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Cross-Border Municipal Bankruptcy Cases – Wait. What? Rewind.

15 Min Read

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A curious tidbit lurks in section 1505 of Chapter 15 of the Bankruptcy Code. Most practitioners know that Chapter 15 applies to the recognition in the United States of a foreign insolvency proceeding. Section 1505 permits a U.S. bankruptcy court to authorize a domestic "trustee" to act in any foreign country on behalf of an estate created under section 541 of the Bankruptcy Code. Among the various parties specially defined as a "trustee" for this unique purpose is a debtor under Chapter 9 of the Bankruptcy Code – a municipality! Why might a municipality need to interact with the foreign representative of a foreign bankruptcy? How might a foreign jurisdiction react to the appearance of a U.S. municipality in its local affairs? And, because there is no estate created in a municipal Chapter 9 case, exactly what authority might a municipality be able to muster? Not unexpectedly, the answers to these questions are rather elusive.

Chapter 15 was enacted in 2005 and is the vehicle under which the foreign representative of a foreign insolvency proceeding enlists the aid of a U.S. bankruptcy court in order to protect and administer the property of a foreign debtor. Chapter 15 presumes the existence of a foreign debtor – *i.e.*, an entity organized abroad. Chapter 15 is intended to be flexibly interpreted to achieve cooperation among domestic and foreign insolvency participants.

Chapter 15 applies in three principal settings: (1) where parties to a foreign proceeding seek assistance in the United States, (2) where parties to a domestic bankruptcy case seek assistance in a foreign country, and (3) where a foreign proceeding and a domestic case for the same debtor are pending concurrently. 11 U.S.C. § 1501(b) (unless otherwise noted, all section references are to the Bankruptcy Code, *i.e.*, Title 11 of the U.S. Code). A case under Chapter 15 is known as an ancillary case (as compared to a plenary case under Chapters 7 or 11 of the Bankruptcy Code), and is commenced by filing a petition with the Bankruptcy Court for "recognition" of the foreign proceeding.

Where can a Chapter 15 ancillary case be commenced? An ancillary case may be commenced in any district: (a) where the foreign debtor has a principal place of business or assets in the United States or, if none, (b) where an action against the debtor is pending in a federal or state court or, if none, (c) where consistent with the interests of justice and the convenience of the parties. 28 U.S.C. § 1410.

Who may be a debtor under Chapter 15? Almost any foreign entity may be a debtor under Chapter 15, except mainly banks with U.S. branches, stockbrokers, or individuals with debts below the Chapter 13 thresholds. A foreign insurance company, although ineligible to be a debtor under other chapters of the Bankruptcy Code, is explicitly eligible for recognition under Chapter 15.

However, there is some ambiguity in the use of the term "debtor" under Chapter 15. "Debtor" is defined in Bankruptcy Code section 101(13) as a person concerning which a case ***under this title*** has been commenced. The Bankruptcy Code (*i.e.*, Title 11), embraces cases under Chapters 7 (liquidation), 9 (municipalities), 11 (reorganizations, railroads and small businesses), 12 (family farmers), 13 (individuals with regular income) and 15 (cross-border). Section 109(a) provides that "only" a person that has a domicile, place of business, or property in the U.S. may be a debtor under Title 11 (again, under any of its various chapters, including Chapter 15). But Chapter 15 has a separate definition of a debtor applicable solely to Chapter 15: "an entity that is the subject of a foreign proceeding." Thus, although not free from doubt, Chapter 15 only permits the commencement of an ancillary case if the debtor is both the subject of a foreign proceeding ***and*** has a domicile, place of business, or property in the U.S. *See In re Barnet*, 737 F.3d 238 (2nd Cir. 2013).

All of Chapter 15 is qualified by a public-policy escape hatch – the Bankruptcy Court may refuse "to take an action governed" by Chapter 15 if it "would be manifestly contrary to the public policy of the United States." 11 U.S.C. § 1506. The cases that have considered this public policy override have concluded that it is a narrow exception intended to be applied only in exceptional circumstances concerning matters of "fundamental importance" (*e.g.*, constitutional guarantees). *E.g., In re PT Bakrie Telecom Tbk*, 601 B.R. 707, 724 (Bankr. S.D.N.Y. 2019) (key consideration is whether the procedures used in the foreign proceeding meet "our fundamental standards of fairness"); *Jaffé v. Samsung Electronics Co., Ltd.*, 737 F.3d 14 (4th Cir. 2013).

