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CROSS-BORDER INSOLVENCY***In re Fairfield Sentry Ltd.: Second Circuit Provides Guidance to “COMI” Determinations in Chapter 15 Cases***

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On April 16, 2013, in *Morning Mist Holdings Ltd. v. Kryz (In re Fairfield Sentry Ltd.)*,¹ the U.S. Court of Appeals for the Second Circuit issued an important decision informing fundamental concepts of cross-border insolvency law as implemented pursuant to Chapter 15 of the Bankruptcy Code. In an issue of first impression for the court, the Second Circuit provided guidance on the determination of a foreign debtor's "center of main interests" (COMI) for purposes of determining whether to grant recognition of a foreign insolvency proceeding as a "foreign main proceeding" in an ancillary case under Chapter 15.

The court held that the relevant period for determining a foreign debtor's COMI is the time of the filing of the Chapter 15 petition and not when the underlying foreign proceeding was commenced, provided that a court may evaluate the gap period between the commencement of the foreign proceeding and the filing of the Chapter 15 petition to determine whether a COMI was manufactured in bad faith. Also, in another issue of first impression, the Second Circuit provided guidance on the application of the "public policy exception" to granting relief under Chapter 15 found in Section 1506 of the Bankruptcy Code. The court's holding was con-

sistent with a majority of courts construing the Section 1506 public policy exception narrowly.

Background of Chapter 15

Chapter 15 of the Bankruptcy Code largely incorporates the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law (the Model Law); it was enacted to, among other things, facilitate cooperation and coordination with foreign proceedings, to facilitate fair and efficient administration of cross-border insolvencies and to protect and maximize a foreign debtor's U.S.-based assets.² Under Chapter 15, a foreign representative of the foreign debtor files a petition for recognition by the U.S. bankruptcy court of a foreign insolvency proceeding as either a "foreign main proceeding" or a "foreign nonmain proceeding."³

² See 11 U.S.C. § 1501.

³ A "foreign main proceeding" means "a foreign proceeding pending in the country where the debtor has its center of main interests." See 11 U.S.C. 1502(4). A "foreign nonmain proceeding" means "a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment." See 11 U.S.C. 1502(5). "Foreign proceeding" means "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to con-

¹ *Morning Mist Holdings Ltd. v. Kryz (In re Fairfield Sentry Ltd.)*, 714 F.3d 127 (2d Cir. 2013)(25 BBLR 564, 4/25/13).

Under Section 1517(a) of the Bankruptcy Code, subject to Section 1506 (the so-called “public policy exception”), after notice and a hearing, an order recognizing a foreign proceeding shall be entered if: (1) such foreign proceeding for which recognition is sought is a foreign main proceeding or foreign nonmain proceeding within the meaning of Section 1502; (2) the foreign representative applying for recognition is a person or body; and (3) the petition meets the requirements of Section 1515 of the Bankruptcy Code. Section 1517(b) of the Bankruptcy Code provides that such foreign proceeding shall be recognized: (1) as a foreign main proceeding if it is pending in the country where the debtor has its center of main interests and (2) as a foreign nonmain proceeding if the debtor has an establishment within the meaning of Section 1502 in the foreign country where a proceeding is pending. An establishment is defined under the Bankruptcy Code as “any place of operations where the debtor carries out a nontransitory economic activity.”⁴

Recognition of a foreign insolvency proceeding as a “foreign nonmain proceeding” enables a foreign representative to seek broad discretionary relief from the U.S. bankruptcy court under Section 1521 of the Bankruptcy Code.⁵ Recognition of a foreign proceeding as a

control or supervision by a foreign court, for the purpose of reorganization or liquidation.” See 11 U.S.C. 101(23).

⁴ See 11 U.S.C. 1502(2).

⁵ Section 1521 of the Bankruptcy Code provides in part that:

(a) Upon recognition of a foreign proceeding, whether main or nonmain, where necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief, including—

- (1) staying the commencement or continuation of an individual action or proceeding concerning the debtor’s assets, rights, obligations or liabilities to the extent they have not been stayed under section 1520(a);
- (2) staying execution against the debtor’s assets to the extent it has not been stayed under section 1520(a);
- (3) suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor to the extent this right has not been suspended under section 1520(a);
- (4) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor’s assets, affairs, rights, obligations or liabilities;
- (5) entrusting the administration or realization of all or part of the debtor’s assets within the territorial jurisdiction of the United States to the foreign representative or another person, including an examiner, authorized by the court;
- (6) extending relief granted under section 1519(a); and
- (7) granting any additional relief that may be available to a trustee, except for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a).

