatively, the foreign representative could commence an ancillary proceeding under §304.

To better understand the implications of §304, let us look at three case.

In a relatively early case under §304, the Bankruptcy Court in the Southern District of New York (In re Culmer, 25 B.R. 621 (1982)) when considering objections to the §304 Petition, held that the Petition was opposed by “only a handful” of local creditors with possible preferential transfers, and that the foreign proceedings (winding up of a Bahamian bank) are in harmony with the laws of the US and should be afforded comity. Thus, the claims, including setoff claims of the objectors, should be determined under the foreign proceedings.

Ten years later in In re Koreag v. Refco (961 F.2d 341 C.A. 2 1992), the Second Circuit Court of Appeals (having jurisdiction over New York Bankruptcy Courts) dealt with §304 in depth. In *Koreag*, the lower court had approved a §304 Petition and ordered that funds under attachment in the US be turned over to the Swiss liquidator. The Circuit Court reversed because it felt a threshold determination on what is “property of the estate” first had to be made under New York law. The Circuit Court reviewed the history of §304 and that the guidelines listed in the section are there to give the Court “maximum flexibility” in handling ancillary cases. The Court went on to conclude that, while the estate of a foreign

debtor is defined by the laws of the jurisdiction in which the foreign proceedings are pending, other applicable law defines the estate's interest in particular property. The use of the term "property of the estate" in §304(b)(2) presupposes an antecedent determination of property interest as a condition to turnover a property to a foreign representative.

The court applied an interest analysis to hold that New York law should apply to determine the estate's interest in property, since New York's primary interest was in defining and protecting the property interests of its citizens and people who do business there, which is more closely related to the particular dispute here than is Switzerland's more general interest in the administration of the debtor's bankruptcy estate.

Then, almost ten years later, the Second Circuit remanded a §304 case to the Bankruptcy Court for a determination of secured status. In In re Treco v. Bank of New York (240 F.3d 148 C.A. 2, 2001) Bank of New York opposed a §304 Petition, claiming to be a secured creditor. The lower courts had approved the §304 proceeding irrespective of whether BNY was secured or not. The Circuit Court decided that the determination of secured status was necessary since a secured claim under Bahamian Law was subordinate to expenses of administration, unlike the norm under US law. Thus, the lower court abused its discretion when it ordered relief under §304 (a turnover from BNY) without determining that "in the discreet context of BNY's claim against (the estate) the order of distribution under Bahamian law was 'substantially in accordance with the order prescribed by' the Bankruptcy Code."

The Circuit Court distinguished *Culmer*, reminding us that it is not bound by the decision of lower courts and that the legislative history of §304 requires the court be flexible based on the circumstances of each case. Interestingly, the court also pointed out that of the nearly \$10 million recovered by the Bahamian liquidators thus far, almost \$8 million had gone to pay administrative expenses, including the fees of the liquidators themselves *at a 50% premium over normal rates!*

Our general review of §304, leads us to conclude that §304 and its legislative history require a flexible approach, so each case will be fact sensitive. Clearly, courts will not blindly defer to foreign proceedings. They will look at the fairness of those proceedings to all creditors (especially foreign (read

that “US” creditors)). Courts will also carefully examine property rights under local law to be certain that property sought to be turned over is first tested under appropriate law.

PREFERENCE RECOVERIES FROM FOREIGN RECIPIENT
UNDER THE BANKRUPTCY CODE

The US Bankruptcy Code (Title 11, United States Code) incorporates a system to recover preferential transfers under §547 (a transfer, to or for the benefit of a creditor, on account of antecedent debt, made while the debtor is insolvent, within the reach back period, which allows the recipient to “do better” than it would in a Chapter 7). I understand that the requirements are fairly similar to the English requirements, except that the US preference law does not require “intent”.

When a foreign transferee is analyzing its liability under a US Bankruptcy Code alleged preference, the main issue is one of jurisdiction. Let us use this hypothetical: A UK vendor receives a telephone order in London from a US customer, accepts the order and ships the goods to the US on 30 day terms. The US customer does not pay timely and, after numerous attempts at collection, the UK vendor finally receives payment in full. Then, several weeks (but less than 90 days) after receipt of the payment, the US customer files a Chapter 11 Petition and seeks to recover the payment as a preferential transfer.

In Pan American World Airways, Inc. v. Care Travel Co., Ltd., 166 B.R. 538 (U.S.D.C.S.D.N.Y., 1993), the Court analyzed the jurisdiction issues. Care Travel had entered into a contract to sell tickets for Pan Am’s India and Pakistan routes. In 1989 Care sued Pan Am in New York and won a verdict. Pan Am filed an appeal, posting a cash appeal bond. During the appeal, Pan Am filed a Petition under Chapter 11 and sought to recover the cash bond as a preference. The Court found that Care’s contact with the fund (the cash bond) was one contact with the US, but the suit itself was most important. Care availed itself of the resources of the state by filing suit against Pan Am in New York, and thus subjected itself to the jurisdiction of the Court. The Court also made short work of Care’s argument that to avoid the deposit defeats the entire purpose of the appeal bond. The Court said that had Pan Am actually paid the money, §547 would have certainly allowed a recovery, so §547 should not do less, simply because the fund had been posted as a cash bond.

In 1995, the District Court in Maxwell Communication Corporation, PLC v. Societe General, PLC, 186 B.R. 807 (U.S.D.C.S.D.N.Y., 1995) was faced with the situation where the debtor was involved in insolvency proceedings in both the UK and the US and where the US examiner and the debtor filed a US preference action against two banks. The Bankruptcy Court dismissed the Complaints and the District Court affirmed holding: (1) there is a presumption that statutes are not meant to be applied extra-territoriality; (2) the plaintiffs did not meet the heavy burden to overcome such presumption; (3) the domestic benefits of maintaining the action were not enough to meet the burden of extra-territoriality; (4) the Bankruptcy Court acted within its discretion to hold that comity required a dismissal of the actions; and (5) the §502(d) disallowance of claims of transferees was inapplicable because §547 was inapplicable.

In essence, the decision for a foreign transferee involves an analysis of not only whether the US Court will determine that it has jurisdiction over the foreign transferee, but also how the transferee's "home" Court would deal with a US judgment entered in the action.

Since there is a procedure under US law for a "special appearance" to contest jurisdiction, depending upon a number of factors (not the least of which is costs), the transferee, with advice of counsel, should decide whether to contest jurisdiction in the US or to simply allow the matter to go forward. If the action is allowed to go forward, the foreign creditor may consider contesting jurisdiction and the judgment when it is sought to be enforced in a foreign court. Of course, to the extent the transferee has assets in the United States, the US Court may be more likely to find jurisdiction or hold those assets to be available for payment of the judgment, once rendered.