The process to launch a Chapter 15 case is relatively straightforward. A foreign representative may commence an ancillary case by filing a petition for recognition. 11 U.S.C. §§ 1504, 1509, 1515. Section 1509 – which is the source of a foreign representative's direct access to the Bankruptcy Court – applies whether or not another case for the debtor is pending under any other provision of the Bankruptcy Code. 11 U.S.C. § 103(l)(2). Once filed, Chapter 15 contemplates an expedited

process to either grant or deny recognition of the foreign proceeding.

A foreign proceeding might be a **main** proceeding (*i.e.*, located in a country where the debtor has the center of its main interests, or "COMI"), or a **nonmain** proceeding (*i.e.*, located in a country where the debtor has an "establishment," that is, "any place of operations where the debtor carries out a nontransitory economic activity"). 11 U.S.C. § 1502(2). Chapter 15 does not define the COMI, although it is presumed to be the debtor's registered office under section 1516(c). The COMI determination is often a matter of some dispute, particularly in light of the differing rights that flow from recognition of a main instead of a nonmain foreign proceeding.

The entry of a recognition order by the Bankruptcy Court under section 1517 is the predicate for triggering the various rights and remedies available to a foreign representative under Chapter 15. Chapter 15 entrusts the Bankruptcy Court as the "gatekeeper" for a foreign representative's access to the Bankruptcy Court and other domestic courts. Indeed, if the Bankruptcy Court denies recognition (either because it refuses to act on the petition if contrary to the public policy of the U.S. or because the petition is otherwise flawed because it does not comply with the requirements of § 1517), the Bankruptcy Court may enter any order necessary to ***prevent*** the foreign representative from obtaining comity or cooperation from courts in the United States. 11 U.S.C. § 1509(d). On the other hand, if recognition is granted, the foreign representative will have the capacity to sue and be sued in any court in the U.S.

Once a foreign main proceeding has been recognized, certain provisions of the Bankruptcy Code (such as the automatic stay and the restrictions on the use or sale of property under § 363) will, pursuant to section 1520, automatically apply to the foreign debtor and its tangible property located "within the territorial jurisdiction" of the United States. Chapter 15's "territorial jurisdiction" provision is intended to replicate the scope of an "estate" otherwise created under the Bankruptcy Code, which concept does not apply to an ancillary case.

This provision will also reach any intangible property of a foreign debtor that is "deemed under applicable nonbankruptcy law to be located" within that territory. 11 U.S.C. § 1502(8). For example, under the UCC, patents, trademarks, copyrights, and software are each generally considered a "general intangible" to which a security interest may attach and be perfected (although in some cases not merely by filing a financing statement). The deemed location where that security interest is enforceable would establish territorial jurisdiction.

In addition to the relief that is automatically granted upon recognition of a foreign proceeding, Chapter 15 identifies further categories of discretionary relief that the Bankruptcy Court may grant to the foreign representative at various stages of the recognition process. These categories are: "provisional relief," "appropriate relief," and "additional assistance."

First, once a petition is filed, and an ancillary case commenced, the Bankruptcy Court can order "provisional relief" if urgently needed pending a decision on recognition (such as staying execution against the debtor's assets). 11 U.S.C. § 1519. This provisional relief expires upon entry of the recognition order unless expressly extended in the order.

Second, if recognition is granted, the foreign representative can also request "appropriate relief" from the Bankruptcy Court under section 1521 (such as the selected application of other provisions of the Bankruptcy Code) to bolster the automatic relief granted under section 1520. It is not uncommon for a recognition order to be festooned with further "appropriate relief," particularly because section 1521(a)(7) permits the court to also grant any "additional relief" that may be available to a trustee.

Notably, however, the Bankruptcy Court may not extend the reach of sections 547, 548 and 550 (avoidance and recovery of preferential and fraudulent transfers) to the ancillary case. Accordingly, a foreign representative does not have authority in an ancillary case to commence garden-variety avoidance actions, and must instead commence a plenary case in order to invoke those rights. On the other hand, turnover proceedings under sections 542 and 543 are not excluded from the "additional relief" that may allowed in an ancillary case under section 1521.

