Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT® SEPTEMBER 2017

LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 13 NUMBER 6 SEPTEMBER 2017

LexisNexis®

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:
Kent K. B. Hanson, J.D., at 415-908-3207
Email: ..... kent.hanson@lexisnexis.com
Outside the United States and Canada, please call . . . . . (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:
Customer Services Department at . . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . . (518) 487-3385
Fax Number . . . . . (800) 828-8341
Customer Service Website . . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call
Your account manager or . . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . . (937) 247-0293

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)
ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2014)

An A.S. Pratt® Publication

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2017-Pub.4789)

Editor-in-Chief, Editor & Board of Editors

licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844.

Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 718.224.2258. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, Attn: Customer Service, 9443 Springboro Pike, Miamisburg, OH 45342-9907.

Second Circuit Affirms Refusal to Approve Foreign Debtor's Asset Sale

By Michael L. Cook*

The U.S. Court of Appeals for the Second Circuit recently affirmed a bankruptcy court's disapproval of an asset sale, because the asset had dramatically increased in value before any court had approved the sale, calling it a "sound business reason" for disapproval. The author of this article explains the decision, which is important to asset buyers in bankruptcy sales.

"[A]ny sale of [a foreign] debtor['s] property [in the U.S.] outside of the ordinary course of business can be approved by the bankruptcy court only after notice, hearing, and a finding of good business reasons to permit the sale," held the U.S. Court of Appeals for the Second Circuit in *In re Fairfield Sentry Ltd.* ("*Sentry II*").[1] The court relied on the language of Bankruptcy Code ("Code") § 1520(a)(2), which mandates the application of Code § 363(b) in a foreign debtor's Chapter 15 case "to a transfer of . . . property that is within the territorial jurisdiction of the United States." In an earlier decision, *In re Fairfield Sentry Ltd.* ("*Sentry I*"),[2] the Second Circuit had ordered the bankruptcy court, on remand, to apply Code § 363(b) to a foreign representative's sale of a foreign debtor's U.S. asset. In *Sentry II*, the Second Circuit affirmed the bankruptcy court's disapproval of the asset sale, because the asset had dramatically increased in value before any court had approved the sale, calling it a "sound business reason" for disapproval.[3]

RELEVANCE

Fairfield Sentry is important to asset buyers in bankruptcy sales. Until the bankruptcy court approves an asset sale, the seller may decline to go forward if it has "no good business reason" for proceeding with the sale—if, for example, the property has increased in value, rendering the original contract price inadequate. A bankruptcy court's "principal responsibility . . . is to secure for

---

* Michael L. Cook, of counsel at Schulte Roth & Zabel LLP and a member of the Board of Editors of *Pratt's Journal of Bankruptcy Law*, has served as a partner in the firm's New York office for 16 years, devoting his practice to business reorganization and creditors' rights litigation, including mediation and arbitration. He may be contacted at michael.cook@srz.com.

[1] 2017 U.S. App. LEXIS 8860, at *11 (2d Cir. May 22, 2017) (unpublished).

[2] 768 F.3d 239 (2d Cir. 2014).

[3] 2017 U.S. App. LEXIS 8860, at *2.

the benefit of creditors the best possible bid."[4] Nor must a U.S. bankruptcy court necessarily defer to a foreign court's judgment as a matter of "comity." Despite Chapter 15's general deference to foreign courts for the sake of consistency, in this case Code § 1520(a)(2) "explicitly" required the bankruptcy court to review the asset sale "to the same extent" as it would in a domestic Chapter 7 or Chapter 11 case.[5]

FACTS

U.S. Recognition of *Sentry* Case

Fairfield Sentry Ltd. ("Sentry") was a British Virgin Islands ("BVI") investment fund that had invested 95 percent of its assets with Bernard L. Madoff Investment Securities LLC ("Madoff"), which later became the subject of a liquidation under the Securities Investor Protection Act ("SIPA"). After Sentry filed three customer claims (collectively, the "SIPA Claim") in the SIPA liquidation, the SIPA trustee and Sentry negotiated a settlement allowing Sentry's SIPA Claim in the amount of $230 million. Sentry itself later became the subject of a BVI liquidation and a BVI Court appointed a "Liquidator" under BVI law. The Liquidator then sought "recognition" of the BVI liquidation under Chapter 15 of the Code as a "foreign main proceeding" in the Southern District of New York. The bankruptcy court entered an order of recognition of the *Sentry* case on July 22, 2010, enabling the Liquidator to use the U.S. bankruptcy court to protect and administer Sentry's assets in the United States (e.g., automatic stay, injunctive relief, sale of property and operation of debtor's business).[6]

Auction of Sentry's SIPA Claim

The Sentry Liquidator auctioned off the Sentry SIPA Claim during the summer of 2010. The successful bidder (the "Buyer") offered to buy it for roughly 32 percent of the allowed amount, a bid that was "several percentage points higher than the other bids," and was accepted by the Liquidator, subject only to later court approval.[7]

The Liquidator and the Buyer negotiated, documented and signed a trade confirmation (the "Confirm") setting forth the material terms of the sale.

