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SECOND CIRCUIT RULES THAT FOREIGN DEBTORS MUST HAVE PLACE OF BUSINESS OR PROPERTY IN THE UNITED STATES FOR RECOGNITION OF A FOREIGN PROCEEDING UNDER CHAPTER 15 OF THE BANKRUPTCY CODE

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On December 11, 2013, the Second Circuit Court of Appeals in the *In re Barnet* proceedings held that a foreign debtor must have a place of business or property in the United States—as required by 11 U.S.C. § 109(a)—for recognition of its "foreign proceeding" in a United States court under Chapter 15 of the Bankruptcy Code.[1]

Chapter 15 was adopted by Congress to incorporate the Model Law on Cross-Border Insolvency and to adopt mechanisms for cooperation between the United States and foreign countries in cross-border insolvency proceedings.[2] A foreign representative authorized to administer the reorganization or liquidation of a foreign debtor's assets or affairs may seek recognition of a foreign proceeding in a United States court to obtain certain relief under the Bankruptcy Code applicable in Chapter 15.[3] Such relief includes the protection of the automatic stay, the right to operate the business, and the ability to sell assets in a foreign main proceeding and additional relief in the discretion of the court.[4]

In the case at issue, Octaviar Administration Pty Ltd. ("OA"), a company incorporated in Australia, commenced a voluntary wind down proceeding in an Australian court and was ordered to be liquidated in July 2009 (the "Australian Proceeding"). In April 2012, the foreign representatives of OA commenced a lawsuit in Australia seeking AUD 210,000,000 against two Australian affiliates of Drawbridge Special Opportunities Fund LP ("Drawbridge"). In August 2012, the foreign representatives sought recognition of the Australian Proceeding under Chapter 15 in the Bankruptcy Court for the Southern District of New York to continue their investigation of potential claims and causes of action against Drawbridge and its affiliates. Despite the fact that OA had no business or assets in the United States, the Bankruptcy Court granted recognition of the Australian Proceeding over Drawbridge's objection (the "Recognition Order"). The foreign representatives then filed a motion seeking discovery from Drawbridge and other parties. Drawbridge's appeal of the Recognition Order was certified directly to the Second Circuit.[5]

Applying a plain meaning reading of the Bankruptcy Code and giving effect to each clause and word of the statute, the Second Circuit vacated the Bankruptcy Court's Recognition Order and held that the requirements of 11 U.S.C. § 109(a) apply to a foreign debtor seeking recognition of a foreign proceeding under Chapter 15. Section 109(a) provides that "only a person that resides or has a domicile, a place of business, or property in the United States … may be a debtor under this title." Further, 11 U.S.C. § 103(a) explicitly states that Chapter 1—which contains § 109(a)—applies in a case under Chapter 15. Accordingly, the Second Circuit concluded that, because the foreign

representatives "made no attempt to establish that OA had a domicile, place of business or property in the United States, recognition should not have been granted."

The Second Circuit rejected an array of statutory and contextual arguments asserted by the foreign representatives. The Court further concluded that the purpose of Chapter 15 would not be undermined by application of § 109(a). Although the Model Law on Cross-Border Insolvency did not contain a requirement akin to § 109(a), it expressly provided that "a State may modify or leave out some of its provisions" and the omission of such requirement from the Model Law "does not suffice to outweigh the express language Congress used in adopting Sections 109(a) and 103(a)." The Second Circuit found this was "especially true" where another provision of federal law, 28 U.S.C. § 1782(a), provided for discovery in aid of foreign proceedings without requiring satisfaction of § 109(a) and noted that, here, the foreign representatives had already commenced an action under this provision and entered into a stipulation in October 2013 with Drawbridge and others requiring the production of documents.

The full effect of the Second Circuit decision will not be known until applied to different factual circumstances. It is clear, in the Second Circuit, that a foreign debtor without a business or assets in the United States will be unable to seek recognition of a foreign proceeding solely to seek discovery from a U.S. entity, but can nonetheless seek such discovery under 28 U.S.C. § 1782(a). Further, foreign debtors seeking to protect, use, operate, or sell U.S. businesses or property under Chapter 15 will satisfy the requirements of 11 U.S.C. § 109(a) and will not be affected by the decision. But foreign debtors without a U.S. business or property, at least in the Second Circuit, will be unable to use Chapter 15 to join U.S. creditors or parties in interest to a foreign proceeding or bind them to a plan of liquidation or reorganization confirmed in a foreign court. This raises serious questions whether U.S. courts would recognize and enforce such orders under the traditional principles of comity.

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[1] Opinion of the Court, *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, No. 13-612-bk (2d Cir. Dec. 11, 2013).
[2] 11 U.S.C. § 1501(a).
[3] *See generally* 11 U.S.C. §§ 101(23)-(24); 1515-1524.
[4] *See* 11 U.S.C. §§ 1519-1521.
[5] *See* Memorandum Opinion in Support of Certification of Direct Appeal to the Court of Appeals for the Second Circuit, *In re Barnet*, Case No. 12-13443 (SCC) (Bankr. S.D.N.Y. Nov. 28, 2012).