Any appropriate relief that is granted under section 1521 may also be modified or terminated upon request of the foreign representative or an entity affected by such relief. 11 U.S.C. § 1522(c). In other words, if a recognition order initially makes a provision of the Bankruptcy Code applicable to the ancillary case (such as § 365, regarding the treatment of executory contracts), either the foreign representative or another affected party may later seek to modify that relief.

Third, after recognition, a foreign representative can also (i) ask for "additional assistance" under the Bankruptcy Code or any other laws of the U.S. pursuant to section 1507, and (ii) commence a plenary domestic bankruptcy case pursuant to section 1511. *See* 11 U.S.C. §§ 1511, 1520(c) and 1528. The commencement of a plenary case under Chapter 11 or 7 would entitle the foreign representative to further remedies not otherwise available in an ancillary case, but would also require the invocation of certain coordination and cooperation provisions under section 1529.

Why might a foreign representative whose foreign proceeding has just been recognized (thus invoking the stay of acts against the foreign debtor and any of its assets in the U.S.) also commence a domestic Chapter 11 case? One reason is to obtain the benefit of avoidance powers that are otherwise unavailable in an ancillary case (*compare* § 1523(a) and § 1521(a)(7)). Another reason is to invoke the expanded reach of an "estate" created under section 541 (which applies to all property of the debtor "wherever located"). This expanded reach, however, is limited only to the extent that such other, non-U.S. assets are also beyond the "jurisdiction and control" of the foreign proceeding. Even if a plenary case is commenced, section 305 empowers the Bankruptcy Court to dismiss or suspend proceedings in that case if the purposes of Chapter 15 would be best served by such dismissal or suspension.

This brings us back to section 1505. Section 1505 permits a Bankruptcy Court to authorize any "trustee" to act in a foreign country on behalf of an estate. It is seemingly misplaced in Chapter 15 because it has no specific tether to either the existence of a foreign proceeding or the commencement of an ancillary case. Rather, it is intended to facilitate the ability of a representative in an existing domestic case to act abroad in an officially enrobed manner. Thus, section 1505 applies whether or not a Chapter 15 case is pending and perhaps more properly belongs in Chapter 1 of the Bankruptcy Code (which contains general provisions applicable to all chapters). Indeed, section 103(l), which provides that Chapter 15 applies only to an ancillary case under such chapter, has an exception for section 1505 that makes it applicable in ***all*** cases under the Bankruptcy Code (*e.g.*, a liquidation under Chapter 7, a reorganization under Chapter 11, or the adjustment of municipal debts under Chapter 9, among others).

Section 1505 is derived from Article 5 of the UNCITRAL model law on cross-border insolvency (which was the platform for Chapter 15 of the Bankruptcy Code, enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005). UNCITRAL is the United

Nations Commission on International Trade Law. The model law was enacted by the general assembly of the U.N. in 1997. *See* G.A. Res. 52/158, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (Jan. 30, 1998). Its main purpose was to serve as a recommended textual platform for countries to legislate a framework to handle instances of cross-border insolvency.

The model law was accompanied by a detailed guide explaining the intent behind each provision. The remarks accompanying Article 5 (the basis for § 1505) suggest that its purpose is to "equip administrators or other authorities appointed in insolvency proceedings in the enacting State to act abroad as foreign representatives of those proceedings. The lack of such authorization in some States has proved to be an obstacle to effective international cooperation in cross-border cases."

The domestic legislative history to section 1505 is also illuminating. Section 1505 varies from the model law because, according to that history, it requires a trustee to "obtain court approval before acting abroad." The model law, by contrast, automatically permitted an administrator to act abroad. This change was made to "ensure that the court has knowledge and control of possibly expensive activities, but it will also have the collateral benefit of providing further assurances to foreign courts that the United States debtor or representative is under judicial authority and supervision." In fact, the legislative history suggests that "first-day orders in reorganization cases should include authorization to act" under section 1505. *See* H.R. Rep. No. 31, at 108-09, 109th Cong., 1st Sess. (2005).

