Expanding use of Chapter 15 tests its protections and limits

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Foreign companies engaged in insolvency proceedings abroad and holding assets in the United States have increasingly employed Chapter 15 of the Bankruptcy Code to achieve their restructuring objectives while avoiding the attendant costs and time associated with plenary proceedings under Chapter 11 of the Bankruptcy Code. As foreign companies and their creditors test the protections and limits of Chapter 15, there have been significant legal developments in Chapter 15 practice. While foreign debtors have pushed the boundaries of the relief available to them, creditors objecting to relief sought by Chapter 15 debtors have generally sought to impose more and more of the restrictions applicable in Chapter 11 on debtors in Chapter 15 cases. In the coming year, we anticipate that use of Chapter 15 by foreign companies will continue to grow, as will creditor scrutiny of its use.

Enacted in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act, Chapter 15 of the Bankruptcy Code incorporates most of the provisions of the United Nations’ Model Law on Cross-Border Insolvency and acts as a mechanism by which foreign representatives may seek comity or cooperation from US bankruptcy courts in assistance or support of foreign insolvency proceedings. A foreign representative is authorised in the foreign proceeding to administer the debtor’s assets or generally to serve as a representative of the foreign proceeding in a Chapter 15 case. Courts have held, however, that judicial appointment of a foreign representative to be recognised in Chapter 15 is not specifically required for the foreign representative to be recognised in Chapter 15. See Vitro S.A.B. de C.V. v. Ad Hoc Group of Vitro Noteholders, et al, 2012 WL 5935360, *11 (5th Cir. 2012) (affirming recognition of foreign representatives appointed by board of directors of foreign debtor rather than by court order).

The provisions of Chapter 15 confer broad powers upon a foreign representative, with only a few specific enumerated exceptions and catch-all protection provisions. Upon a bankruptcy court’s recognition of a foreign proceeding, the foreign representative (which may be a debtor but may also be an unaffiliated entity, such as a liquidator or a trustee appointed in the foreign proceeding) may pursue relief under certain provisions of the Bankruptcy Code that are automatically applicable to Chapter 15 proceedings, including section 363 of the Bankruptcy Code (that governs use and sale of debtor property outside the ordinary course of business). A sale of assets in a Chapter 15 proceeding can be achieved either by requesting that the bankruptcy court recognise and enforce a sale order issued by a foreign court, or by motion for bankruptcy court approval of the sale under section 363 of the Bankruptcy Code. Asset sales under section 363 of the Bankruptcy Code have become more prevalent in Chapter 15 proceedings. See, e.g., In re Qimonda AG, Case No. 09-14766 (RGM) (E.D. Va. Mar. 10, 2010); In re Cinram Int’l Inc., Case No. 12-11882-KJC (D. Del. July 25, 2012); In re Elpida Memory, Inc., Case No. 12-10947-CSS (D.

In addition to increasing use by foreign representatives of powers specifically conferred by the Bankruptcy Code, foreign representatives have also sought to employ a bankruptcy trustee’s ‘avoidance’ powers in Chapter 15 proceedings, despite express statutory exclusion of certain of the Bankruptcy Code’s avoidance provisions (e.g., sections 522, 544, 545, 547, 548, 550 and 724(a) of the Bankruptcy Code) from relief that is available to foreign representatives under section 1521 of the Bankruptcy Code. Some courts have authorised foreign representatives to exercise avoidance powers (powers to unravel and undo transactions detrimental to creditors) that are granted to the representatives under the laws of the jurisdictions in which the relevant foreign proceedings are being pursued (see In re Condor Ins. Ltd., 601 F.3d 319 (5th Cir. 2010)); and have also permitted foreign representatives to pursue avoidance actions under section 553 of the Bankruptcy Code (relating to avoidance of setoffs), because section 553 is not specifically listed among the excluded provisions in section 1521 (see In re Awal Bank, BSC, 455 B.R. 73 (Bankr. S.D.N.Y. 2011)). The willingness of US bankruptcy courts to allow foreign representatives in Chapter 15 cases to commence avoidance actions (previously thought to fall outside a foreign representative’s authority) may reduce a primary motivation for foreign debtors to commence plenary Chapter 11 proceedings rather than ancillary Chapter 15 proceedings.

