



# INSOL International

## Strategic Considerations for Creditors Facing a Debtor in Chapter 15 Under the United States Bankruptcy

May 2008

Technical Series Issue No. 5

## Acknowledgement

INSOL is pleased to present yet another interesting paper under its “Technical Papers Series”. This is the 5<sup>th</sup> paper in this series and it was written by Mr. John J Rapisardi, Ingrid Bagby, and William Golden in the financial restructuring department of Cadwalader, Wickersham & Taft LLP.

In 2005, The United States adopted the UNCITRAL Model law on cross-border insolvency by including the new Chapter 15 to the Bankruptcy Code through the Bankruptcy Abuse Prevention and Consumer Protection Act.

Chapter 15 provides for effective mechanisms for dealing with insolvency cases involving debtors, assets, claimants and other parties that are involved in an insolvency process but based in different countries. This is mainly achieved by promoting effective co-operation between the United States courts and the foreign courts and other competent authorities.

This paper highlights some of the important considerations that creditors should be aware of when dealing with a debtor under the chapter 15 procedure. They are explained as strategies for creditors to consider once chapter 15 relief is granted and the listed strategies are extremely useful and practical information.

INSOL would like to thank Mr. John J Rapisardi partner in the financial restructuring department of Cadwalader, Wickersham & Taft LLP and also Ingrid Bagby, a partner of the firm, and William Golden, an associate of the firm, who assisted in the preparation of this excellent paper. Our members will no doubt find the information in this paper very valuable.

## Strategic Considerations for Creditors Facing a Debtor in Chapter 15 Under the United States Bankruptcy<sup>\*</sup>

### Contents

Acknowledgement	i
Introduction	1
Evaluating the Propriety of the Chapter 15 Filing	2
Strategies for Creditors Once Chapter 15 Relief is Granted	5
A. Relief from the Automatic Stay	5
B. Right to Seek Adequate Protection	6
C. Creditor's Right to a Lien against Proceeds	7
D. Creditors' Right as to Sales of Property	8
E. Protections for Financial Contract Participants	9
F. Modification or Termination of Relief in the Chapter 15 Case	10
G. Actions Manifestly Contrary to Public Policy	10
Conclusion	11

INSOL International  
2-3 Philpot Lane, London EC3M 8AQ, UK  
Tel: +44 (0)207 929 6679 Fax: +44 (0)207 929 6678  
[www.insol.org](http://www.insol.org)

Copyright © No part of this document may be reproduced or transmitted in any form or by any means without the prior permission of INSOL International. The publishers and authors accept no responsibility for any loss occasioned to any person acting or refraining from acting as a result of any view expressed herein.

---

<sup>\*</sup> John J. Rapisardi is a partner in the financial restructuring department of Cadwalader, Wickersham & Taft. Ingrid Bagby, a partner of the firm, and William Golden, an associate of the firm, assisted in the preparation of this article.

# Strategic Considerations for Creditors Facing a Debtor in Chapter 15 Under the United States Bankruptcy<sup>\*</sup>

By: John J. Rapisardi and Ingrid Bagby

## Introduction

Chapter 15 is the newest provision of the United States Bankruptcy Code<sup>1</sup>, having been enacted just two years ago. During this short period, sparse case law has developed under chapter 15, leaving creditors of foreign companies that seek chapter 15 relief in uncharted waters. Chapter 15 replaced section 304, which previously governed the grant of recognition and relief in aid of foreign bankruptcy proceedings in the United States. Although it is a relatively new statute, the provisions of chapter 15 will be familiar to many, it closely follows the Model Law on Cross-Border Insolvency promulgated by UNCITRAL.<sup>2</sup>

Chapter 15 allows a non-U.S. debtor to receive some of the protections of U.S. bankruptcy law without having to commence full bankruptcy proceedings in the United States. The principle goal of chapter 15 is to facilitate providing one worldwide forum for the resolution of claims against, and the reorganization or liquidation of, the debtor instead of several parallel, and potentially conflicting, proceedings in multiple international jurisdictions.<sup>3</sup> While recognizing the jurisdiction of the relevant foreign proceeding to ultimately control the reorganization or liquidation of the debtor, chapter 15 gives the United States Bankruptcy Court (the “Bankruptcy Court”) a great deal of power and discretion over the debtor’s use and control of its U.S.-based assets. This reflects the status of chapter 15 as a compromise between the two opposing principles of territoriality and universality.<sup>4</sup>

---

<sup>\*</sup> **John J. Rapisardi** is a partner in the financial restructuring department of Cadwalader, Wickersham & Taft. **Ingrid Bagby**, a partner of the firm, and **William Golden**, an associate of the firm, assisted in the preparation of this article.

