Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

2 New Decisions Clarify Chapter 15 Requirements

By **James T. Bentley** (May 17, 2018, 12:45 PM EDT)

In April, two decisions from the Southern District of New York were added to the burgeoning body of case law under Chapter 15 of the Bankruptcy Code.[1] The decisions addressed (1) whether nonconsensual third-party releases granted in a foreign jurisdiction are enforceable in the U.S. under Chapter 15, (2) whether foreign breach of fiduciary duty judgment claims follow directors who move to the U.S. and, if so, are those claims "property" under the Bankruptcy Code, and (3) how much (or how little) does a debtor need to place on retainer with a U.S. law firm to have "property" in the U.S.?

When the dust settled, one decision held that a scheme of arrangement sanctioned under U.K. law providing nonconsensual third-party releases is enforceable under Chapter 15. This decision stands in contrast to the general prohibition of these nonconsensual releases in most Chapter 11 cases. Further, as this article suggests, this decision may provide a backdoor for some U.S. companies with foreign parents to obtain otherwise nonconsensual releases by utilizing foreign proceedings and Chapter 15. The second decision held that a judgment claim for breach of fiduciary duty under Australian law followed the breaching directors to New York, and satisfied the Bankruptcy Code's requirement that a debtor have property in the U.S. to file for bankruptcy. Finally, both decisions reaffirmed several Second Circuit holdings that retainers placed with U.S. law firms constitute property of the debtor in the U.S.; the surprising part was the required amount.

In re Avanti Communications Group PLC[2]

In Avanti, the court tackled the question of whether nonconsensual third-party releases granted by the High Court of Justice of England and Wales in a scheme of arrangement should be recognized and enforced under Chapter 15.

Avanti, a U.K. satellite operator, ran into trouble due to delays with the launch of two satellites and an overleveraged balance sheet. In addition to significant senior debt, Avanti also had two issues of notes — 2021 notes and 2023 notes — that were guaranteed by Avanti and each of its direct and indirect subsidiaries (the "subsidiary guarantors").

An ad hoc group of investors coalesced to negotiate with the troubled Avanti. In late December 2017, the ad hoc group and some additional noteholders (collectively, the "consenting creditors") reached a deal pursuant to which (1) the 2023 notes would be equitized and receive 92.5 percent of Avanti's restructured equity and (2) the 2021 notes would be amended to, among other things, reduce the interest rate. Critically, the consenting creditors' deal was predicated on Avanti and its subsidiary

guarantors receiving releases of any claim that might be brought against them in connection with the equitization of the 2023 notes (the "Avanti release"). If obtained, the Avanti release would preclude all creditors from ever seeking to recover against Avanti or the subsidiary guarantors under these guarantees.

In February 2018, Avanti applied to the High Court of Justice of England and Wales for permission to convene a meeting of creditors to consider and approve a scheme of arrangement. The U.K. court sanctioned the creditor meeting and authorized the appointment of a foreign representative to seek relief under Chapter 15. At the scheme meeting, creditors holding approximately 98 percent of the value of the 2023 notes voted for the scheme; none voted against it. After the scheme meeting, Avanti's foreign representative filed for Chapter 15 seeking to "enjoin[] parties from taking any action inconsistent with the scheme in the U.S., including giving effect to the releases set out in the Scheme."[3]

While the scheme was overwhelmingly approved in the U.K., some creditors did not vote at all. If the scheme were recognized under Chapter 15, then those nonvoters would be enjoined from ever seeking redress against the U.S. assets of Avanti or its subsidiary guarantors. In Chapter 11 proceedings in the U.S., courts generally are not receptive to "deemed consent" provisions in plans and disclosure statements — particularly in the Second Circuit.[4] In Chapter 15 cases, however, courts in the Second Circuit have been permissive of nonconsensual third-party releases in foreign proceedings where voting (i.e., due process) occurred.[5]

