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Second Circuit Holds That the Bankruptcy Code's Debtor Eligibility Requirements Apply in a Foreign Proceeding Under Chapter 15

In *Drawbridge Special Opportunities Fund LP* v. *Barnet (In Re Barnet)*, 737 F.3d 238 (2d Cir. 2013) ("Barnet"), the United States Court of Appeals for the Second Circuit held that the eligibility requirements for debtors set forth in section 109(a) of the Bankruptcy Code apply in chapter 15 proceedings. Thus, a bankruptcy court cannot recognize a foreign proceeding under chapter 15 unless the foreign debtor has a domicile, place of business or property in the United States, just like any other debtor under the Bankruptcy Code. While bankruptcy courts generally view "property" expansively for purposes of section 109, *Barnet* may limit the ease with which a foreign representative obtains relief under chapter 15, at least in the Second Circuit.

Chapter 15

Before turning to *Barnet*, a word about chapter 15: This chapter of the Bankruptcy Code incorporates the Model Law on Cross-Border Insolvency to provide effective mechanisms for dealing with cases of cross-border insolvency.[1] Congress's stated objectives for chapter 15 include promoting cooperation between the United States courts and courts and other competent authorities of foreign countries involved in cross-border insolvency cases, so that there is greater legal certainty for trade and investment and fair and efficient administration of cross-border insolvencies.[2] A foreign representative of a foreign debtor may seek recognition of the foreign reorganization or liquidation proceeding by U.S. bankruptcy courts to obtain the relief set forth in chapter 15, including the ability to take discovery with court approval.[3] Now to the *Barnet* decision.

Background

Octaviar Administration Pty Ltd. ("OA"), an Australian company, was the subject of a liquidation proceeding in Australia. In April 2012, OA's court-appointed liquidators filed a lawsuit against various Australian affiliates of Drawbridge Special Opportunities Fund LP ("Drawbridge"). The foreign representatives subsequently petitioned a U.S. bankruptcy court for an order recognizing the Australian

[1] 11 U.S.C. § 1501.

[2] 11 U.S.C. § 1501(a).

[3] 11 U.S.C. § 1521(a)(4).

liquidation proceeding as a foreign main proceeding under section 1515 of the Bankruptcy Code (the "Recognition Order"). At the oral argument for the Recognition Order, the foreign representatives stated their intention to take discovery from the American directors of the Drawbridge affiliates sued in the Australian liquidation proceeding. Drawbridge objected to the foreign representatives' petition but the bankruptcy court ultimately entered the Recognition Order. The foreign representatives then sought and obtained a discovery order against Drawbridge.

The bankruptcy court granted a joint application by the parties for certification of the Recognition Order for direct appeal to the Second Circuit.[4] In February 2013, the Second Circuit granted the joint application and issued a stay of discovery.

The Decision

Based on a "straightforward" interpretation of the Bankruptcy Code, the Second Circuit concluded that section 109(a)[5] applies in a chapter 15 proceeding.[6] The Second Circuit emphasized that "where a statute's language is plain, the sole function of the courts is to enforce it according to its terms."[7] The court noted that section 103(a) of the Bankruptcy Code provides that chapter 1 "of this title . . . appl[ies] in a case under chapter 15." Because section 109 is within chapter 1, the Second Circuit reasoned that "by the plain terms of the statute," section 109 applies to a case under chapter 15.[8]

The Second Circuit rejected each of the foreign representatives' arguments to the contrary. First, the foreign representatives argued that section 109 applies only to a debtor under the Bankruptcy Code, not a foreign representative seeking recognition of a foreign proceeding.[9] The Second Circuit dismissed the

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4 The Bankruptcy Court explained that (1) there was no controlling precedent governing its holding that a debtor "within the meaning of chapter 15 is not required to have a domicile, residence, place of business or property within the United States;" (2) this issue was a matter of public importance, as it would "dramatically impact the jurisdiction of the United States bankruptcy courts and the use of Chapter 15 to assist in the administration of cross-border insolvency cases and the legitimate investigation of claims and assets in the United States;" and (3) direct appeal would "materially advance the progress of this Chapter 15 case." Mem. Op. in Supp. Of Certification of Direct Appeal to the Court of Appeals for the Second Circuit at 6,9, *In re Barnet*, No. 12-13443, Dkt. No. 47 (Bankr. S.D.N.Y. Nov. 28, 2012).

5 Section 109(a) provides, in relevant part, that "only a person who resides or has a domicile, a place of business, or property in the United States . . . may be a debtor under this title. . . ." 11 U.S.C. §109(a).

6 The Second Circuit noted that the "straightforward nature" of the statutory interpretation "bears emphasis." 737 F.3d at 247.

7 *Id.* at 246 (citation omitted).

8 *Id.* at 247.