<sup>1</sup> 11 U.S.C. § 101 *et seq.* For the remainder of this article, any citations to a specific section or chapter, unless otherwise specified, are in reference to the United States Bankruptcy Code.

<sup>2</sup> UNCITRAL is the United Nations Commission on International Trade Law. The goal of UNCITRAL is promote the progressive harmonization and unification of the law of international trade.

<sup>3</sup> Section 1501(a) of the Bankruptcy Code states that the express purpose of Chapter 15 is to provide an effective mechanism for dealing with cross border insolvencies by: (i) promoting cooperation between the United States and foreign courts, (ii) providing greater legal certainty for trade and investment, (iii) promoting the fair and efficient administration of cross-border insolvency cases, (iv) protecting and maximizing the assets of the debtor, and (v) facilitating the rescue of financially troubled businesses. 11 U.S.C. § 1501(a).

<sup>4</sup> International insolvency lawyers like to speak of two opposing principles: universality and territoriality. Under a pure system of universality, one main proceeding would have plenary power to administer the debtor’s liquidation or reorganization worldwide. Under a pure system of territoriality, independent proceedings would take place in every jurisdiction in which the debtor had assets. The assets would be distributed according to the independent priorities of each country. Chapter 15 can be viewed as a further move towards a system of universality.

By definition, any creditor of an insolvent company is in a difficult, and sometimes frustrating, position. Being a creditor of a foreign bankrupt corporation adds yet another layer of difficulty and complexity to this less than ideal situation, as a creditor may be forced to protect its rights in a foreign court with a different and unfamiliar set of rules and priorities than those of the United States. Therefore, when dealing with a foreign debtor, creditors in such situations must be aware of their strategic options under chapter 15.

But, a creditor faced with a request by a debtor for relief under chapter 15 by a debtor has certain rights and remedies. For example, the creditor should consider whether it has a basis upon which to object to the chapter 15 filing, and force the debtor to commence full, plenary bankruptcy proceedings in the United States. Further, once the U.S. court has granted the foreign debtor relief under chapter 15, the creditor enjoys certain protections under the Bankruptcy Code. And importantly, because chapter 15 does not distinguish between U.S. creditors and foreign creditors in terms of access to or standing in the Bankruptcy Court, non-U.S. creditors should be just as familiar with their rights under chapter 15, as they may find tactical advantages available in the U.S. court that are not present in the foreign proceeding.<sup>5</sup> Thus, by understanding the basic provisions of chapter 15, a creditor can develop strategies to protect and preserve its rights vis à vis the debtor.

### **Evaluating the Propriety of the Chapter 15 Filing**

The first challenge a creditor faces with a chapter 15 case is to determine whether the creditor can object to the debtor's chapter 15 petition and prevent the debtor from obtaining relief. If such objection is successful, the debtor would be forced to file a chapter 7 or chapter 11 petition within the United States in order to be afforded the protections of U.S. bankruptcy law. If the chapter 15 petition is rejected and no chapter 7 or chapter 11 case is commenced, the creditor may proceed to enforce its rights as against the U.S. based property of the debtor without any of the restrictions of the Bankruptcy Code.<sup>6</sup>

The majority of reported case law under chapter 15 in the past two years has concerned the initial question of whether a foreign proceeding qualifies for relief under chapter 15. In order to qualify for relief, a chapter 15 petition must be filed by a "foreign representative" involved in a "foreign proceeding" as defined in sections 101(23) and 101(24) of the Bankruptcy Code.<sup>7</sup> When chapter 15

---

<sup>5</sup> Pursuant to section 1513(a), foreign creditors are to be given the same commencement and participation rights in a bankruptcy case as domestic creditors.