---

[4] *Sentry I*, 768 F.3d at 246–47 (quoting *In re Fin. News Network, Inc.*, 980 F.2d 165, 169 (2d Cir. 1992)).

[5] *Sentry II*, 2017 U.S. App. LEXIS 8860, at *14.

[6] *Sentry I*, 768 F.3d at 243.

[7] *Id.* at 242.

Among other things, the Confirm was to be governed by New York law and was expressly "subject to approval by both the U.S. bankruptcy court and the BVI Court," with a requirement that the Liquidator "promptly [seek] the approval of the BVI Court of the terms and conditions of [the Confirm]."[8]

Increase in Value of SIPA Claim

Three days after the parties signed the Confirm, the Madoff trustee entered into a settlement agreement with an unrelated third party that materially "increased the value of Sentry's SIPA Claim from 32% to more than 50% of the . . . allowed amount of the claim (an increase of approximately $40 million)."[9]

BVI Court Approval of Confirm Subject to U.S. Bankruptcy Court Approval

As a result of changed circumstances, the Liquidator declined to seek BVI Court approval of the Confirm, causing the Buyer to move in the BVI Court for an order compelling performance by the Liquidator to comply. In response, the Liquidator asked the BVI Court "not to approve the transfer to [the Buyer] at the bid price because, given the sudden increase in the value of the SIPA Claim, it was not in the best interests of the Sentry estate."[10] The Liquidator also argued that U.S. bankruptcy court approval was required under Code §§ 1520(a)(2) and 363.[11]

The BVI Court approved the sale of the SIPA Claim under the Confirm despite the Liquidator's objection, subject to further approval of the U.S. bankruptcy court.[12] In doing so, it stressed that the U.S. bankruptcy court had "a choice whether or not to approve" the proposed sale.[13]

U.S. Bankruptcy Court's Refusal to Review Contracts

The Liquidator moved in the U.S. bankruptcy court seeking review of the Confirm and, more important, "an order disapproving" the sale. Denying the Liquidator's motion, the bankruptcy court described it as "seller's remorse" and a "last-ditch effort" to undo the sale. It also declined to review the transaction because it reasoned that the "[s]ale does not involve the transfer of an interest in property within the United States."[14] In its view, "comity dictates that [the

---

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.* at 243.

[14] *In re Fairfield Sentry Ltd.*, 484 B.R. 615, 617, 618 (Bankr. S.D.N.Y. 2013).

U.S. bankruptcy court] defer to the BVI judgment" by approving the sale.[15] On the first round of appeal, the district court questioned whether Code § 363 even applied, but agreed that the bankruptcy court's denial of the Liquidator's challenge to the sale was proper because "[c]ourts should be loath to interfere with corporate decisions absent a showing of bad faith, self-interest, or gross negligence."[16]

SENTRY I

Chapter 15 Requires Full Bankruptcy Court Review

The BVI liquidation was a "foreign main proceeding" as defined in Chapter 15 of the Code, noted the Second Circuit.[17] According to the court, the Chapter 15 proceeding protected "Sentry's United States assets from creditor action and [allowed the Liquidator] to obtain the rights and benefits of Chapter 15."[18] A U.S. bankruptcy court must therefore fully review any proposed "transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States."[19] More important, § 1520(a)(2) provides that the U.S. bankruptcy court must conduct its review "to the same extent that [§ 363] would apply to property of an estate" in a domestic bankruptcy case.[20]

SIPA Claim Is Property

The Second Circuit rejected the parties' technical arguments over the nature of the SIPA Claim, holding that it was "property" and that Sentry was selling its "rights, title and interest in and to [its] claims against" Madoff in the Madoff SIPA liquidation. "In other words, the SIPA Claim is a 'chose in action.'"[21]

SIPA Claim within the United States

The SIPA Claim was also within the territorial jurisdiction of the United States, held the court. Code § 1502(8) includes the following property "[w]ithin the territorial jurisdiction of the United States: . . . [I]ntangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may

---

[15] *Id.* at 628.

[16] *In re Fairfield Sentry Ltd.*, No. 13 Civ. 1524(AKH) at *1, 2 (S.D.N.Y. July 3, 2013).

[17] *Sentry I*, 768 F. 3d at 243.

[18] *Id.*

[19] *Id.* (quoting Code § 1520(a)(2)).

[20] *Id.* at 244 (quoting Code § 1520(a)(2)).

[21] *Id.* at 244.

properly be seized or garnished by an action in a Federal or State court in the United States."

