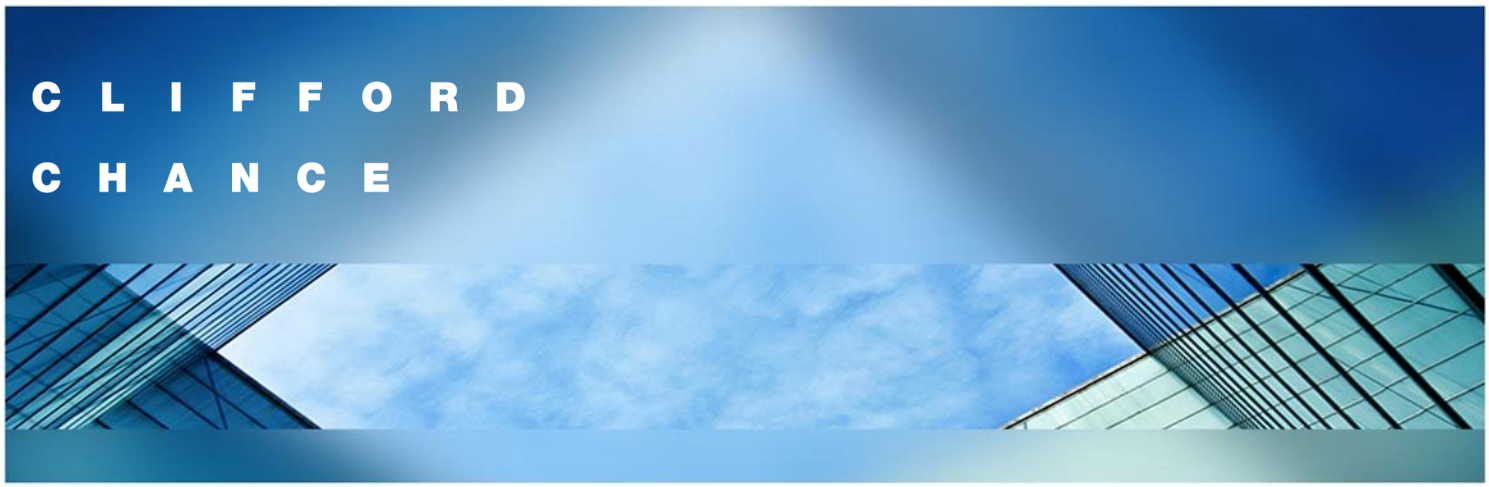

CHAPTER 15 UPDATE – KEY EARLY 2024 DECISIONS *(AL ZAWAWI, SUNAC, & WAYNE BURT)*

In the almost 20 years since the enactment of Chapter 15 of the US Bankruptcy Code, the protections afforded by that Chapter to debtors in foreign proceedings have become much more commonplace. Nevertheless, the exact parameters of Chapter 15 continue to evolve through US court decisions. That evolution was particularly clear in the first four months of 2024, where three different courts weighed in on important Chapter 15 issues.

In this update, we first examine an Eleventh Circuit Court of Appeals decision on the often-debated issue of whether the Chapter 15 recognition of a foreign insolvency proceeding requires the foreign "debtor" to have property or other ties to the United States. We then review a New York bankruptcy court's analysis of a foreign debtor's "center of main interests" (or "COMI"), a necessary and basic determination in any Chapter 15 bankruptcy case that ultimately defines the rights and protections afforded to that debtor. And finally, we review a decision of the Third Circuit Court of Appeals involving a much-debated issue related to Chapter 15 cases: is Chapter 15 the exclusive means by which foreign debtors can obtain US court assistance in connection with foreign insolvency-related proceedings.

ELEVENTH CIRCUIT EXAMINES WHETHER PROPERTY IN THE US IS REQUIRED TO INVOKE CHAPTER 15

To be a "debtor" under the Bankruptcy Code, Section 109 requires that a person or entity must reside or have a domicile, a place of business, or property in the US. This seems logical where, for example, a person or entity seeks to take advantage of Chapter 11, the US's powerful reorganization regime. Whether that requirement must be satisfied in Chapter 15, the Chapter of the Bankruptcy Code used to provide US court aid to foreign restructuring proceedings, seems much less obvious. The Eleventh Circuit recently grappled with this much-debated issue in the case of *Al Zawawi v. Diss (In re Al Zawawi*), 97 F.4th 1244 (11th Cir. 2024).