<sup>6</sup> Creditors in the U.S. that are subject to the jurisdiction of the debtor's home court, however, still must observe any restrictions imposed by the court supervising the foreign insolvency proceeding.

<sup>7</sup> Section 101(23) defines "foreign proceeding" as "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, 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, for the purpose of reorganization, or liquidation." Section 101(24) defines "foreign representative" as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as representative of such foreign proceeding."

was enacted, Congress also amended the existing definition of “foreign proceeding.” Previously under section 304, in order to qualify for relief, a “foreign proceeding” had to be pending in a foreign country that was the debtor’s “domicile, residence, principal place of business,” or the location of the debtor’s “principal assets.”<sup>8</sup> In contrast to the former section 304, section 1502 creates two classes of foreign proceedings, the “foreign main proceeding” and the “foreign nonmain proceeding.” To qualify as a “foreign main proceeding”, the proceeding must be in the country “where the debtor has the center of its main interests.” If the proceeding fails to qualify as a foreign main proceeding, the debtor must have at least “an establishment” in the foreign country in order to qualify for a “foreign nonmain proceeding.”<sup>9</sup>

In a recent decision, the Bankruptcy Court for the Southern District of New York refused to recognize the debtors’ winding-up proceedings in the Cayman Islands (under the Companies Law of the Cayman Islands) as either a foreign main proceeding or a foreign nonmain proceeding.<sup>10</sup> In the Bear Stearns case, two hedge funds incorporated in the Cayman Islands had the vast majority of their business in the United States. Upon the commencement of winding-up proceedings in the Cayman Islands, the joint provisional liquidators filed for chapter 15 recognition of the Cayman proceeding as a foreign main proceeding in the United States Bankruptcy Court. No creditors objected to the joint provisional liquidators’ request for chapter 15 relief, however the Bankruptcy Court *sua sponte*, examined the foreign proceedings’ qualifications for relief under chapter 15. Because the Cayman Islands did not constitute the Bear Stearns fund’s “COMI” or center of main interests, the Bankruptcy Court concluded that their insolvency proceedings in the Cayman Islands could not qualify as foreign main proceedings.<sup>11</sup> The Bankruptcy Court also concluded that the proceedings could not qualify as foreign nonmain proceedings because the funds did not have an establishment within the Cayman Islands conducting “nontransitory economic activity”, in large part because the funds’ main connections to the Cayman Islands related solely to administrative functions.<sup>12</sup> The Court in Bear Stearns stated that in order to receive the protections provided by U.S. bankruptcy law, the two hedge funds would be required to file for protection under chapter 7 or chapter 11 of the United States Bankruptcy Code.<sup>13</sup>

<sup>8</sup> Once it was determined that the foreign proceeding met the definition of “foreign proceeding” under section 304, the Bankruptcy Court was given great flexibility in granting ancillary relief to a foreign representative. Chapter 15 adopts a more mechanical procedural approach that requires a court to determine whether a foreign proceeding is a “foreign main proceeding” or “foreign nonmain proceeding” before any relief can be granted. In re Bear Stearns High-Grade Structure Credit Strategies Master Fund Ltd., 374 B.R. 122, 132 (Bankr. S.D.N.Y. 2004).

<sup>9</sup> To be a foreign main proceeding under chapter 15, the proceeding must be in “the country where the debtor has the center of its main interests.” 11 U.S.C. § 1502(4). To be a foreign nonmain proceeding, a proceeding must be in a “country where the debtor has an establishment.” 11 U.S.C. § 1502(5). “Establishment” is defined as “any place of operations where the debtor carries out nontransitory economic activity.” 11 U.S.C. § 1502(2). In order for a foreign proceeding to be recognized under chapter 15, it must constitute *either* a foreign main proceeding or a foreign nonmain proceeding. *See In re Bear Stearns High-Grade Structure Credit Strategies Master Fund Ltd.*, 374 B.R. at 126-7 (Bankr. S.D.N.Y. 2007).

<sup>10</sup> In re Bear Stearns High-Grade Structure Credit Strategies Master Fund Ltd., 374 B.R. 122 (S.D.N.Y. 2007).

<sup>11</sup> *Id.* at 131.

<sup>12</sup> *Id.* at 131.

