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The Second Circuit Rules that the Filing of a Chapter 15 Petition is the Relevant Period for Determining a Foreign Debtor’s “Center of Main Interests” (or “COMI”) and that “COMI” Factors Include Any Relevant Activities of the Foreign Debtor

In *Morning Mist Holdings Ltd. v. Kryz (In re Fairfield Sentry Ltd.)*, Case No. 11-4376, 2013 WL 1593348 (2d Cir. Apr. 16, 2013), the Court of Appeals for the Second Circuit (the “Court” or “Second Circuit”) ruled that the time of the filing of a chapter 15 petition determines a foreign debtor’s center of main interests, or “COMI,” for purposes of recognizing a foreign proceeding as a “foreign main proceeding” under the Bankruptcy Code. In doing so, the Second Circuit rejected the notion that a COMI determination requires consideration of a foreign debtor’s operational history, but recognized that a bankruptcy court may properly examine the period between the commencement of the foreign proceeding and the filing of a chapter 15 petition to ensure that a foreign debtor has not manipulated its COMI in bad faith. In addition to deciding the *period* governing the COMI determination, the Second Circuit adopted a *broad and flexible standard for deciding* COMI, concluding that any relevant activities, including liquidation activities and administrative functions, may be considered. Finally, the Second Circuit confirmed that the “public policy” exception to chapter 15 relief should be narrowly construed and invoked only in exceptional circumstances.¹

COMI: What Is It And Why Does It Matter?

Chapter 15 of the Bankruptcy Code (“Chapter 15”) governs US bankruptcy court recognition of foreign insolvency cases.² COMI refers to a foreign debtor’s “center of its main interests,” an undefined statutory metric courts apply that determines the scope of US relief available to a foreign debtor in a foreign insolvency case under the Bankruptcy Code.³ Notably, Chapter 15 grants broad automatic relief where the foreign insolvency case is pending in the country of a debtor’s COMI (a “foreign main proceeding”), including application of the automatic stay to the debtor and its property in the US.⁴ Other foreign insolvency cases may also benefit from Chapter 15 (“foreign non-main proceedings”), but broad relief is

¹ *Morning Mist Holdings Ltd. v. Kryz (In re Fairfield Sentry Ltd.)*, Case No. 11-4376, 2013 WL 1593348, at *10 (2d Cir. Apr. 16, 2013) (“Fairfield Sentry II”).

² *In re Millennium Global Emerging Credit Master Fund Ltd.*, 474 B.R. 88, 91 (S.D.N.Y. 2012).

³ 11 U.S.C. § 1502(4).

⁴ 11 U.S.C. §§ 1502(4), 1520.

not automatic; its availability depends instead on the bankruptcy court's discretion (which courts generally exercise liberally).⁵ A foreign proceeding which is neither main nor non-main may not be eligible for Chapter 15 relief at all, and where the foreign debtor cannot otherwise satisfy the jurisdictional requirements of the Bankruptcy Code, the foreign debtor may be shut out from bankruptcy court access entirely.⁶

Fairfield Sentry – a Madoff Feeder Fund – Files for Chapter 15 Relief

Fairfield Sentry Limited ("Sentry"), organized and incorporated under the law of the British Virgin Islands ("BVI"), was a vehicle for mainly non-U.S. persons to invest with Bernard L. Madoff Investment Securities, Inc. ("BLMIS").⁷ Fairfield Greenwich Group ("FGG"), based in New York, served as Sentry's investment manager.⁸ In December 2008, it was publicly revealed that BLMIS had been operated as a massive Ponzi scheme, as a result of which, billions of dollars of investor funds (including funds held on behalf of Sentry) had been paid out by BLMIS as returns of principal, fictitious profits, or otherwise dissipated and misappropriated.⁹ Sentry ceased its routine operations following the 2008 disclosure of the Madoff Ponzi scheme, and its board began winding down Sentry's business and preserving its assets in anticipation of litigation and bankruptcy.¹⁰

On July 21, 2009, the High Court of Justice of the Eastern Caribbean Supreme Court (the "BVI Court") entered an order commencing Sentry's liquidation proceeding in the BVI (the "BVI Proceeding"). Some eleven months later, on June 14, 2010, the BVI liquidators filed a petition for recognition with the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") of the BVI liquidation proceedings under Chapter 15 (the "Chapter 15 Petition") to, among other things, facilitate the liquidators' access to U.S. courts in connection with the pursuit of Sentry's claims, and to afford the liquidators discovery rights.¹¹ Previously, in May 2009, Sentry shareholder Morning Mist Holdings Limited ("Morning Mist") had filed a derivative action in a New York state court alleging that Sentry's directors, management and service providers breached duties to Sentry (the "Derivative Action").¹²

⁵ 11 U.S.C. §§ 1502(5), 1521.

⁶ See, e.g., *Lavie v. Ran (In re Ran)*, 607 F.3d 1017, 1022 (5th Cir. 2010).

