Chapter 15: A sword and a shield

David Conaway discusses some recent cases that show how Chapter 15 has primarily been utilised by foreign debtors to both assert claims and protect their assets

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> **COMPANIES DOING BUSINESS GLOBALLY WILL INEVITABLY ENCOUNTER ISSUES WITH THEIR CUSTOMERS OR COUNTER-PARTIES IN THE SUPPLY CHAIN**

The ruling: Chapter 15 Debtors can assert avoidance actions under state law

On March 23, 2017, the United States Bankruptcy Court for the Southern District of Florida, Miami Division, ruled that a foreign debtor could use Chapter 15 to assert "avoidance actions" in the US under state law (in this case New York fraudulent conveyance statutes).

In 2010, the United States Fifth Circuit Court of Appeals similarly ruled that a foreign debtor could use Chapter 15 to assert "avoidance actions" in the US based on foreign law. My article in the International Committee Newsletter of the American Bankruptcy Institute ("ABI") dated November 2011 discusses the Fifth Circuit case, *Condor Insurance Ltd.*, in detail. By contrast, the statutory language of Chapter 15 is clear that foreign debtors cannot assert "avoidance actions" based on the provisions set forth in the US Bankruptcy Code, specifically including Sections 547 (preferences) and 548 (fraudulent conveyances).

Chapter 15: Background

Companies doing business globally will inevitably encounter issues with their customers or counter-parties in the supply chain.

Such issues include foreign insolvency proceedings of such a customer or counter-party in their "home" country. Since there is no uniform global insolvency law, the outcome for the company is primarily dependent on the insolvency law in the foreign jurisdiction. If the potential risk to exposure of the company is material, participating in the foreign proceeding is advisable.

Global companies are likely to have assets, liabilities, contracts, property or employees throughout the world. If such a company initiates insolvency proceedings in its home country, it is likely the company will also need to address issues in the other countries. In recognition of this, and to promote comity among countries, in 1997, the United Nations Commission on International Trade Law (UNCITRAL) published its Model Law on Cross-Border Insolvency. To date, 43 countries have adopted the Model Law, including the US, which adopted the Model Law in 2005 as Chapter 15.

Proceedings under the US Chapter 15 are ancillary to a foreign main proceedings regarding the debtor company's overall restructuring. As such, Chapter 15 is a powerful tool for foreign debtors to deal with assets and claims in the US Chapter 15 has primarily been utilised by foreign debtors both as a sword, and as a shield. As a sword, Chapter 15 allows a foreign debtor to assert claims and to obtain discovery with respect to companies or assets in the US

As a shield, Chapter 15 allows a foreign debtor to protect its US assets by invoking the "automatic stay" of Section 362 of the US Bankruptcy Code, which is a broad injunction against any claims or lawsuits against the foreign debtor or its US assets. In fact, some US Bankruptcy Courts have also applied the "automatic stay" extraterritorially, to debtors' assets outside the US.

Federal law vs. State law in the US

Sections 547 and 548 of the US Bankruptcy Code allow for the avoidance and recovery of "preferential payments" and "fraudulent conveyances", including conveyances that are "constructively" fraudulent, or made for "less than reasonably equivalent value".

Many US states also have state corporate or insolvency laws that include a state law preference provision, applicable to debtors who utilise such state laws as an alternative to Chapter 11. In addition, the Uniform Law Commission, within the National Conference of Commissioners of United States Laws, over the years has adopted various uniform commercial laws for all US states to consider adopting by state legislatures. Notably, based on England's Fraudulent Conveyance Action of 1571 (Statute of 13 Elizabeth), the Uniform Law Commission has adopted the Uniform Fraudulent Conveyance Action (1918), the Uniform Fraudulent Transfer Act (1984) ("UFTA") and the Uniform Voidable Transactions Act (2014) ("UVTA"). At this point, most US states have adopted the UFTA, with the prediction that most states will migrate to the UVTA in coming years. Generally, all of these state laws provide for the avoidance and recovery of "fraudulent conveyances", based on actual and constructive fraud. Such claims can be pursued without a pending Chapter 11 case. However, Section 544 of the US Bankruptcy Code allows debtors' estates to utilise state law avoidance laws in addition to

those in the Bankruptcy Code.

The Banco Cruzeiro Do Sul S.A. bankruptcy ruling

The US Bankruptcy Court in Miami, in the Chapter 15 proceedings of Brazilian bank *Banco Cruzeiro Do Sul S.A.* ("BCSUL"), expanded the "sword" for foreign debtors by allowing BCSUL's trustee to assert a fraudulent conveyance claim under the New York law to recover a New York City penthouse apartment.