Creditors are taking more active roles in Chapter 15 proceedings, resulting in increased Chapter 15 litigation and judicial scrutiny. For example, a bondholder group has been very active in connection with both Elpida Memory’s Chapter 15 case (pending in the United States Bankruptcy Court for the District of Delaware) and the company’s primary foreign insolvency proceeding (pending in the Tokyo District Court). The bondholders in the Elpida Chapter 15 case petitioned the Bankruptcy Court in Delaware to appoint a ‘court representative’ to facilitate and coordinate cooperation between the Bankruptcy Court and the Tokyo District Court. The bondholders alleged that Elpida’s foreign representatives had failed to adequately apprise the Bankruptcy Court of the ongoing proceedings in the Tokyo District Court, to the detriment of the debtors’ estates and the interests of domestic creditors. Although the Bankruptcy Court declined to appoint a ‘court representative’, the bondholders’ request for such a representative evidences that creditors and other constituents are employing creative Chapter 15 strategies to protect their interests.

Although the relief available under Chapter 15 is broad, it is far from unlimited. In several recent decisions, bankruptcy courts have declined to grant requests for relief by foreign representatives. Courts have denied requested relief on the ‘narrow’ exception contained in section 1506 of the Bankruptcy Code, which provides that requests for relief may be denied if they would be “manifestly contrary to the public policy of the United States”. Courts have applied section 1506 to deny foreign representatives’ requests to reject certain intellectual property licences based on German law without providing the protections set forth in section 365(n) of the Bankruptcy Code (In re Qimonda AG, 433 B.R. 547 (E.D. Va. 2010)); and to access electronic communications in the United States in potential violation of a debtor’s due process rights (In re Toft, 453 B.R. 186 (Bankr. S.D.N.Y. 2011)).

Relief requested by foreign representatives may be denied based upon other sections of Chapter 15, even if a bankruptcy court does not directly rely on public policy considerations. A bankruptcy court may deny relief based on section 1507 (listing factors for courts to consider in granting additional assistance) or section 1522 (requiring that the interests of creditors and the debtor be sufficiently protected). In the case of Vitro S.A.B., the Court of Appeals for the Fifth Circuit relied upon sections 1507 and 1522 to affirm a Texas bankruptcy court’s decision to deny enforcement of a reorganisation plan that had been approved by the Mexican court presiding over Vitro’s primary reorganisation proceeding. The Vitro plan provided for recoveries to Vitro’s existing shareholders, but failed to pay Vitro’s creditors in full and released certain of Vitro’s non-debtor subsidiaries from guaran-
tee obligations, thereby extinguishing guarantee claims held by Vitro’s bondholders against the non-debtor entities. Although the bankruptcy court denied enforcement of the Vitro plan relying upon the section 1506 public policy exception, on appeal the Fifth Circuit instead relied upon the limitations contained in sections 1507 and 1522 to affirm, stating that “Vitro has failed to show the presence of the kind of comparable extraordinary circumstances that would make enforcement of such a plan possible in the United States.” *In re Vitro*, 2012 WL 5935360 at *23. The Fifth Circuit’s holding in *Vitro* suggests that in order to protect creditors, US bankruptcy courts may deny enforcement of relief ordered by a foreign court, even if the bankruptcy court does not rely on public policy considerations in denying such requested relief.

Given recent developments in Chapter 15 practice, foreign companies considering commencing a Chapter 15 proceeding under the Bankruptcy Code as a proceeding ancillary to a foreign insolvency proceeding, should carefully consider both the relief available to a foreign representative in its native proceeding as well as the relief that is or might be available under various chapters of the Bankruptcy Code. Foreign companies should seek strategic advice from experienced US bankruptcy counsel about the extent (and limits) of available relief in Chapter 15 proceedings, how their United States creditors and other parties in interest might react to Chapter 15 proceedings, and whether there are non-Chapter 15 alternatives to accomplish a foreign company’s restructuring objectives.

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