<sup>13</sup> *Id.* at 132-3.

Since the Bear Stearns decision, at least one other Bankruptcy Judge has followed a similar rationale, and declined to grant recognition under chapter 15 to a Cayman Islands liquidation.<sup>14</sup> In the case of the Basis Yield hedge fund, the Bankruptcy Court stated that recognition of a foreign proceeding under section 1517 is not a “rubber stamp exercise.”<sup>15</sup> The Bankruptcy Court in Basis Yield denied summary judgment in favor of the fund’s joint provisional liquidators, and stated that in order to obtain recognition under chapter 15 as a foreign main proceeding, the joint provisional liquidators had to submit evidence proving that the Cayman Islands were the COMI of the debtor. Because the joint provisional liquidators had failed to present such evidence to the Court, the Bankruptcy Court in Basis Yield held that the Cayman liquidation was not entitled to recognition as a matter of law.<sup>16</sup>

The Bear Stearns decision provides a powerful weapon to creditors of companies incorporated abroad, but whose primary business and operations are within the United States. If a creditor has examined the debtor’s contacts with its “home” jurisdiction and determined that they are few, the creditor may have a basis upon which to challenge a chapter 15 filing by the foreign representative. Where a creditor can successfully challenge a chapter 15 petition, the foreign debtor would have to commence a case under either chapter 7 or chapter 11 in order to receive the protection of U.S. bankruptcy law.

A creditor needs to decide relatively quickly on its strategy when the debtor files for chapter 15 protection.<sup>17</sup> Further, a creditor must consider whether defeating the chapter 15 case is the best strategy, as he or she may find themselves in a worse position if the going-concern value of the debtor is diminished by the lack of protection under U.S. law. For example, such a creditor could lose the proverbial “race to the courthouse” to enforce its rights on the debtor’s assets, and then find itself in a worse position compared to other creditors. Additionally, a creditor should consider that chapter 11 proceedings are costly in the United States and forcing a debtor to sustain parallel plenary proceedings in two jurisdictions in order to receive the protection of U.S. bankruptcy law could prove harmful to reorganization efforts. However, such concerns may not be present in a straightforward liquidation scenario where the creditors are fighting among themselves over priority of payment from the remains of the debtor.

In certain instances, it may be beneficial for both the debtor and the creditor for the debtor to pursue dual plenary proceedings in the United States and a foreign jurisdiction. Both, or one of the parties, may benefit from the treatment under US law, in contrast to the treatment under foreign law. For

<sup>14</sup> In re Basis Yield Alpha Fund (Master), 381 B.R. 37 (S.D.N.Y. 2008).

<sup>15</sup> Id. at 40.

<sup>16</sup> Id. at 55.

<sup>17</sup> Pursuant to section 1519, temporary relief may be granted automatically upon the filing of the chapter 15 application and extends through the gap period until the chapter 15 application is ruled upon by the Bankruptcy Court. Section 1521 lists the types of relief that are granted when the Bankruptcy Court recognizes the foreign proceeding and replaces the temporary relief granted under section 1519. Pursuant to Rule 1011(b) of the Federal Rules of Bankruptcy Procedure, any party in interest has twenty (20) days from the date of the service of the summons in which to object to the chapter 15 petition for recognition.

example, if a foreign debtor has businesses in the United States that require a significant operational restructuring, the debtor would need the full powers given to debtors in chapter 11 to effectuate such a restructuring. The more limited powers given to a foreign representative in chapter 15 may be insufficient to accomplish a successful operational restructuring.<sup>18</sup>

## **Strategies for Creditors Once Chapter 15 Relief is Granted**

If a foreign proceeding is granted recognition under chapter 15, a creditor still has many remedies available to it under the Bankruptcy Code. Chapter 15 incorporates several of the rights and remedies available to creditors of domestic debtors in chapter 7 and chapter 11 cases. As explained below, section 1520 allows a creditor in a chapter 15 case to import certain sections of the Bankruptcy Code, applicable to domestic main proceedings, to protect the creditor's property or its interests in the debtor's United States property.