Ultimately, the court evaluated three factors in deciding that issues limiting the grant of nonconsensual third-party releases in Chapter 11 cases do not apply in Chapter 15 cases. First, under U.K. law, holders representing not less than 75 percent in value of each creditor class must vote in favor of the scheme. Second, under U.K. law, the entire accepting class is bound by the terms of the scheme; thus, the 2023 noteholders are bound by the Avanti releases in the U.K. Finally, the court considered comity, noting that the "failure of a U.S. bankruptcy court to enforce the [nonconsensual third-party releases] could result in prejudicial treatment of creditors to the detriment of the Debtor's reorganization efforts."[6]

Interestingly, the Avanti decision potentially could open the door for some U.S. subsidiaries to avail themselves of a foreign jurisdiction's lower standard for nonconsensual third-party releases. There is nothing in the Bankruptcy Code that precludes U.S. subsidiaries from seeking Chapter 15 relief; in fact, they have done so.[7] If a U.S. subsidiary obtains a release in a foreign proceeding, then the U.S. subsidiary could seek recognition under Chapter 15. Using the Avanti decision, that U.S. subsidiary likely would receive a nonconsensual third-party release that it otherwise could not obtain under Chapter 11. It will be interesting to see how U.S. bankruptcy courts address this apparent incongruity.

In re BCI Finances Pty Ltd. (In Liquidation) et al.[8][9]

In BCI Finances, the court resolved whether a judgment claim for breach of fiduciary duty under Australian law followed the breaching directors to the U.S. and, importantly, whether such claim satisfied the Bankruptcy Code's requirement that a debtor have property in the U.S. before filing for Chapter 15. BCI Finances and two of its affiliates (collectively, "BCI") were Australian companies subject to significant tax assessments they could not satisfy and accusation that their directors had engaged in fraud.[10] BCI was placed into liquidation in Australia. In August 2014, liquidators were appointed and commenced an Australian action against several directors asserting that they had breached their fiduciary duties to BCI. After a trial, the Australian court issued a judgment in the liquidators' favor. While the amount of damages was being determined, one of the directors, Andrew Binetter, admitted

liability of at least 20 million Australian dollars (approximately $15 million) and left Australia to live in New York City. The liquidators followed and filed for Chapter 15 seeking to obtain discovery from Binetter.

To obtain relief under Chapter 15, the Second Circuit has held that a debtor must satisfy the eligibility requirements of Section 109(a) of the Bankruptcy Code, which provides that "only a person that resides or has domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title."[11] Here, BCI's liquidators asserted that the breach of fiduciary duty claims constituted property in New York City because that is where Binetter resided. Binetter objected, asserting, among other things, that the situs of the fiduciary duty claims was Australia, where the alleged damages had occurred and the judgment had been entered.

The court began its analysis noting that state law determines the nature of a debtor's claim in property.[12] The court held that New York choice-of-law rules applied and, therefore, Australian substantive law governed the dispute because (1) the fiduciary duty claims arose from acts committed in Australia, (2) any recovery would be distributed to foreign creditors through the Australian proceeding, and (3) Andrew Binetter is an Australian citizen.

Given that the choice of law was Australian, the next question — whether the breach of fiduciary duty claims are property in the U.S. under Australian law — was left to a battle of expert witnesses for each side.[13] The liquidators' Australian law expert opined that a claim for breach of fiduciary duty is a "chose in action."[14][15] The liquidators' expert testified that under Australian law, the situs of a chose in action is "generally situated where the [judgment] debtor resides."[16] Thus, an Australian court was likely to hold that the breach of fiduciary duty claim against Binetter was located in New York.[17] Binetter's Australian law expert, on the other hand, argued that it is only a "general proposition" of Australian law that a chose in action resides where the judgement debtor is located.[18] Instead, Binetter's expert attempted to attach a temporal element to the breach of fiduciary duty claim, arguing that the situs of the claim should be determined "at the time the breach occurred."[19]

The court found the liquidators' expert more persuasive, noting that the situs of a chose in action also turns on enforcement considerations.[20] Moreover, in dicta, the court noted that "as a general matter, where a court has both subject matter and personal jurisdiction, the claim subject to the litigation is present in that court."[21] The court found that this reasoning would also result in a New York situs for the fiduciary duty claims given that Binetter resides in New York and the bankruptcy court had jurisdiction over matters impacting the BCI debtors and their estates.