While the opinion of the court was unique to the circumstances and thus potentially uninteresting from a global perspective, two of the judges weighed in separately with detailed analyses on the opposing sides of the Section 109 debate. This commentary should provide insightful guidance on the applicability of Section 109 to Chapter 15 cases.

By way of background, Chapter 15 was added to the Bankruptcy Code in 2005. It was designed to provide a mechanism for United States bankruptcy courts to aid foreign bankruptcy proceedings. Because Chapter 15 emerged from the United Nations Commission on International Trade Law (aka, "UNCITRAL"), a Commission in which the United States was an active member, it is largely independent of the other Chapters of the Bankruptcy Code. Chapter 15 expressly includes a provision on construction, one that requires US bankruptcy courts to consider the international origin of Chapter 15 and the related need to promote consistent outcomes for similarly adopted statutes across the globe.

The facts of *In re Al Zawawi* are rather straightforward. In 2019, Talal Qais Abdulmunem Al Zawawi, an Omani citizen and resident of the United Kingdom, was divorced from his wife in the United Kingdom. Thereafter, a court in the United Kingdom entered a judgment in favor of Al Zawawi's ex-wife for more than $24 million. After Al Zawawi failed to pay the judgment, the UK court adjudged Al Zawawi bankrupt and appointed joint trustees in connection with the case. Because Al Zawawi appeared to have assets in Florida, the UK trustees filed a Chapter 15 proceeding in Florida. Al Zawawi opposed that filing on the basis that the trustees did not satisfy the Section 109 requirement that he reside, or have a domicile, a place of business or property in the US.

After two rulings in favor of the UK trustees, the matter was appealed to the Eleventh Circuit. There, all three judges on the panel found – in an "opinion of the court" – that even though a plain reading of the Bankruptcy Code indicates that Section 109 *does* apply in Chapter 15 cases, they were bound by an Eleventh Circuit 1988 (pre-Chapter 15) decision applying similar law (the predecessor to Chapter 15) which held that Section 109 did *not* apply to an "ancillary" proceeding; that is, a proceeding in the US seeking relief to support a proceeding in a foreign country. Thus, because of a decision binding only on courts in the Eleventh Circuit, the Eleventh Circuit found that the UK proceeding should be recognized in this instance. That conclusion, in itself, would probably merit only modest attention. However, two of the circuit judges each wrote their own "concurrences" to the decision. Each of the concurrences sounds very much like a dissent and provides meaningful guidance for understanding each side of the Section 109 dispute.

In the first concurrence, Judge Lagoa stated that if the prior 1988 opinion did not exist, she would reverse the bankruptcy court's decision on the ground that a "plain" reading of Section 109 and another section mandates that Section 109 applies to Chapter 15. This view is consistent with the Second Circuit panel's much-criticized decision in *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013) where the Second Circuit held that the Chapter 15 definition of "debtor" does not replace the definition of "debtor" in Section 109, and even if it did, it would not render Section 109 inapplicable in

Chapter 15 cases. Bankruptcy courts in other circuits have declined to follow *Barnet*.

The second concurrence spanned more than 47 pages (more than twice the length of the majority opinion). In it, Judge Tjoflat provided a treatise-like analysis of the history and purpose of the Bankruptcy Code generally and Chapter 15 specifically, as well as the Eleventh Circuit's 1988 opinion. In light of the foregoing, and considering statutory construction principles, Judge Tjoflat explained why the term "debtor" in the context of a Chapter 15 foreign proceeding was different than the term "debtor" used in Section 109. In summary, the result of this expansive analysis is a roadmap for a court in later proceedings (perhaps in the Eleventh Circuit *en banc* or the US Supreme Court) to disagree with the Second Circuit in *Barnet* and hold that Section 109 does not apply to limit who may be a debtor in cases under Chapter 15.

Takeaways: Judge Tjoflat's analysis provides strong support for the proposition that the drafters of Chapter 15 had not intended that a Chapter 15 "debtor" be required to satisfy Section 109. However, recognizing the inconsistent interpretations of the law that already exist, the only real "fix" – at least to obtain consistent outcomes across the United States – is for either the Supreme Court to decide who is correct or for Congress to fix the statute. Neither path seems likely to be followed in the near term.