### **A. Relief from the Automatic Stay**

Perhaps the most powerful defensive weapon in the debtor's arsenal is the protection of the automatic stay. In order to prevent a race to courthouses around the world, to preserve the debtor's estate for an equitable distribution to creditors and, in some reorganization cases, to allow the debtor to continue to operate its business, U.S. bankruptcy law provides for an automatic stay upon the filing of a voluntary bankruptcy petition. Often, the most immediate reason a debtor files a bankruptcy petition is to get the broad protections afforded by the automatic stay and to allow the debtor to continue to operate its businesses.<sup>19</sup> Among other things, the automatic stay prevents a secured creditor from foreclosing on a security interest in the debtor's property and prevents a creditor from perfecting a security interest on the debtor's property without first receiving court permission.<sup>20</sup> Additionally, most lawsuits against the debtor are stayed pending action by the Bankruptcy Court. Under U.S. law, the automatic stay extends worldwide and the Bankruptcy Court has the power to enforce the stay.<sup>21</sup> For practical purposes, the worldwide power of the automatic stay usually will have a deterrent effect on only those creditors subject to the jurisdiction of the Bankruptcy Court.

If a foreign proceeding is granted recognition as a foreign main proceeding under chapter 15, the automatic stay applies to all property of the debtor within the territorial jurisdiction of the United

<sup>18</sup> Such powers, not available to a chapter 15 debtor, but available to a chapter 11 debtor, include but are not limited to: (1) powers under the United States fraudulent transfer laws, (2) the ability to reject executory contracts, (3) the power to restructure or reschedule repayment of tax claims as part of a plan of reorganization, (4) the power to pursue avoidance actions and (5) the power to cramdown creditors as part of a plan of reorganization. Specifically section 1523 contains limitations on the debtor's power if only a chapter 15 (as opposed to a chapter 7 or chapter 11) has been filed in the United States. 11 U.S.C. § 1523.

<sup>19</sup> In the chapter 15 case, the foreign representative is explicitly authorized to operate the debtor's business. 11 U.S.C. § 1520(a)(3).

<sup>20</sup> 11 U.S.C. § 362(a)(4).

<sup>21</sup> 11 U.S.C. §§ 362, 541.



States, subject to certain exceptions.<sup>22</sup> In contrast, pursuant to section 1521, upon the recognition of a foreign nonmain proceeding, the Bankruptcy Court has discretion to impose a stay on certain actions concerning the debtor's assets within the United States. A creditor however, can seek relief in the Bankruptcy Court to have the stay lifted in order to pursue its claims. For example, in certain circumstances, a creditor may seek to have the automatic stay modified so that it can protect its interest in property that is in the debtor's possession.<sup>23</sup> Creditors should be aware that recognition of a foreign insolvency proceeding under chapter 15 does not affect the right of a creditor to pursue an action in a foreign country against the debtor to the extent such action is necessary to preserve a claim against the debtor.<sup>24</sup> Thus, where a creditor has a claim against the debtor in a foreign jurisdiction that is approaching the statute of limitations, that creditor is permitted to pursue its action in the foreign jurisdiction in order to protect its claim from being extinguished.

## **B. Right to Seek Adequate Protection**

One foundation of U.S. bankruptcy law is respect for the interests and rights of secured creditors. However, U.S. bankruptcy law also restricts secured creditors from destroying the debtor's going concern value by foreclosing on property subject to security interests but also essential to the continued operation of the debtor. Although a U.S. bankruptcy filing generally enjoins a secured creditor from foreclosing on collateral securing its interest due to the automatic stay, such secured creditor enjoys certain protections under the Bankruptcy Code to compensate that creditor. For example, a secured creditor may be concerned that the debtor's continued use of the property during bankruptcy will decrease its value due to wear and tear, and thus reduce the secured creditor's collateral. The secured creditor also may be concerned that in order to preserve cash, the debtor may not properly maintain the collateral. In these circumstances, the secured creditor has the right to file a motion with the Bankruptcy Court to seek adequate protection of its security interest.<sup>25</sup>

If a creditor possesses a valid security interest in the debtor's U.S. property, the creditor may file a motion pursuant to section 361 for adequate protection of its security interest. Pursuant to section 361, once the Bankruptcy Court finds that the creditor is entitled to adequate protection, the Bankruptcy Court may provide various types of relief, including: (1) requiring the debtor to make periodic cash payment to the creditor to compensate for any diminished value of the property, (2) requiring the debtor to provide an additional or replacement lien to compensate the creditor for decreases in the collateral's value, or (3) fashioning a remedy that provides a creditor with the

<sup>22</sup> Section 1520(a) provides that section 362 applies to all property of the debtor located within the territorial jurisdiction of the United States.