⁷ In *Fairfield Sentry Limited*, Case No. 10-civ.-7311 (GBD), 2011 WL 4357421, at *1 (S.D.N.Y. Sept. 16, 2011) ("Fairfield Sentry I").

⁸ *Id.*

⁹ *Id.*

¹⁰ *Fairfield Sentry II*, 2013 WL 1593348, at *1.

¹¹ *Fairfield Sentry I*, 2011 WL 4357421, at *2.

¹² *Fairfield Sentry II*, 2013 WL 1593348, at *2.

Over Morning Mist's objection, the Bankruptcy Court issued an order on July 22, 2010 recognizing the BVI Proceeding as a "foreign main proceeding" under section 1517(b)(1) of the Bankruptcy Code, and staying Morning Mist's Derivative Action.¹³

Morning Mist appealed to the United States District Court for the Southern District of New York (the "District Court"), arguing that the bankruptcy court erred by relying upon the BVI Proceeding, including activities incidental thereto, to determine that Sentry's COMI was in the BVI.¹⁴ On appeal, the District Court affirmed the Bankruptcy Court ruling, concluding that the Bankruptcy Court properly (i) considered the time at and around Sentry's Chapter 15 Petition in determining its COMI, and (ii) considered the liquidators' activities as part of the COMI determination.¹⁵ The District Court also rejected Morning Mist's argument that recognition of the BVI Proceeding violated U.S. public policy because the BVI Proceeding was "cloaked" in secrecy.¹⁶ On further appeal, the Second Circuit affirmed the lower court decisions.¹⁷

The Chapter 15 Petition Date Determines COMI

Throughout, Morning Mist argued that the Bankruptcy Court should have considered Sentry's entire 18 year operational history to make the COMI finding, which it believed was in New York. To identify the relevant date for the COMI determination, the Second Circuit considered (i) the statutory text, (ii) guidance from other federal courts, and (iii) international sources.¹⁸

Turning first to the Bankruptcy Code itself, the Second Circuit noted that Chapter 15 does not define COMI. It found relevant that the statute does, however, define a "foreign main proceeding" in the present tense – that is, a proceeding that *is* pending where the debtor *has* its COMI. From this, the Court concluded that Congress intended that the Chapter 15 filing date – not the debtor's entire operational history – should anchor the COMI analysis.¹⁹

¹³ *Fairfield Sentry I*, 2011 WL 4357421, at *2.

¹⁴ *Fairfield Sentry I*, 2011 WL 4357421, at *4; *Fairfield Sentry II*, 2013 WL 1593348, at *3.

¹⁵ *Fairfield Sentry II*, 2013 WL 1593348, at *3.

¹⁶ *Fairfield Sentry I*, 2011 WL 4357421, at *8-9.

¹⁷ *Fairfield Sentry II*, 2013 WL 1593348, at *11.

¹⁸ *Id.* at *4.

¹⁹ *Id.* at *4-5.

The Second Circuit also relied on other federal court decisions in reaching its conclusion, nearly all of which found the Chapter 15 filing date as the relevant date for COMI purposes.²⁰ Significantly, the Court rejected a line of reasoning adopted by a Southern District bankruptcy court – and affirmed on appeal by the District Court – which equated “COMI” with the American jurisdictional concept of “principal place of business.”²¹ In *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011), *aff’d*, 474 B.R. 88 (S.D.N.Y. 2012) (“Millennium Global”), the bankruptcy court reasoned that “if the term ‘principal place of business’ is substituted for ‘center of main interests,’ it is obvious that the date for determining an entity’s place of business refers to the business of the entity *before* it was placed in liquidation” because “[a] debtor does not continue to have a principal place of business after liquidation is ordered and the business stops operating.”²² From this, the *Millennium Global* bankruptcy court had concluded that the appropriate date for determining COMI is on or about the date of the commencement of the foreign proceeding for which recognition is sought, not the date of the chapter 15 filing in the US.²³ The Second Circuit, however, was not convinced that COMI and “principal place of business” were interchangeable, finding that Congress rejected the “principal place of business” construct – previously embedded in superseded section 304 of the Bankruptcy Code – when it enacted Chapter 15 in 2005.²⁴

Finally, the Second Circuit found that foreign sources, such as the European Union insolvency regulation, were of limited use in resolving whether US courts should determine COMI at the time of the Chapter 15 petition or in some other way.²⁵ Here, the Court found that the EU insolvency regime was a poor analog to Chapter 15 because a main insolvency proceeding in one EU member state is automatically recognized by all other EU member states.²⁶ As such, the EU regulations had no need for a recognition petition such as that provided under Chapter 15. The Court therefore concluded that the EU regulations might propound a broader time frame for considering COMI, but that the underlying rationale for doing so was not a good fit for construing Chapter 15.²⁷

²⁰ *Id.* at *5.

²¹ *Id.* at *6.

²² *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63, 72 (Bankr. S.D.N.Y. 2011), *aff’d*, 474 B.R. 88 (S.D.N.Y. 2012) (emphasis added).

