ANALYSIS

Navigating Cross-Border Insolvencies: Balancing Efficiency and Eligibility

In this article, Richard J. Bernard and Roya Imani explore the challenges faced by U.S. debtors aiming to qualify for Chapter 15 recognition.

September 17, 2023 at 12:00 PM

Bankruptcy

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Although Chapter 11 under the Bankruptcy Code represents a powerful corporate restructuring tool, many complain about the cost of Chapter 11. Other countries have restructuring and liquidation regimes that may represent more efficient tools to restructure or liquidate non-U.S.-based companies with U.S. subsidiaries and operations. Joint non-U.S. and U.S. proceedings may be the only realistic solution for mega cases like Nortel (Canada, United States and United Kingdom), Lehman Brothers (United States and United Kingdom) and Enron (United States and Canada).

There are, however, significant costs and complexities of running parallel proceedings with multiple courts around the world applying different laws and reaching conflicting rulings. When restructuring or liquidating a non–U.S.-based company with U.S. operations, practitioners should consider the benefit and efficiency of utilizing the company's home country laws under a foreign proceeding and a Chapter 15 in the United States.

Overview

Given the global economy, it is common for foreign companies to have U.S. subsidiaries with their own creditors and assets within the United States. Faced with this cross-border presence, foreign-based companies must decide how to safeguard their assets in the United States, manage U.S. creditors, and most efficiently restructure or liquidate the company. Imposing one nation's laws onto another requires some level of consent or waiver of sovereignty by the other nation.

Chapter 15 of the Bankruptcy Code represents such a mechanism. It does not have all of the robust tools of Chapter 11, but it does provide for certain protections to assist in the administration of the foreign proceeding.

Chapter 15 of the Bankruptcy Code allows U.S. bankruptcy courts to grant recognition to a liquidation or restructuring proceeding pending in another nation (i.e., a foreign proceeding). A “foreign representative” (whether the debtor, trustee, liquidator or administrator) appointed in the foreign proceeding may seek an array of relief, including enjoining litigation against the Chapter 15 debtor, preserving such debtor’s assets and pursuing certain claims in the United States.

This strategic recourse enables foreign debtors to orchestrate the entire insolvency process from their home jurisdiction, all while benefiting from the automatic stay in the United States.

Foreign debtors have taken advantage of Chapter 15 for years, including recently. Specifically, however, the foreign debtors and their U.S. subsidiaries and affiliates are parties to the foreign proceeding. The foreign representative appointed for the non-U.S. and U.S. debtors files a Chapter 15 in the United States, seeking recognition for both the non-U.S. and U.S. debtors.

Chapter 15 does not prohibit U.S. entities from Chapter 15; however, it may be more difficult for the U.S. debtor to satisfy the criteria necessary for recognition under Chapter 15. Specifically, U.S. debtors may lack the requisite “outward looking factors” (i.e., conduct non-transitory economic activity) within the jurisdiction hosting the foreign proceeding to obtain recognition in the U.S.

This article explores the challenges faced by U.S. debtors aiming to qualify for Chapter 15 recognition.

International Comity

In 1997, the United Nations Commission on International Trade Law introduced the Model Law on Cross-Border Insolvency (the Model Law), which forms the basis of the recognition of foreign insolvency or restructuring proceedings by a court in a different country. This framework has been embraced by over 50 jurisdictions, including the United States, Canada, Japan, Mexico, South Africa, Israel and the United Kingdom.

Guided by the Model Law, Chapter 15 was integrated into the Bankruptcy Code through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 to “encourage cooperation between the United States and foreign countries with respect to transnational insolvency cases.”

Requirements of Chapter 15

A court can only grant recognition of a “foreign proceeding” if one exists. For a U.S. bankruptcy court to grant recognition of a foreign proceeding, the foreign representative must satisfy the criteria set forth in section 1517 of the Bankruptcy Code, which requires, among other things, an existing “debtor” who is “the subject of a foreign proceeding.” A “foreign proceeding” is defined, in part, as “a collective judicial or administrative proceeding in a foreign country . . . 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. . . ”

Recognition of the foreign proceeding can take the form of a “foreign main proceeding” or a “foreign non-main proceeding.” A “foreign main proceeding” is defined as a “foreign proceeding pending in the country where the debtor has the center of its main interests.” Determining the center of main interests involves various factors, such as location of debtor’s headquarters, primary assets, majority of creditors and jurisdiction whose law will apply to most disputes.