The bankruptcy court in *Sentry I* held that the SIPA Claim was "located with the debtor in the BVI," but the Second Circuit found that analysis to be "incomplete."[22] According to the Second Circuit, the SIPA Claim was "subject to attachment or garnishment and may be properly seized by an action in a Federal or State court in the United States."[23] Citing New York CPLR §§ 5201(b) and 6202, the court found that "any property which could be assigned or transferred" is subject to attachment and garnishment in New York. The Madoff SIPA trustee was located in New York and was "statutorily obligated to distribute to Sentry its pro rata share of the recovered assets" on the allowed SIPA Claim.[24]

Comity Not Applicable

The Second Circuit in *Sentry I* also rejected the lower courts' deference to the BVI Court's judgment approving the sale. In its view, Code Chapter 15 imposed "certain requirements and considerations that act as a brake or limitation on comity."[25] Thus, there is no automatic blanket deference to foreign rulings. Because the "plain" language of Code § 1520(a)(2) directed the U.S. bankruptcy court to apply § 363 "to the same extent" as it would in a Chapter 7 or a Chapter 11 case, the bankruptcy court was "required to conduct" a full review of the proposed sale when, as was the case here, the debtor sought to sell a property interest within the territorial jurisdiction of the United States.[26] As noted, the BVI Court apparently never "expect[ed] or desire[d] deference" here. That court had "expressly declined to rule on whether the [asset sale] required approval under section 363."[27]

SENTRY II

The district court in *Sentry II* affirmed the bankruptcy court's disapproval of the transaction, on remand from the Second Circuit, because the Liquidator had provided a "sound business reason" for disapproval.[28] The Buyer argued

---

[22] *Id.*

[23] *Id.*

[24] *Id.* at 245.

[25] *Id.* (quoting *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1054 (5th Cir. 2012)).

[26] *Id.* at 246.

[27] *Id.*

[28] 2017 U.S. App. LEXIS 8860, at *2. In finding that the Liquidator had provided a "sound

that the bankruptcy court had erred in disapproving the asset sale because it had previously entrusted "the administration . . . of the debtor's assets within the territorial jurisdiction of the United States to the foreign representative." It also argued that the bankruptcy court had given "insufficient weight in its Section 363(b) analysis to comity values."[29] Holding that the mandate of *Sentry I* foreclosed both of these arguments, the Second Circuit declined "to reconsider [its] direction in [*Sentry I*] that the bankruptcy court was obliged to conduct a § 363(b) review."[30]

First, the Buyer "made effectively the same argument in the earlier appeal that it now advances."[31] In fact, said the court, "*Sentry I* . . . both impliedly rejected the Entrustment Argument [made by the Buyer] and limited the lower courts' consideration on remand to a traditional section 363(b) analysis."[32]

The Second Circuit also rejected the Buyer's argument that "comity values should instead have weighed as a dispositive factor in" the bankruptcy court's review on remand. According to the Second Circuit, "this is effectively the same argument" made by the Buyer in *Sentry I*, and "is barred by the mandate" in that decision.[33]

The Second Circuit also rejected the Buyer's request for reconsideration of its prior ruling, explaining that it had identified "no clear error."[34] First the court rejected the Buyer's argument that the earlier entrustment order issued by the bankruptcy court gave the Liquidator "unfettered ability to convert the Debtor's non-cash assets into cash, including by selling them . . . ."[35] According to the court, however, "the § 1520(a)(2) specific requirement as to non-ordinary-course property sales governs instead of the general conferral-of-authority language in" another part of the statute.[36] Moreover, "section 1520(a)(2) is an 'express statutory command that, in any Chapter 15 ancillary proceeding, the

---

business reason" for disapproval of the asset sale, Judge Bernstein gave substantial weight to the SIPA Claim's increase in value. *In re Fairfield Sentry Ltd.*, 539 B.R. 658, 669 (Bankr. S.D.N.Y. 2015) ([T]he most important factor and the one factor the Second Circuit specifically directed this Court to consider [(whether the asset is increasing or decreasing in value)] plainly weighs against the approval of the sale.).

[29] *Id* at *3.

[30] *Id.*

[31] *Id.* at *7.

[32] *Id.* at *8–*9.

[33] *Id.* at *9.

[34] *Id.* at *11.

[35] *Id.* at *11–*12.

[36] *Id.* at *13.

requirements of § 363 apply to the same extent as in Chapter 7 or 11 [cases].'"[37]

Finally, the court rejected the Buyer's argument that "in a Chapter 15 proceeding, facilitating transnational cooperation is the most important factor."[38] Aside from the Buyer's failure to convince the court to reach a "result contrary to that reached in the *Sentry I*," the Second Circuit stressed that the "post-sale increase in value of [the SIPA Claim] against [Madoff] still provides a 'good business reason' to disapprove the transaction . . . that is not clearly outweighed by comity, where, as here, the BVI Court's statements signal that it did not 'expect . . . or desire . . . deference' to its approval of the Sale."[39]

COMMENT

The Liquidator was a fiduciary who had a duty to withdraw from the Confirm once the SIPA Claim dramatically increased in value before any court approved the sale. The U.S. bankruptcy court had an obligation to approve only the highest or best bid. It had no "good business reason" and no valid legal reason for deferring to the BVI Court's misjudgment. As the Second Circuit noted in 1983, a court must consider "whether the asset is increasing or decreasing in value" in order to find "a good business reason" to approve an asset sale.[40]

---

[37] *Id.* at *14 (quoting *Sentry I*, 768 F.3d at 245).

[38] *Sentry II*, 2017 U.S. App. LEXIS 8860, at *15.

[39] *Id.* at *16 (quoting *Sentry I*, 768 F.3d at 246).

[40] *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983).