<sup>23</sup> 11 U.S.C. § 362(d). Specifically under section 363(d), the Bankruptcy Court shall allow a creditor to repossess property if the debtor has no equity in the property and the property is not necessary for a successful reorganization of the debtor.

<sup>24</sup> See 11 U.S.C. § 1520(b).

<sup>25</sup> 11 U.S.C. §§ 361, 363(e).

“indubitable equivalent” of the creditor’s interest in the property.<sup>26</sup> Section 1520 provides that creditors in a chapter 15 case have the same right to seek adequate protection from the Bankruptcy Court under section 361 with regards to security interests in any U.S.-based property of the debtor.

For example, if the Bankruptcy Court orders periodic cash payments for adequate protection and the foreign debtor subsequently fails to make those payments, the Bankruptcy Court could modify the automatic stay and permit that creditor to foreclose on its collateral, regardless of its effect on the debtor’s reorganization in the foreign proceeding. The Bankruptcy Court also may grant the secured creditor a replacement lien on property of the debtor that is unencumbered by security interests and that is within the U.S. Further, if the secured creditor is substantially oversecured (meaning the value of the collateral is more than the secured claim), the “equity cushion” can serve as the secured creditor’s adequate protection, such that the Bankruptcy Court likely will not order additional adequate protection.

Secured creditors faced with a chapter 15 case should be aware that section 361 restricts the foreign representative of the foreign proceeding from disposing of U.S.-based property in which a creditor has a security interest without first providing for compensation to the secured creditor. This prevents a foreign representative from making an end run around the creditor’s security interest by selling such collateral free and clear of the security interest in a foreign jurisdiction.

### **C. Creditor’s Right to a Lien against Proceeds**

In addition to a potential right to adequate protection, a secured creditor may be able to claim a lien on proceeds from its collateral. Generally, a creditor may not create a lien on property acquired after the commencement of a bankruptcy case, based on a pre-bankruptcy security agreement between the debtor and the creditor. However, section 552(b) provides an exception for security agreements that extend to property of the debtor acquired after the commencement of the bankruptcy case. This exception allows a creditor to create a lien on any proceeds, products, offspring, or profits of such property acquired after the bankruptcy filing, as long as such action is specifically contemplated by the security agreement. Secured creditors should note that section 552(b)’s exception is specifically incorporated into chapter 15 cases.<sup>27</sup> Thus, secured creditors may possess revolving inventory liens on U.S.-based inventory of the debtor, and such creditors’ rights to proceeds of their collateral, even proceeds generated post-petition, will continue to be protected.

---

<sup>26</sup> 11 U.S.C. § 361.

<sup>27</sup> Section 1520(a)(2) states that section 552(b) will apply to property of the foreign debtor that is within the territorial jurisdiction of the United States “to the same extent” that it applies to property of a domestic debtor’s estate.

#### D. Creditors' Rights as to Sales of Property

In order to permit a debtor to reorganize or liquidate in the most efficient and cost-effective manner, chapter 15 allows a foreign debtor to utilize those provisions of the Bankruptcy Code authorizing a debtor to use, lease or sell its U.S.-based property outside the ordinary course of business. Pursuant to section 1520(a)(2), chapter 15 has explicitly incorporated those provisions of the Code providing for the use, lease or sale of assets. Section 363 allows a debtor to conduct a sale of property “free and clear” of liens, claims or encumbrances outside the ordinary course of the debtor’s business. However, before it can sell property free and clear of liens, a debtor is required to follow certain procedures contained in section 363. If the debtor does not fulfill all of the requirements of section 363, a creditor will be able to challenge and object to the proposed transaction. Creditors should be aware, however, that unlike sales of assets conducted outside the ordinary course of the debtor’s business, sales of U.S.-based assets within the ordinary course of business are permitted without a notice and hearing before the Bankruptcy Court.<sup>28</sup>

Potential grounds for objection to a sale outside the ordinary course include the lack of requisite notice to creditors and parties in interest. Sales of U.S. based assets outside the ordinary course of business require a notice and hearing before the Bankruptcy Court. Pursuant to Rule 2002 of the Federal Rules of Bankruptcy Procedure, a debtor is required to give at least twenty days notice of the proposed sale to all parties in interest, including those parties not within the United States. If a creditor objects to the proposed asset sale, the objection and the proposed sale become a contested matter that will be resolved in a proceeding before the Bankruptcy Court.