Notwithstanding the requirement for court approval, section 1505 is permissive, not mandatory. Very often, trustees or other representatives in domestic bankruptcy cases are able to act abroad, quite capably, without the court's seal of approval under section 1505. Section 1505, thus, is perhaps best employed when a foreign entity either disputes a trustee's mandate or requires further corroboration of a trustee's credentials. Conversely, in fact, there is no requirement that a foreign representative of a foreign proceeding actually commence a Chapter 15 case as a condition to exercising control over U.S. property owned by the foreign debtor. Neither federal nor state law requires a foreign representative to obtain a prior order from a court in the United States before disposing of property located in the United States. *In re Iida*, 377 B.R. 243 (B.A.P. 9th Cir. 2007). Likewise, section 1509(f) does not affect any right that a foreign representative may have to sue in a U.S. court to collect a claim that is property of the debtor, whether or not an ancillary case has been commenced or recognized.

Another domestic adaptation in section 1505 is to specifically identify the various parties qualified to act abroad. Section 1505 empowers any trustee, as defined in section 1502(6), ***or*** "another entity (including an examiner)" to act abroad. A trustee can be any trustee appointed under the Bankruptcy Code, a debtor in possession, or a municipal debtor in a Chapter 9 case. The express inclusion of a municipality was needed because Chapter 9 does not permit the appointment of a trustee to exercise municipal affairs. Rather, for purposes of Chapter 9, whenever a provision of the Bankruptcy Code that otherwise applies to a trustee is invoked in Chapter 9, it is deemed to refer to the municipal debtor itself. (There is an odd quirk in Chapter 9, however, that permits the court to appoint a trustee to pursue avoidance actions that the municipality refuses to pursue; this type of trustee, if appointed, would likely fit within the catchall bucket of trustees that may be empowered under § 1505.)

According to the legislative history, section 1505 "also contemplates the designation of an examiner or other natural person to act for the estate in one or more foreign countries where appropriate. One instance might be a case in which the designated person had a special expertise relevant to that assignment. Another might be where the foreign court would be more comfortable with a designated person than with an entity like a debtor in possession. Either are to be recognized under the Model Law." This flexibility – to appoint a particular, named individual – would certainly be worthwhile to overcome the resistance that foreign entities might have to distinctive U.S. concepts such as the debtor in possession.

As noted, section 1505 applies whether or not a foreign proceeding involving a foreign debtor is pending abroad. It also applies whether or not the foreign country where the trustee appears has enacted its own matching legislation based on the UNCITRAL model law. Hence, a trustee in a domestic case can be authorized to take steps in any foreign country to advance the administration of a domestic estate. This might entail the sale of property located abroad but titled in a domestic debtor. Or, regulatory approval to domesticate cash or other assets maintained in a foreign financial institution. Or perhaps obtaining testimony or other evidence that might aid the prosecution of an adversary proceeding in the domestic case. If, however, a foreign proceeding is in fact pending abroad, section 1505 works in tandem with sections 1526 and 1527 of Chapter 15 to provide that the trustee, if authorized by the Bankruptcy Court and subject to its supervision, may "communicate directly with a foreign court or a foreign representative."

It will, at this point, come as no surprise that there is no such creature as a cross-border municipal bankruptcy case. Yet, just like any other trustee of a domestic bankruptcy case, a municipality may need to act in a foreign country to facilitate a consensual adjustment of its debts, perhaps because municipal bonds may be registered for the benefit of foreign owners. Another plausible scenario where foreign cooperation might be needed is in the case of municipal special revenue bonds based on cross-border projects or systems (such as flood control or irrigation districts). It is, of course, quite natural that municipalities, like private debtors, will increasingly enjoy the advantages of foreign investment and trade.

Section 1505 marshals a potentially unlimited toolbox to maximize the value of a domestic estate. Whether and how the need to act abroad might arise, practitioners in any case under the Bankruptcy Code should keep in mind this overlooked statutory nugget. Although buried within Chapter 15, ***any*** debtor in ***any*** case under the Bankruptcy Code has the power to seek the court's imprimatur to act abroad. Indeed, the court can tailor the relief to appoint any person with "special expertise" relevant to the task – even, potentially, an elected official of a municipality. There appear to be no limits to the ingenuity of a court, debtors and creditors to dispatch a bankruptcy envoy to roam abroad.

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