

Client Alert

Insolvency & Restructuring



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Foreign Bankruptcies Gaining Significant Recognition in the United States

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by Nadine J. Youssef

On October 17, 2005, The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") took effect. Among other changes, the Act includes a comprehensive change to the provisions in the U.S. Bankruptcy Code (the "Code") concerning international insolvencies. This Client Alert briefly outlines those changes.

Ancillary Petitions in General

Under the Code and the Act, a foreign representative appointed in a foreign bankruptcy proceeding may file a case in the U.S. ancillary to the foreign proceeding by filing an ancillary bankruptcy petition in the U.S. to administer the foreign debtor's assets located in the U.S.

Under the Code, U.S. bankruptcy courts increasingly recognized the authority of foreign bankruptcy courts to administer the foreign debtor's assets within the U.S. and to enjoin creditors in the U.S. from commencing or continuing legal action against foreign debtors in the U.S. This is no doubt the result of the increase in the number of cross-border insolvencies in recent years. The Act merely codifies this shift towards international recognition of cross-border insolvencies. In fact, the stated statutory purpose for the provisions in the Act addressing international insolvencies is to incorporate the Model Law on Cross-Border Insolvency so as to provide effective mechanisms for dealing with cases of cross-border insolvency with the following objectives: (1) increasing cooperation between U.S. courts and courts of foreign countries involved in cross-border insolvency cases, (2) greater legal certainty for trade and investment, (3) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, (4) protection and maximization of the value of the debtor's assets, and (5) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

Although it is not wholly clear from the language of the Act, it is generally believed that ancillary proceedings filed in the U.S. after October 17, 2005 are governed by the Act, and ancillary proceedings filed in the U.S. before October 17, 2005 are governed by the Code.

Procedural Changes in Ancillary Proceedings

Under the Code and the Act, after a foreign representative files an ancillary bankruptcy petition, the bankruptcy court conducts a hearing to determine whether to grant the foreign debtor's petition if a creditor objects to such a petition.

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Under the Code, the foreign debtor obtains only the relief the foreign debtor requests as set forth in the ancillary petition. The foreign debtor obtains no relief from the bankruptcy court until the bankruptcy court grants the ancillary petition.

The Act contains some significant changes from the Code in this regard. First, the Act provides a foreign debtor with interim relief between the time of the filing of the ancillary petition and the time that the bankruptcy court conducts a hearing regarding whether or not recognize the petition. Under the Act, the bankruptcy court may, where relief is urgently needed to protect the assets of the foreign debtor or the interests of the creditors, accord temporary relief to the foreign debtor including the following: (1) staying execution against the debtor's assets; (2) entrusting the administration of the debtor's assets located in the U.S. to the foreign representative to protect the value of the assets; (3) suspending the right to transfer, encumber or otherwise dispose of the foreign debtor's assets; (4) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets or affairs; and (5) granting any additional relief that may be available to a bankruptcy trustee under the Act.

Second, in addition to the relief the foreign debtor obtains as requested in the foreign debtor's ancillary petition, the Act provides the foreign debtor with automatic forms of relief upon the granting of the ancillary petition. These automatic forms of relief include the following:

- ▶ Application of the automatic stay to the foreign debtor and the foreign debtor's property within the U.S.
- ▶ Operation of the debtor's business in the ordinary course of business.
- ▶ Avoidance of unauthorized post-petition transfers of property of the foreign debtor's estate in the U.S.

Note that the foregoing automatic forms of relief apply to foreign main proceedings only, i.e., proceedings pending in a country where the debtor has the center of its main interests.

- ▶ Any additional relief that may be available to a bankruptcy trustee under the Code with the exception of the authority to pursue avoidance actions, including preference actions and fraudulent conveyance actions, by the foreign representative.
- ▶ Intervention by the foreign representative in any proceedings in a State or Federal court of the U.S. in which the foreign debtor is a party.

In determining whether to grant the ancillary relief requested by the foreign debtor, the statutory considerations have remained essentially the same:

- ▶ Just treatment of all holders of claims against or interests in the foreign debtor's property;
- ▶ Protection of claim holders in the U.S. against prejudice and inconvenience in the processing of claims in the foreign proceeding;
- ▶ Prevention of preferential or fraudulent dispositions of the foreign debtor's property;



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Vol. 1300, No. 1306

Client Alert

- ▶ Distribution of proceeds of the foreign debtor's property substantially in accordance with the order prescribed by the Bankruptcy Code; and
- ▶ If appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

Changes in Scope of Ancillary Relief

The Code provides for the following primary forms of ancillary relief if requested by the foreign debtor:

- ▶ Enjoinment of the commencement or continuation of any action against the foreign debtor or the foreign debtor's property with respect to property involved in the foreign proceeding;
- ▶ Enjoinment of the commencement or continuation of the enforcement of any judgment against the foreign debtor with respect to property involved in the foreign proceeding;
- ▶ Enjoinment of any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the foreign debtor's property belonging to the foreign debtor's estate;
- ▶ Turnover of property of the foreign debtor's estate, or the proceeds of such property to the foreign representative; and
- ▶ Other appropriate relief.

The Act essentially provides for the same forms of relief as the Code in addition to the following:

- ▶ Provision for the examination of witnesses, the taking of evidence or the delivery of information concerning the foreign debtor's assets, affairs, rights, obligations or liabilities; and
- ▶ Entrustment of the administration or realization of all or part of the foreign debtor's assets within the U.S. to the foreign representative or any other person authorized by the bankruptcy court.

In addition to the foregoing, the Act contains significant new provisions to increase communication and cooperation between U.S. courts and foreign bankruptcy courts. The Act provides as follows:

- ▶ The U.S. bankruptcy court in which the foreign debtor files its ancillary petition shall cooperate to the "maximum extent possible" with a foreign court or a foreign representative.
- ▶ The U.S. bankruptcy court is entitled to communicate directly with, or to request information or assistance directly from, a foreign court or a foreign representative, subject to the rights of a party in interest to notice and participation.
- ▶ The trustee or any other person appointed by the U.S. bankruptcy court shall cooperate to the "maximum extent possible" with a foreign court or a foreign representative.



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Vol. 1300, No. 1306

Client Alert

- ▶ The trustee or any other person appointed by the U.S. bankruptcy court is entitled to communicate directly with a foreign court or a foreign representative.
- ▶ The means of cooperation available to the U.S. bankruptcy court or a person appointed by such court include the following: (1) appointment of a person or body to act at the direction of the court; (2) communication of information by any means deemed appropriate by the court; (3) coordination of the administration and supervision of the debtor's assets and affairs; (4) approval or implementation of agreements regarding the coordination of proceedings between the U.S. bankruptcy court and the foreign court; and (5) coordination of concurrent proceedings regarding the same debtor.

This Client Alert is a summary of the provisions in the Act and the Code affecting ancillary proceedings only. Please contact us if you would like any additional information regarding the Act.

Los Angeles +1.213.488.7100

William B. Freeman [\(bio\)](#)
william.freeman@pillsburylaw.com

Nadine J. Youssef [\(bio\)](#)
nadine.youssef@pillsburylaw.com

Orange County +1.714.436.6800

Craig A. Barbarosh [\(bio\)](#)
craig.barbarosh@pillsburylaw.com

San Francisco +1.415.983.1000

Philip S. Warden [\(bio\)](#)
philip.warden@pillsburylaw.com

M. David Minnick [\(bio\)](#)
david.minnick@pillsburylaw.com

New York +1.212.858.1000

Karen B. Dine [\(bio\)](#)
karen.dine@pillsburylaw.com



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