9 *Id.* at 248.

attempted distinction, noting that, while recognition is sought by a foreign representative, the "presence of a debtor" is "inextricably entwined" with the nature of a chapter 15 proceeding (both in terms of how it is defined and the relief that may be granted).[10]

Second, the foreign representatives argued that the definition of "debtor" contained in section 1502 of the Bankruptcy Code is the only definition that applies in chapter 15 cases.[11] The Second Circuit rejected this "preclusive reading" of section 1502, finding it irreconcilable with the clear mandate of section 103.[12] The court noted that even if such a reading were appropriate, it would not render section 109's requirements inapplicable in chapter 15 cases.[13] The court reasoned that section 1502 cannot affect the definitions contained in chapter 1 of the Bankruptcy Code because the scope of section 1502 is expressly limited to chapter 15.[14] Given that the definitions of both "foreign proceeding" and "foreign representative" are contained in chapter 1 and require a "debtor," a foreign debtor must satisfy section 109 to meet any requirements in chapter 15 that rely on these two definitions.[15]

Third, the foreign representatives argued that application of section 109(a) to chapter 15 would be inconsistent with section 1528 of the Bankruptcy Code[16] and 28 U.S.C. § 1410.[17] The Second Circuit

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[10] *Id.*

[11] *Id.* Section 1502(1) provides, in relevant part, that "[f]or the purposes of this chapter [15], the term "debtor" means an entity that is the subject of a foreign proceeding. . . ." 11 U.S.C. § 1502(1).

[12] 737 F.3d at 248.

[13] *Id.* at 248-49.

[14] *Id.* at 249.

[15] *Id.* at 249. The Second Circuit noted that the foreign representatives' proposed interpretation would render section 109(a) meaningless, as the "result would be that Section 109(a) would have no application under any circumstances." *Id.*

[16] *Id.* at 250. Section 1528 provides that "[a]fter recognition of a foreign main proceeding, a case under another chapter of this title may be commenced only if the debtor has assets in the United States." 11 U.S.C. § 1528.

[17] Section 1410 provides for the venue of cases ancillary to foreign proceedings, and states:

A case under chapter 15 of title 11 may be commenced in the district court of the United States for the district—

(1) in which the debtor has its principal place of business or principal assets in the United States;

(2) if the debtor does not have a place of business or assets in the United States, in which there is pending against the debtor an action or proceeding in a Federal or State court; or

(3) in a case other than those specified in paragraph (1) or (2), in which venue will be consistent with the interests of justice and the convenience of the parties, having regard to the relief sought by the foreign representative. 28 U.S.C. § 1410.

dismissed both arguments. The Second Circuit held that section 1528 is more, not less restrictive, than section 109(a).[18] Accordingly, there is "nothing disharmonious" in applying section 109(a) to chapter 15, and then requiring that section 1528 be met before a case under another chapter of title 11 may be commenced.[19] The Second Circuit acknowledged that the foreign representatives came "closer to the mark" by arguing that 28 U.S.C. § 1410 provides a venue for chapter 15 cases even where the debtor has no assets of place of business within the United States.[20] However, the Second Circuit characterized this statute as "purely procedural" and observed that allowing the venue statute to control the outcome in this case would "allow the tail to wag the dog."[21]

Finally, the foreign representatives argued that the purpose of chapter 15 would be undermined by the application of section 109(a).[22] However, the Second Circuit held that none of the stated purposes of chapter 15 are dispositive, as "they could all be accomplished with or without the imposition" of section 109(a).[23] It acknowledged that the Model Law on Cross-Border Insolvency, on which chapter 15 was based, does not contain an express requirement such as section 109(a). However, the Second Circuit reasoned, this omission did not outweigh the express language of sections 109(a) and 103. The Second Circuit concluded that Congress "may have intended to limit" chapter 15's relief because additional relief, such as 28 U.S.C. § 1782(a) – which provides for discovery for foreign proceedings without any requirement akin to section 109(a) – was already available outside of chapter 15.[24]

Conclusion

The extent to which courts outside the Second Circuit will follow *Barnet* remains to be seen. While the decision at first blush seems to raise the jurisdictional bar, obtaining property in the United States for purposes of section 109 may not be an insurmountable obstacle for many foreign debtors and foreign representatives. *Cf. In re Yukos Oil Co.*, 321 BR. 396 (S.D. Tex. 2005) (holding that nominal amount of property held in United States in the form of attorney retainer satisfied eligibility requirements of section 109(a)); *In re Globo Comunicacoes E Participacoes S.A.*, 317 B.R. 235 (S.D.N.Y. 2004) (holding that only nominal amount of property located in United States required to satisfy section 109(a)); *In re Aerovias Nacionales de Colombia S.A.*, 303 B.R. 1 (Bankr. S.D.N.Y. 2003) (same); *In re Global Ocean Carriers*

[18] 737 F.3d at 250.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.* at 251.

[24] *Id.*

Ltd., 251 B.R. 31 (Bankr. D. Del.2000) (same). In instances where section 109(a)'s requirements cannot be met, other avenues for relief may be available, depending upon the foreign representative's ultimate objectives. For example, foreign representatives may be able to seek discovery pursuant to 28 U.S.C. § 1782(a).

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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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