In practice, the property requirement is often less problematic than might initially appear because most Chapter 15 cases are voluntarily filed by a representative of the debtor. In such instances, Section 109 is simply prophylactically addressed by good lawyers – as it has been since *Barnet* – by creating an escrow account in the US, thus satisfying the property requirement. Indeed, foreign debtors who utilize Chapter 11 often satisfy Section 109 with a similar approach. Confusion over the law may certainly remain for now (at least outside of the Second and Eleventh Circuits), however, where a foreign representative seeks to use Chapter 15 to obtain and use US recognition as a sword.

BANKRUPTCY COURT FINDS SOME ELASTICITY IN THE DEFINITION OF COMI

Under Chapter 15, the scope of relief available to a foreign representative of a foreign debtor is dictated in part by the location of the debtor's center of main interests, or "COMI." If the debtor's proceeding is taking place in the country where the debtor has its COMI, the foreign proceeding and the debtor's foreign representative are entitled to more automatic protections – similar to the protections afforded in a Chapter 11 bankruptcy case – than if the proceeding was taking place outside of the debtor's COMI. Thus, the COMI concept – a framework that is used in different legal systems throughout the world – is a very important distinction in each bankruptcy case. This was certainly true in the recent Southern District of New York bankruptcy case of *In re Sunac China Holdings Ltd.,* 656 B.R. 715 (Bankr. S.D.N.Y. 2024).

Sunac was a company that – through subsidiaries – was one of the largest property development businesses in the People's Republic of China ("PRC"). However, Sunac was incorporated in the Cayman Islands and was listed on the Hong Kong stock exchange. Given these attributes, the court conducted a detailed

review of whether Sunac's creditor and court-approved Hong Kong restructuring – a "scheme of arrangement" – was filed in Sunac's COMI.

In its analysis, the bankruptcy court first dispensed with the notion that Sunac's COMI was in the Cayman Islands. Although the Bankruptcy Code establishes a presumption that the location of a debtor's registered office is its center of main interests, the court found this presumption rebutted by the fact that the company had no other connection to the Cayman Islands: it conducted no business there, had no assets or creditors there and, perhaps most importantly, chose not to restructure there.

The court then analyzed whether the PRC was Sunac's COMI. The court explained that most of the company's executives, almost all of its senior management, and most of its board of directors were based in the PRC. Likewise, Sunac's most valuable assets – receivables totaling more than $11 billion – were located in the PRC. However, the court declined to rely on a "mechanical tallying up" of these factors. Rather, it found "little question" that Hong Kong was "the primary place where [Sunac] carried out its business activities." Among other things, the court highlighted that (a) the debtor's restructuring activities were led by its CFO in Hong Kong, (b) board approval of the restructuring took place virtually or in Hong Kong, (c) prior to its restructuring, Sunac primarily raised capital in Hong Kong, was listed on the Hong Kong stock exchange and was subject to oversight by the Hong Kong Securities and Futures Commission and (d) both creditor expectations and creditor support for Sunac's Hong Kong scheme lent support to the determination that Hong Kong was the company's COMI.

Takeaways. While it was important to the bankruptcy court that the Second Circuit's baseline COMI principle held true (that is, that "COMI lies where the debtor conducts its regular business"), the bankruptcy court also observed that deference to the forum chosen by the debtor and supported by its creditors is entitled to "significant weight." Thus, creditors who might dispute COMI choice must be proactive, and certainly cannot idly await a bankruptcy court's *sua sponte* review of COMI and expect a favorable outcome. Additionally, as several footnotes in the decision suggest that Sunac could have effectively shifted its COMI to the Cayman Islands by seeking to restructure its debts there rather than in Hong Kong, the decision could also be read as a roadmap for debtors seeking to restructure in favorable jurisdictions where creditor opposition is not an issue.

THE THIRD CIRCUIT APPLIES COMITY WITHOUT A CHAPTER 15 FILING

Comity is the principle that courts of one jurisdiction should recognize and give effect to judicial decrees and decisions of another jurisdiction, subject to certain safeguards. In such situations, a court should ask whether it should decline to exercise jurisdiction over matters more appropriately adjudicated elsewhere. In connection with foreign insolvency cases, a number of courts have found that the sole method by which a foreign debtor can obtain comity in the US is through a Chapter 15 filing. However, in a recent case the Third Circuit explained that comity may be extended to a foreign insolvency proceeding where no Chapter 15 case had been filed, suggesting that Chapter 15 is not the sole method by which a foreign debtor can obtain comity in the US.