1. Further, in order to sell U.S. based property free and clear of all interests and liens, the chapter 15 foreign debtor must meet at least one of five conditions set out in section 363(f): Applicable U.S. non-bankruptcy law permits such sale free and clear of interest,
2. The creditor possessing the interest consents to such sale,
3. The interest is a lien and the sale price is greater than the aggregate value of all the liens on the property,
4. The interest is subject to a *bona fide* dispute, or
5. The creditor could be compelled, in either a legal or equitable proceeding, to accept money in satisfaction of such an interest.

---

<sup>28</sup> For example, a sale of inventory by a retail debtor likely would be considered within the ordinary course of the debtor’s business and therefore, would not require Bankruptcy Court approval. Under the Bankruptcy Code, such approval of ordinary course transactions is assumed to be given when the debtor is given the power to continue to operate its business after the bankruptcy filing.

These factors prevent a debtor from selling the collateral relating to a creditor's security interest without either compensating such creditor or obtaining that creditor's permission.

Further, the Bankruptcy Court will not permit the sale of property by the debtor if such prohibition is necessary to adequately protect the secured creditor's interest.<sup>29</sup> Combined with provision of section 361's provision for adequate protection of a secured creditor, a foreign debtor may be prevented from selling the U.S. based collateral (even if that sale was authorized by the foreign court) and, in effect, defeating the creditor's security interest. From a practical perspective, however, it may be advantageous for a creditor of a foreign debtor to consent to the sale free and clear of its lien, if the secured creditor is being compensated for its consent in the foreign proceeding. But when the collateral is sold free and clear of liens in the United States without the consent of the secured creditor, then the secured creditor must at least receive the value of its security interest in cash from the proceeds of the sale.<sup>30</sup>

A creditor needs to be alert to any proposed sales of U.S.-based property, and to respond quickly in the Bankruptcy Court if the creditor intends to object. In order to encourage the finality of such asset sales, the ability of a creditor to reverse a sale on a appeal is limited under the Bankruptcy Code.<sup>31</sup> It is therefore, particularly important for the creditor to make its full case before the Bankruptcy Court before the sale is approved and consummated. Thus, a creditor should take full advantage of the protections and procedures afforded under the Bankruptcy Code to object to a sale of U.S. based assets outside of the ordinary course of business, so that the foreign debtor has to defend the propriety of the sale before the Bankruptcy Court.

## **E. Protections for Financial Contract Participants**

Under chapter 15, the so-called "safe harbor provisions" of the Bankruptcy Code are applicable to foreign debtors that are parties to certain types of financial contracts.<sup>32</sup> These safe harbors exempt certain transactions from the provisions of the automatic stay and are primarily designed to preserve the smooth functioning of financial markets by allowing counter-parties to such contracts with the foreign debtor to terminate, liquidate, or accelerate certain securities contracts, swaps, commodities contracts, and repurchase agreements, despite the imposition of the Bankruptcy Code's automatic stay.<sup>33</sup> A creditor that is a participant in financial contracts with the debtor, which are governed by United States law, could terminate and liquidate such contracts even after the bankruptcy filing.

<sup>29</sup> See 11 U.S.C. § 363(e).

<sup>30</sup> Section 363(f)(5) allows the debtor to sell the property free and clear of liens and pay cash to the creditor if the debtor could compel the creditor "to accept a money satisfaction" of its interest.

<sup>31</sup> Section 363(m) provides that a reversal or modification on appeal of a sale does not affect the validity of the sale as long as the buyer purchased the property in good faith.

<sup>32</sup> 11 U.S.C. §§ 555, 556, 559, 560, 561, 562.