While the BCI Finances decision regarding the location of Australian fiduciary duty claim judgments may seem of limited utility, it is the court's determination that such a claim constitutes property satisfying Section 109(a) of the Bankruptcy Code that should be helpful to prospective debtors. In other words, debtors need not have tangible property in the U.S. to seek Chapter 15 relief.

Size Does Not Matter When it Comes to Retainers in Chapter 15 Cases

It is well-settled law in the Second Circuit that when a debtor places a retainer in a law firm's bank account prior to filing its Chapter 15 petition it fulfills the "property" requirement under Section 109(a) of the Bankruptcy Code.[22]

Nevertheless, in the BCI Finances case, Binetter argued that placing cash on retainer in the U.S. was a litigation tactic designed by the liquidators to achieve a deceptive nexus to the U.S. and should not be

countenanced by the court. The court overruled the objection and held that the debtor's retainer constituted property satisfying the Bankruptcy Code's requirements. What made the BCI Finances decision notable was the size of the retainer. In that case, the liquidators put a mere $1,250 on retainer with their U.S. law firm. The court noted that courts have held that the "property" requirement in Section 109(a) of the Bankruptcy Code is "satisfied by even a minimal amount of property located in the United States."[23] That such a relatively small retainer was enough to satisfy the property requirement to file Chapter 15 should also be welcome news to debtors (although maybe not to their law firms).

James T. Bentley is special counsel at Schulte Roth & Zabel LLP.

[1] Chapter 15 of the U.S. Bankruptcy Code facilitates cross-border insolvency proceedings by authorizing U.S. bankruptcy courts to assist a representative of a foreign court in his or her administration of a foreign insolvency proceeding in the U.S.

[2] In re Avanti Communications Group PLC, 2018 WL 172554, *12 (Bankr. S.D.N.Y. Apr. 9, 2018).

[3] 2018 WL 172554, *2.

[4] 2018 WL 172554, *11 (citations omitted).

[5] 2018 WL 172554, *11 (collecting cases).

[6] 2018 WL 172554, *13 (citations omitted).

[7] See, e.g.,In re Karhoo, No. 16-13545 (Bankr. S.D.N.Y. 2016) (U.K. parent company with U.S. subsidiaries commenced administration proceedings in the U.K. for itself and U.S. subsidiaries; U.S. subsidiaries later sought and were granted recognition as foreign main proceedings under Chapter 15).

[8] A link to the decision may be found here. Citations reference page numbers in the decision.

[9] Case No. 17-11266 (SHL) Bankr. S.D.N.Y. Apr. 24, 2018

[10] Page 2

[11] 11 U.S.C. § 109(a).

[12] P.12 (collecting cases).

[13] P. 18.

[14] Black's Law Dictionary defines a chose in action as: a thing in action; a right of bringing an action or right to recover a debt or money. Right of proceeding in a court of law to procure payment of sum of money, or right to recover a personal chattel or a sum of money in action.

[15] (P. 19).

[16] (P. 20).

[17] Id.

[18] Id.

[19] Id.

[20] Id.

[21] (P. 24) (citation omitted).

[22] See, e.g., In re Suntech Power Holdings Co. Ltd., 520 B.R. 399 (Bankr. S.D.N.Y. 2014) (debtor who opened a bank account and transferred funds into that account one day before filing bankruptcy petition met the requirements of Section 109(a)).

[23] P. 9 (citations omitted).