²³ *Id.* at 76.

²⁴ *Fairfield Sentry II*, 2013 WL 1593348, at *6.

²⁵ *Id.* at *7.

²⁶ *Id.*

²⁷ *Id.*

In the end, the Second Circuit held that a debtor's COMI should be determined based on its activities at or around the time the Chapter 15 petition is filed, but that a court may consider the period between the commencement of the foreign case and the Chapter 15 filing to ensure that a debtor did not manipulate its COMI in bad faith.²⁸

Any Relevant Activities May Inform the COMI Determination

The parties also disputed what factors a bankruptcy court should consider when locating COMI. Morning Mist argued that Sentry's liquidation activities in the BVI Proceeding were irrelevant to the COMI determination. The liquidators, on the other hand, maintained that these activities and the BVI Proceeding itself were critical to the determination.²⁹

The Second Circuit held that a bankruptcy court may consider any relevant activities, including liquidation activities and administrative functions, in the COMI analysis.³⁰ In adopting this standard, the Court approved of a widely adopted list of factors courts have generally considered when making the determination:

- 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
- The jurisdiction whose law would apply to most disputes.³¹

While finding this nonexclusive list a helpful guide, the Second Circuit found that the specific factors were neither required nor dispositive. Instead, the Court found that the absence of a statutory definition for a

²⁸ *Id.* at *8.

²⁹ *Fairfield Sentry II*, 2103 WL 1593348, at *8.

³⁰ *Id.*

³¹ *Id.* (quoting *In re SPhinX, Ltd.*, 351 B.R. 103, 117 (Bankr. S.D.N.Y. 2006)).

term that is not self-defining (COMI) signified that the text was an open-ended invitation for judicial development based on the facts presented, without prescription or limitation.³²

Applying these principles, the Court readily affirmed the decision of the District Court (which affirmed the Bankruptcy Court) recognizing Sentry's BVI Proceeding as a foreign main proceeding based, in part, on Sentry's winding-up activities in the BVI when it filed its Chapter 15 Petition.³³

The BVI Proceeding's Restricted Access to Court Documents Did Not Violate US Public Policy

Morning Mist also argued that the confidentiality of the BVI Proceeding – in which a number of court records were filed under seal – violated US public policy.³⁴ Section 1506 of the Bankruptcy Code allows a court to refuse relief in favor of a foreign proceeding if the action would be “manifestly contrary to the public policy of the United States.”³⁵

In a matter of first impression for the Second Circuit, the Court ruled that the statutory wording and legislative history of section 1506 requires a narrow reading of the public policy exception. It agreed with other courts that the exception should be read “restrictively” and invoked only under “exceptional circumstances.”³⁶

Applying this standard to Morning Mist's arguments, the Second Circuit did not view the confidentiality of the BVI Proceeding as offensive to US public policy. Not only did the Court disagree with Morning Mists' characterization of the BVI Proceeding as “shrouded in secrecy,” but it also found that US policy itself did not recognize an unfettered public access to court records.³⁷ As a result, important as public access to court documents may be, the Second Circuit did not find it an exceptional or fundamental right. Rather, it was a qualified right, and as such, the Court found no basis on which to conclude that recognizing the BVI Proceeding on that ground was manifestly contrary to US public policy.³⁸

³² *Id.* at *9.

³³ *Id.*

³⁴ *Id.* at *10.

³⁵ 11 U.S.C. § 1506.

³⁶ *Fairfield Sentry II*, 2013 WL 1593348, at *10.

³⁷ *Id.*

³⁸ *Id.* at *10-11.

Conclusion

The Second Circuit's ruling that the filing of the Chapter 15 petition provides the relevant period for determining a foreign debtor's COMI, subject to an inquiry into whether the process has been manipulated, is only the second circuit level opinion on the issue, and the first in the context of a corporate debtor.³⁹ The decision infuses the recognition process for foreign insolvency cases with a welcome degree of certainty; its definitive guidance on timing, coupled with an open-ended and fact specific standard for factors appropriately considered when making the COMI determination, ensures the continued accessibility of US courts to foreign debtors in need of assistance under the Bankruptcy Code. While the Court rejected the "principal place of business" construct for purposes of *when* to determine COMI, it nonetheless believed the construct relevant for purposes of determining the *existence* of COMI as of the Chapter 15 petition date. The decision accordingly should not signal a material departure from the "nerve center" or "principal place of business" approach to determining corporate group COMI in cross-border restructuring cases. Finally, the Second Circuit adopted the main stream federal court interpretation of Chapter 15's "public policy" exception as restrictive and applicable only under exceptional circumstances concerning matters of fundamental importance to the U.S.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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³⁹ See *In re Ran*, 607 F.3d at 1025-26 (concluding that an individual debtor's COMI is determined when the chapter 15 petition is filed and declining to look back at the debtor's history to conclude COMI lies elsewhere).