<sup>33</sup> Sections 555, 556, 559, 560, 561 and 562 set forth the primary provisions related to the "safe harbors" afforded to qualifying financial and commodities contracts.

For example, if a party has several commodity swap agreements with a foreign corporation that subsequently commences bankruptcy proceedings, that contract counter-party generally would be barred by the automatic stay from terminating a contract with the debtor based on the bankruptcy. However, because commodity swaps are covered under the Bankruptcy Code's safe harbor provisions, the counter-party could terminate and liquidate such swaps despite the chapter 15 filing. Parties to financial and commodity contracts thus should examine carefully their agreements carefully to determine if they fall within any of the Bankruptcy Code's safe harbor provisions.

#### **F. Modification or Termination of Relief in the Chapter 15 Case**

Section 1522(c) allows a creditor to request that the Bankruptcy Court modify or terminate relief under chapter 15. While the statute does not provide specific grounds for the modification or termination of relief, one of the potential grounds may include a change in the status of the foreign proceeding. Under section 1518, the foreign representative is required to notify the Bankruptcy Court of any "substantial change in the status" of the foreign proceeding. If there have been substantive changes in the foreign proceeding that may affect its standing to qualify for relief under chapter 15, a creditor presumably could request pursuant to section 1522(c) that the Bankruptcy Court modify its original order and perhaps curtail some of the restraints placed on creditors.

#### **G. Actions Manifestly Contrary to Public Policy**

A final measure of protection for creditors under chapter 15 is contained in section 1506, which provides that the Bankruptcy Court may refuse to take any action that would be manifestly contrary to the public policy of the United States. Although it has yet to be used in such a manner, a creditor who believes that it is being treated in an egregiously unfair manner by a foreign court may wish to seek modification or termination of the chapter 15 relief on the basis that the chapter 15 case is perpetuating a violation of United States public policy. For example, a creditor whose claim was completely disallowed in the foreign proceeding, but whose claim would be allowed under U.S. bankruptcy law, arguably could attempt to utilize this "public policy" exception to seek relief from the United States court.<sup>34</sup>

<sup>34</sup> One instance where section 1506 has been litigated involved the chapter 15 case of a Canadian producer of the drug Ephedra. The United States court overseeing the chapter 15 petition of the Canadian manufacturer allowed the Canadian insolvency proceeding to handle the Ephedra tort claims resolution process, even though it would involve mandatory arbitration and made no provision for a jury trial. While such a mandatory arbitration procedure would not be approved in a United States bankruptcy proceeding, the chapter 15 court concluded that the procedural difference was not "manifestly contrary" to the public policy of the United States. Once certain amendments to the Canadian claims resolution proceeding were made, the U.S. court recognized the Canadian proceeding as a foreign main proceeding under chapter 15. In re Ephedra Products Liability Litigation, 349 B.R. 333 (S.D.N.Y. 2006)

## Conclusion

Creditors should take a practical approach when dealing with a chapter 15 debtor. If foreign law is favorable to the creditor's position, it may make sense for the creditor to allow the foreign proceeding to be the debtor's "home court", and not to intervene in the foreign debtor's chapter 15 case. If however, the foreign law is unfavorable, or the creditor believes that the foreign proceeding is egregiously favoring foreign-based creditors, creditors should utilize the protections of chapter 15 to insure that they are not treated unfairly. Additionally, if a creditor is part of a group of similarly situated U.S.-based creditors, it may make sense for the various creditors to form an ad-hoc committee to take advantage of judicial economy, reduce their overall legal costs and coordinate their strategies. Such ad-hoc committees may or may not be recognized by the foreign proceeding but often are granted an opportunity to be heard in the Bankruptcy Court.

Finally, creditors faced with a chapter 15 case should not assume that they will have to litigate all of their issues in a foreign jurisdiction. While the goal of a chapter 15 case often is to allow the "home court" to handle most of the significant aspects of a bankruptcy, creditors do have certain rights and protections under chapter 15, which incorporates many of the creditor protections contained in the rest of the Bankruptcy Code. Thus, it is critical for creditors to understand the statutory and procedural scheme created by chapter 15, so they can take appropriate action to protect their interests in both the United States and in the applicable foreign jurisdiction.