In 2020, Wayne Burt PTE, Ltd. (“Wayne Burt”), a Singaporean corporation with its principal place of business in Singapore, was sued in district court in New Jersey for allegedly defaulting on a loan agreement. At the time, Wayne Burt was in liquidation proceedings in Singapore. Once Wayne Burt’s liquidators were made aware of the New Jersey lawsuit, they did not seek Chapter 15 recognition, even though Chapter 15 may have allowed them to stay the litigation. Instead, the liquidators sought to dismiss the lawsuit in deference to the Singaporean proceedings on grounds of "international comity." Reviewing case law from prior to the enactment of Chapter 15 in 2005, the district court decided to defer to the Singapore proceeding and dismissed the New Jersey lawsuit.

On appeal, the Third Circuit wrote in *Vertiv, Inc. v. Wayne Burt PTE, Ltd.*, 92 F.4th 169 (3d Cir. 2024) to "clarify the standard" and "provide additional direction to courts" in determining whether to abstain from adjudicating cases in deference to foreign insolvency proceedings. Relying primarily on comity principles set forth by the Third Circuit in a pre-Chapter 15 case, the court outlined a non-exhaustive list of factors for courts to consider, including whether the US and foreign proceedings are "parallel." Although the court ultimately vacated the dismissal of the New Jersey lawsuit to permit the district court to analyze the relevant factors in the first instance, the opinion clearly sets forth a path for the liquidators to secure dismissal of the New Jersey lawsuit in deference to the Singaporean liquidation.

In summary, although a quick reading of the Third Circuit’s decision would suggest that the Third Circuit has determined that Chapter 15 is not the exclusive method by which appropriate parties in foreign insolvency proceedings should seek US recognition, the Third Circuit never addressed the liquidators’ failure to commence a Chapter 15 case for Wayne Burt, nor did the Third Circuit mention the many decisions that refused to grant assistance to a foreign representative who did not first obtain relief under Chapter 15. Additionally, the Circuit judges failed to cite to the legislative history that indicates that Chapter 15 was "intended to be the exclusive door to ancillary assistance to foreign proceedings." Of note, there are also decisions that find that Chapter 15 is not the exclusive method to seek recognition in this situation, but those were not relied upon by the Circuit in its decision.

Takeaways. Faced with a foreign debtor that seeks recognition of a foreign insolvency proceeding without a Chapter 15, judges in the Third Circuit (which includes Delaware and New Jersey) will point to the Third Circuit’s ruling in *Wayne Burt* to conclude that a Chapter 15 filing is not necessary. However, while courts of appeals decisions are often considered carefully by all courts outside of that circuit, it is not clear that this ruling should persuade other courts because the Third Circuit did not address the fundamental issue of whether Chapter 15 is the exclusive remedy for foreign debtors in insolvency cases. As a result, foreign representatives who seek recognition of a foreign proceeding outside of the Third Circuit – including, for example, in the Second Circuit (which includes New York) or the Fifth Circuit (which includes Texas) – should not rely on the reasoning of *Wayne Burt* and should instead continue to consider seeking protection under Chapter 15 of the Bankruptcy Code.

CONTACTS

Douglas Deutsch
Partner

T +1 212 878 4935
E douglas.deutsch
@cliffordchance.com

Maja Zerjal Fink
Partner

T +1 212 878 3188
E maja.zerjalfink
@cliffordchance.com

Brian Lohan
Partner

T +1 212 878 3187
E brian.lohan
@cliffordchance.com

Michelle McGreal
Partner

T +1 212 878 8378
E michelle.mcgreal
@cliffordchance.com

Sarah Campbell
Counsel

T +1 212 878 3427
E sarah.campbell
@cliffordchance.com

Robert Johnson
Associate

T +1 212 878 8004
E robert.johnson
@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Delhi • Dubai • Düsseldorf • Frankfurt • Hong Kong • Houston • Istanbul • London • Luxembourg • Madrid • Milan • Munich • Newcastle • New York • Paris • Perth • Prague • Riyadh* • Rome • São Paulo • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

*AS&H Clifford Chance, a joint venture entered into by Clifford Chance LLP.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.