(b) Upon recognition of a foreign proceeding, whether main or nonmain, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor’s assets located in the United States to the foreign representative or another person, including an examiner, authorized by the court, provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected.

“foreign main proceeding” affords a foreign representative certain automatic relief under Section 1520 of the Bankruptcy Code, including application of the “automatic stay” of Section 362 of the Bankruptcy Code to the debtor and property of the debtor within the territorial jurisdiction of the United States and the ability of the foreign representative to use, sell or lease property pursuant to Section 363 of the Bankruptcy Code that is located within the territorial jurisdiction of the United States (to the same extent Section 363 would apply to property of the estate).⁶

Section 1507 of the Bankruptcy Code permits a court to grant a foreign representative “additional assistance” where recognition of a foreign proceeding is granted, subject to specific limitations stated elsewhere in Chapter 15.⁷

During the gap period between the filing of the Chapter 15 petition and court recognition, Section 1519 of

(c) In granting relief under this section to a representative of a foreign nonmain proceeding, the court must be satisfied that the relief relates to assets that, under the law of the United States, should be administered in the foreign nonmain proceeding or concerns information required in that proceeding.

(d) The court may not enjoin a police or regulatory act of a governmental unit, including a criminal action or proceeding, under this section.

(e) The standards, procedures, and limitations applicable to an injunction shall apply to relief under paragraphs (1), (2), (3), and (6) of subsection (a).

⁶ See 11 U.S.C. §§ 1520. Section 1520(a) of the Bankruptcy Code provides that:

[u]pon recognition of a foreign proceeding that is a foreign main proceeding—

- (1) sections 361 and 362 apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States;
- (2) sections 363, 549, and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the sections would apply to property of an estate;
- (3) unless the court orders otherwise, the foreign representative may operate the debtor’s business and may exercise the rights and powers of a trustee under and to the extent provided by sections 363 and 552; and
- (4) section 552 applies to property of the debtor that is within the territorial jurisdiction of the United States.

⁷ Recently, in *In re Vitro, S.A.B. de C.V.*, the Fifth Circuit Court of Appeals considered the interplay between Sections 1507 and 1521 of the Bankruptcy Code. The court developed the following methodology for determining which section requested relief must fall under. First, a court should consider the specific relief enumerated under Sections 1521(a) and (b) of the Bankruptcy Code. Second, if the relief is not explicitly provided for there, a court should then consider whether the requested relief falls more generally under Section 1521’s grant of any appropriate relief. The Fifth Circuit held that “appropriate relief” is relief previously available under Chapter 15’s predecessor, the now-repealed Section 304 of the Bankruptcy Code. Finally, only if a court determines that the requested relief was not formerly available under Section 304 should a court consider whether relief would be appropriate as “additional assistance” under Section 1507. See *In re Vitro S.A.B. de CV*, 701 F.3d 1031 (5th Cir. 2012).

the Bankruptcy Code provides that the debtor's foreign representative may request relief that is "urgently needed to protect the assets of the debtor or the interests of the creditors." *Id.* This interim relief is broad enough to encompass a stay on the execution of the debtor's U.S. assets and to suspend the right to transfer, encumber, or otherwise dispose of the U.S. assets of the debtor, and a temporary restraining order of this fashion has become a form of "first-day" relief often awarded shortly after the filing of a Chapter 15 petition.

A gating issue in Chapter 15 cases is whether a foreign proceeding should be considered a foreign main proceeding or a foreign nonmain proceeding. This is due to the fact that, as referenced above, certain relief is automatic for foreign main proceedings but not for foreign nonmain proceedings. As a foreign main proceeding is defined as a "foreign proceeding pending in the country where the debtor has the center of its main interests," an important determination in the context of a Chapter 15 petition is the location of the debtor's COMI. The Bankruptcy Code creates a rebuttable presumption that a debtor's COMI is the country where the debtor has its registered office; however, the Bankruptcy Code does not otherwise define COMI. *Morning Mist* clarifies the issue of the relevant time period for determining a debtor's COMI.

