Chapter 15: US Bankruptcy Court bars class action lawsuit

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We recently represented the Joint Liquidators (and former Joint Administrators) (the 'Joint Liquidators") in a UK insolvency proceeding under the Insolvency Act of 1986, to file a Chapter 15 petition regarding a UK-based footwear manufacturer, Mahabis Limited ("Mahabis").

We filed the Chapter 15 petition in the US Bankruptcy Court for the Western District of North Carolina (Charlotte). The purpose of the Chapter 15 filing was to invoke the Section 362 automatic stay regarding threatened class action litigation and obtain other relief provided to foreign representatives under Chapter 15, necessary for the joint liquidators to finalise the liquidation and distribution of assets to creditors.

The Bankruptcy Court entered an order granting the Chapter 15 petition for recognition without issue. In doing so, the US Bankruptcy Court recognised the UK proceedings as foreign main proceedings, invoking application of the Section 362 automatic stay of all existing or future litigation, which included the threatened class action litigation.

Upon receipt of notice of the Chapter 15 Order for Recognition, the potential class action plaintiffs filed a motion to vacate the order for recognition on a number of bases, including lack of notice of the hearing on the Chapter 15 petition and improper venue in the Western District of North Carolina.

The strategy of the potential class action claimants was to ignore and override the United Nations Model Law on Cross-Border Insolvency (the "Model Law"), adopted in the US as Chapter 15, with the US tort litigation "system". A subsidiary goal was to obtain discovery from the joint liquidators regarding potential third-party insurance coverage for tort claims.

The Bankruptcy Court denied all relief sought by the potential class action plaintiffs. Notably, the Court concluded the following:

1. Notice

The Chapter 15 petition need not be served on claimants of threatened litigation. Rather, Chapter 15 requires that the petition be served on claimants regarding "pending" litigation, even though the Joint Liquidators disclosed that they had notice of potential claims by the tort claimants.

2. Automatic stay

The Recognition Order "*is clear and unambiguous: No person or entity may (a) commence or continue any legal proceedings (including, without limitation, any judicial, quasi-judicial, administrative, or regulatory proceedings or arbitration) or action against the Debtor, its assets located in the United States, or the proceeds thereof…*" In addition, under Sections 362 and 1520 of the Bankruptcy Code, the automatic stay is a "*bar against filing any legal proceedings against the UK debtor,*" which bar arises by operation of law and is triggered automatically by the entry of the recognition order.

The US Bankruptcy Court noted that the intended purpose of the automatic stay "*provides the UK debtor respite from creditors and their collection efforts by preventing creditors acting unilaterally to the detriment of other creditors…*" The US Court further noted that the "*UK debtor and its worldwide creditors … will suffer prejudice if the Objecting Parties' Class Action Lawsuit is given priority over the UK debtor's right to use a single forum (the UK) to develop and administer an orderly liquidation and to resolve claims…*"

Moreover, "*it is widely recognised that the costs imposed by importing the class action device into the bankruptcy claims allowance process are significant and usually prohibitive. Class litigation is inherently more time-consuming than the expedited bankruptcy procedure for resolving contested matters.*" "*While the objecting parties may prefer the US tort system over the UK insolvency proceedings…, affording the objecting parties different treatment than similarly situated creditors in the UK proceedings would contravene the carefully crafted balance developed by Congress when it enacted Chapter 15.*"

The Bankruptcy Court also took this opportunity to express its views on a US Bankruptcy Court's role in a cross-border insolvency matters. "*The Court is also cognizant of its role in this Chapter 15 case. The United Nations Commission on International Trade Law*

("UNCITRAL") promulgated the Model Law on Cross-Border Insolvency (the "Model Law") in 1997. Chapter 15 of the Bankruptcy Code, which is based upon the Model Law, was adopted by Congress in 2005. Before 2005, former section 304 of the Bankruptcy Code provided the statutory framework for dealing with ancillary cases filed in the US relating to foreign insolvency proceedings. Many of the principles – particularly comity – that were applied in ancillary proceedings under section 304 were carried forward and apply today in Chapter 15 cases. See In re Atlas Shipping A/S, 404 B.R. 726, 738 (Bankr. S.D.N.Y. 2009) ("Nevertheless, many of the principles underlying §304 remain in effect under chapter 15. Significantly, chapter 15 specifically contemplates that the court should be guided by principles of comity and cooperation with foreign courts in deciding whether to grant the foreign representative additional post-recognition relief. This is evidenced by the pervasiveness with which comity appears in chapter 15's provisions.")."

3. Discovery

Under Section 1521(a)(4) of the Bankruptcy Code, the Bankruptcy Court may grant relief "*providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities…*" Regarding the ability of a creditor to obtain discovery of the foreign representative in a Chapter 15 proceedings, the Court stated:

> *"Discovery in a Chapter 15 foreign main proceedings falls under §1521(a)(4). Chapter 15 discovery, like all discretionary relief under §1521, is one-sided, as it can only be granted "at the request of the foreign representative." 11 U.S.C. §1521(a) (emphasis added)."*

Despite the tort claimants' position, the US Bankruptcy Court ruled that only the joint liquidators, not the potential class action plaintiffs, could conduct discovery including examination of witnesses, written interrogatories or document production. "*If the objecting parties wish to obtain documents, they cannot do so in the context of ancillary proceedings such as the Chapter 15 case, but rather must seek such relief in the UK Proceedings. Therefore, the Motion for Clarification's request for a copy of any insurance policy is also denied.*"

The Bankruptcy Court's ruling in Mahabis can be found at 2020 WL (Westlaw) 2731870. The Mahabis ruling is important, and likely quite helpful to foreign representatives from any jurisdiction in pursuing Chapter 15 relief in the US. A survey of extant Chapter 15 cases indicates it is the first ruling to clearly prohibit class action claims in Chapter 15 proceedings as a result of the automatic stay. Foreign representatives can also take note of the court's clear ruling on Section 1521(a)(4) that third parties may not seek discovery from a Chapter 15 debtor or its foreign representative. Finally, the Bankruptcy Court made clear that notice of the Chapter 15 petition need not be provided to claimants with respect to merely threatened or potential litigation.

The ruling also contains a strong policy statement regarding US Bankruptcy Court's role in cross-border insolvency proceedings, particularly that comity is a primary policy goal of the Model Law, which Chapter 15 embraces. ■

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