Ownership of BCSUL was controlled by the Indio da Costa family, and managed by Felippe and Octavio Indio da Costa. According to allegations in the trustee's complaint in the Chapter 15 adversary proceedings, Felippe purchased a New York apartment with funds improperly diverted from BCSUL. The apartment was subsequently conveyed to a BVI Company, Alina Corporation ("Alina"), controlled by Felippe.

In response, Alina filed a motion to dismiss the adversary proceedings, in part arguing that Chapter 15 does not permit a foreign debtor to assert "avoidance actions", based on an express exclusion of Sections 547 and 548 in Chapter 15. The Bankruptcy Court rejected this argument, and denied the defendant's motion to dismiss on this issue. The Court concluded that as a matter of statutory construction, Chapter 15 expressly excludes the specified avoidance provisions in the US Bankruptcy Code, and nothing more. Thus, the clear intent of Chapter 15 was to not exclude avoidance actions based on other law. The Bankruptcy Court also noted a Chapter 15 foreign debtor's right to sue and be sued in the US.

However, In *In Re Hellas Telecommunications (Luxembourg)* II SCA, 524 B.R. 488, 495 (Bankr. S.D.N.Y.) adhered to, 526 B.R. 499 (Bankr. S.D.N.Y. 2015) (Hosking I), the US Bankruptcy Court for the Southern District of New York ruled that a Chapter 15 foreign representative lacked standing to assert state law avoidance claims in a Chapter 15 case. In connection with an LBO transaction involving Hellas Telecommunications, Greece's largest telecommunications company, Hellas migrated its COMI (Center of Main Interest) from Luxembourg to the U.K. and initiated insolvency proceedings under U.K. insolvency law. The foreign representative then filed Chapter 15 proceedings in the US Bankruptcy Court for the Southern District of New York. The Hellas foreign representative filed fraudulent conveyance claims under the New York state law to recover approximately 1.57 billion Euros. The Bankruptcy Court skirted the issue of whether a Chapter 15 foreign representative could pursue claims under applicable US state law, and noted the *Condor Insurance* case mentioned above.

In a Chapter 11 case, *FAH Liquidating Corp. f/k/a Fisker Automotive Holdings, Inc.*, the Delaware Bankruptcy Court, on June 13, 2017, allowed the trustee to assert claims extraterritorially against BMW for fraudulent conveyance under Section 548 of the Bankruptcy Code in the amount of $793,761, and for unjust enrichment for $32.5 million. The Court concluded that the payments to BMW occurred in Germany because the development work was by a German company performed in Germany, it was a German contract applying German law, delivery under the contract was in Germany, and payment was owed in Euros. That payments originated in the US did not overcome the German "center of gravity".

Benefit to non-US debtors

These cases have an impact for the European companies that are in insolvency proceedings in the EU but also seek relief under Chapter 15 in the US showing them how to use the automatic stay, to seek discovery or to assert claims against third-parties located in or with assets in the US.

The Chapter 15 case law is clear that such Chapter 15 debtors may not utilise Sections 547 and 548 of the US Bankruptcy Code to enhance the value of the insolvency estates. However, the cases discussed herein indicate that such Chapter 15 debtors are able to utilise (1) avoidance actions under the insolvency laws of the jurisdiction of the foreign main proceedings, and (2) US state laws. As such, foreign debtors in a Chapter 15 case are able to increase the value of their estates for the benefit of the creditors.

Takeaway

The *Condor Insurance* and the *Banco Cruzeiro* cases make clear that foreign debtors in those jurisdictions are entitled to assert avoidance actions in the US based on applicable US state law and based on the avoidance laws of the foreign jurisdiction.

Since 2005, US Bankruptcy Courts have broadly interpreted Chapter 15 to allow foreign debtors maximum flexibility in protecting assets and pursuing claims. It is predictable that other courts will follow *Condor Insurance* and *Banco Cruzeiro*, encouraging foreign debtors to assert avoidance actions in Chapter 15 cases under state law in the US and under foreign law, to enhance the value of insolvent debtors' estates. The recent Fisker's decision indicates that a Chapter 11 estate may apply avoidance actions including Section 548, and likely also Section 547 (preferences), extra-territorially to payments in connection with foreign transactions.

A company with material risk associated with a customer or counter-party in overseas insolvency proceedings is advised to participate in the foreign proceedings regarding its claims, contracts, and risks. In addition, the company should monitor any Chapter 15 filing of the foreign debtor in the US, which could increase "avoidance action" risk. ■

> **THESE HAVE AN IMPACT ON EUROPEAN COMPANIES THAT ARE IN AN INSOLVENCY PROCEEDING IN THE EU BUT ALSO SEEK RELIEF UNDER CHAPTER 15 IN THE US**

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