Under Section 1506 of the Bankruptcy Code, the bankruptcy court may deny a foreign representative relief to which it is otherwise entitled under Chapter 15 if such relief is "manifestly contrary to the public policy of the United States" (i.e., the "public policy exception"). *Morning Mist* also provides clarity as to the appropriate interpretation of the public policy exception.

Morning Mist

Factual Background

The case arose from the Chapter 15 filing of Fairfield Sentry Ltd. (Sentry), the largest of the "feeder funds" that invested roughly 95 percent of its assets, or more than US\$7 billion, with Bernard L. Madoff Investment Securities LLC (BLMIS). Sentry administered its business interests from the British Virgin Islands (BVI), where its registered office, registered agent, registered secretary and corporate documents, among other things, were located. When Bernard Madoff was arrested in December 2008, Sentry's independent directors refocused Sentry's administration on the wind down of its business and the preservation of assets in anticipation of litigation and bankruptcy.

In July 2009, a BVI court commenced liquidation proceedings under BVI law and appointed liquidators with custody and control of all assets of Sentry (the BVI Proceeding). On June 14, 2010 (the Petition Date), Sentry's authorized representatives petitioned the U.S. Bankruptcy Court for the Southern District of New York (the Bankruptcy Court) for recognition of the BVI Proceeding as a "foreign main proceeding" under Chapter 15.

As of the Petition Date, Sentry had millions of dollars of liquid assets in Ireland, the United Kingdom and the BVI, as well as billions of dollars of claims on account of customer funds, redemption for false profits and similar redemption claims. The Bankruptcy Court found that Sentry had no place of business, no management and no tangible assets located in the United States; the Bankruptcy Court further found that Sentry

had severed its ties with BLMIS and other U.S. businesses long before the Petition Date. The Bankruptcy Court ultimately granted the petition for recognition of the BVI Proceeding as a "foreign main proceeding."

Morning Mist Holdings Ltd. (Morning Mist), a Sentry shareholder that had filed a derivative action on behalf of Sentry in a New York state court prior to the commencement of the BVI Proceeding, appealed the recognition order of the Bankruptcy Court. Morning Mist argued that, when considering Sentry's full operational history, Sentry's COMI was not in the BVI and that, accordingly, Sentry should not enjoy the benefit of the U.S.-based stay of proceedings that would follow such a finding. The U.S. District Court for the Southern District of New York affirmed the order of the Bankruptcy Court. Morning Mist appealed to the Second Circuit, and the Second Circuit affirmed.

Opinion of the Second Circuit

The primary issue before the Second Circuit was whether Sentry's COMI was in the BVI. The court held that the determination is based on a debtor's COMI at the time of filing of the Chapter 15 petition, not at the commencement of the foreign proceeding. The Second Circuit further held, however, that a court may look at the period between the commencement of the foreign proceeding and the filing of the Chapter 15 petition to ensure that the debtor has not manipulated its COMI in bad faith. Aside from temporal considerations, the Second Circuit held that courts may consider any number of factors in determining COMI, including the debtor's liquidation activities in anticipation of litigation and bankruptcy. The Second Circuit cited with approval a list of non-exclusive factors developed by the U.S. Bankruptcy Court for the Southern District of New York in *In re Sphinx, Ltd.*⁸ Such non-exclusive factors are: the location of the debtor's headquarters; the location of those who actually manage the debtor (which, conceivably could be the headquarters of a holding company); the location of the debtor's primary assets; the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes.

Recognizing that few courts have examined the meaning of COMI under Chapter 15 with respect to the applicable time frame for determining COMI, the Second Circuit looked to the text of the statute, the opinions of other federal courts and international sources to reach its holding. The court found that the reference to COMI in the present tense in Section 1517 of the Bankruptcy Code (which speaks to the requirements for granting a Chapter 15 petition) suggests that a court should examine a debtor's COMI at the time of the filing of the Chapter 15 petition.⁹ This interpretation is consistent with the interpretation of the Fifth Circuit in *In re Ran*, 607 F.3d 1017 (5th Cir. 2010).

The court also rejected the argument that the "principal place of business" test, which is an American jurisdictional concept that requires consideration of a debt-

⁸ 351 B.R. 103, 117 (Bankr. S.D.N.Y. 2006).