Upon recognition of a foreign main proceeding, actions impacting the debtor and its assets are stayed. The foreign proceeding may be recognized as a foreign non-main proceeding provided that the debtor maintains an “establishment” in the country where the foreign proceeding is pending. The Bankruptcy Code defines an “establishment” as “any place of operations where the debtor carries out a non-transitory economic activity.” The Bankruptcy Code does not define the terms “place of operations” or “nontransitory activity.” The determination relies on the circumstances of each case and may differ based on whether the debtor is a corporation or an individual.

Upon recognition as a foreign non-main proceeding, the recognizing court has discretion to “grant any appropriate relief” necessary for safeguarding the debtor’s assets or the interests of the creditors, which could include a stay of actions against the debtor and its assets.

Is There Really a Foreign Proceeding as to the U.S. Companies?

In *In re Mood Media*, a Chapter 15 petitioner sought to obtain recognition of a foreign proceeding pending in Canada. The Canadian parent company was an applicant in the foreign proceeding, but the U.S. subsidiaries were not able to be applicants because an entity must be a Canadian corporation to do so.

A central question was whether the 14 U.S. subsidiaries could be classified as “debtors” within the meaning of section 1502(1) of the Bankruptcy Code. Judge Michael E. Wiles ruled that these subsidiaries did not fulfill the criteria of “debtors” as outlined in Section 1502(1) because the U.S. subsidiaries were “not applicants in the Canadian case; they were not authorized or directed to do anything to effect a reorganization of their own liabilities; and no order was issued that exerted any control, or purported to exert any control, or contemplated any control over the assets and affairs of the U.S. companies. In fact, the only effect that the proceeding had on the U.S. companies was that the Canadian court issued orders that prevented the *creditors* of the U.S. companies from doing certain things. None of this is sufficient to make the U.S. companies ‘debtors’ in the way that was contemplated by Chapter 15.”

Another issue was whether the foreign proceeding could be recognized as a foreign non-main proceeding, even if the U.S. subsidiaries could be regarded as debtors. The evidence highlighted the interconnected nature of the companies as an integrated enterprise, with some shared management, professionals, and administrative services. Nevertheless, the court concluded that these factors did not establish that the U.S. subsidiaries maintained a base of operations in Canada from which market-facing activities were conducted.

However, the court noted that the decision not to recognize the foreign proceeding as to the U.S. subsidiaries would not have any substantial impact on the substantive relief of the petitioner's goal, i.e. the recognition of the discharge of guarantees provided by the U.S. subsidiaries under the Canadian plan of arrangement.

Even more recently, on Jan. 23, 2023, Inscape Corp. and its two U.S. subsidiaries filed petitions for recognition under Chapter 15 in the United States Bankruptcy Court for the Southern District of New York. The three debtors were all applicants in a pending Companies' Creditors Arrangement Act ("CCAA") proceeding in Canada. At the initial recognition hearing, Judge Wiles requested counsel for the foreign representative to provide more information concerning the two U.S. subsidiaries and their qualifications as Chapter 15 debtors.

In response, the foreign representative supplemented the petition and declaration to provide specific information regarding each of the U.S. Chapter 15 debtors and the bases for qualification. The foreign representative addressed the following factors as to each U.S. debtor: "the location of the debtor's headquarters, the location of those who actually manage the debtor (which, conceivably, could be the headquarters of a holding company), 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."

Upon review of the supplemental information, Judge Wiles, by order dated March 1, 2023, recognized the CCAA proceeding as the foreign main proceeding for all three debtors.

These recent cases demonstrate that while managing the insolvency process from a foreign jurisdiction might seem more streamlined than initiating a separate Chapter 11 case for U.S. entities, there are constraints on U.S. entities' eligibility under Chapter 15. When seeking Chapter 15 recognition, U.S. bankruptcy courts will apply the Chapter 15 requirements to each debtor, and the U.S.-based subsidiaries must be parties to the foreign proceeding and independently satisfy the requirements to become Chapter 15 debtors. If they can qualify for Chapter 15, it may be more efficient and cost-effective to restructure or liquidate the debtors out of the foreign proceeding.

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