⁹ Section 1517(b)(1) of the Bankruptcy Code provides that a "foreign proceeding shall be recognized . . . as a foreign main proceeding if it is pending in the country where the debtor has the center of its main interests." *Id.* § 1517(b)(1) (emphasis added).

or's full operational history, should control the COMI analysis. The Second Circuit found that COMI was used in Chapter 15 as the relevant concept instead of principal place of business so as to conform more closely with the Model Law; however, the court noted that the "principal place of business" test may be useful in the analysis to determine COMI. Lastly, the court found international sources informative because such sources underscored the importance of factors that indicate regularity and ascertainability of a debtor's COMI to third parties, but the court otherwise found these international sources to be of limited use in determining the relevant time frame for assessing COMI under Chapter 15.

The Second Circuit provided no limits on what other factors could be examined by a court in determining COMI. The Second Circuit held that any relevant activities, including liquidation activities and administrative functions, may be considered in the COMI analysis. In sum, a debtor's COMI will be determined upon the facts and circumstances of each unique case and, absent a finding of bad faith COMI manipulation, will be determined temporally based on the debtor's activities at or around the time of the filing of the Chapter 15 petition.

The Second Circuit ultimately found no clear error in the Bankruptcy Court's findings of fact, which supported the conclusion that Sentry's COMI was in the BVI as of the Petition Date and that Sentry had not manufactured its COMI in bad faith.

Public Policy Exception

Morning Mist also argued that the BVI court restricted public access to the BVI Proceeding in several ways and that the private and confidential nature of the BVI Proceeding was "manifestly contrary to the public policy of the United States" within the meaning of Section 1506 of the Bankruptcy Code.

The application of Section 1506 was an issue of first impression before the Second Circuit, which applied the exception narrowly, consistent with a majority of other U.S. federal courts. The Second Circuit cited the legislative history, which states that "[t]he word 'manifestly' in international usage restricts the public policy exception to the most fundamental policies of the United States." Although the preservation of the right to inspect and copy judicial records is an important public policy objective of U.S. law, the Second Circuit noted that such right is a qualified right, not an absolute right. The court further noted that public summaries of the BVI Proceeding were available, and that nonparties

could have applied to the BVI court for access to sealed documents. The court, therefore, concluded that there was no basis to hold that the recognition of the BVI Proceeding was manifestly contrary to U.S. public policy.

Implications of the Morning Mist Decision

Morning Mist importantly provides circuit-level guidance on the determination of a foreign debtor's COMI. *Morning Mist* holds that the relevant period for determining a foreign debtor's COMI is the time of the filing of the Chapter 15 petition and not when the underlying foreign proceeding commenced. A court in determining where COMI is located may look at all relevant factors at or around the time of the filing of the Chapter 15 petition, including liquidation activities. This means that a determination of COMI will be highly factual in nature, resulting in a more deferential standard of review of a bankruptcy court's determination on appeal. Notwithstanding the seemingly bright line test for when to determine COMI, the Second Circuit left the door open for courts to determine that COMI has been manipulated in bad faith. To determine whether COMI has been manipulated in bad faith, a court also may evaluate the period between the commencement of the foreign proceeding and the filing of the Chapter 15 petition. Again, as this determination is highly factual in nature, the findings of the bankruptcy court will be accorded a great deal of deference on appeal. Also, as a practical matter, an opponent of a Chapter 15 petition on the ground that COMI has been manipulated in bad faith will likely have to adduce significant evidence in support of that contention in order to overcome the general rule that COMI is to be determined as of the date of the filing of the Chapter 15 petition. Although COMI jurisprudence will continue to develop on a case-by-case basis, leaving much of the outcome dependent on the factual findings made by the bankruptcy court, *Morning Mist* undoubtedly provides clarity to such jurisprudence by establishing temporal guidelines for the analysis.

With respect to the analysis of the scope of the public policy exception under Section 1506 of the Bankruptcy Code, the Second Circuit's narrow interpretation is in line with most other courts that have addressed the issue. As a result, the opponent of a Chapter 15 petition on public policy grounds will have to demonstrate that granting recognition of a foreign proceeding under Chapter 15 implicates a significant issue of U.S. law.

