

Presentation of

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**Cross-Border Insolvency:  
Chapter 15 as a Sword and a Shield; Madoff and Fairfield  
Sentry; UNCITRAL Model Laws on the Horizon**

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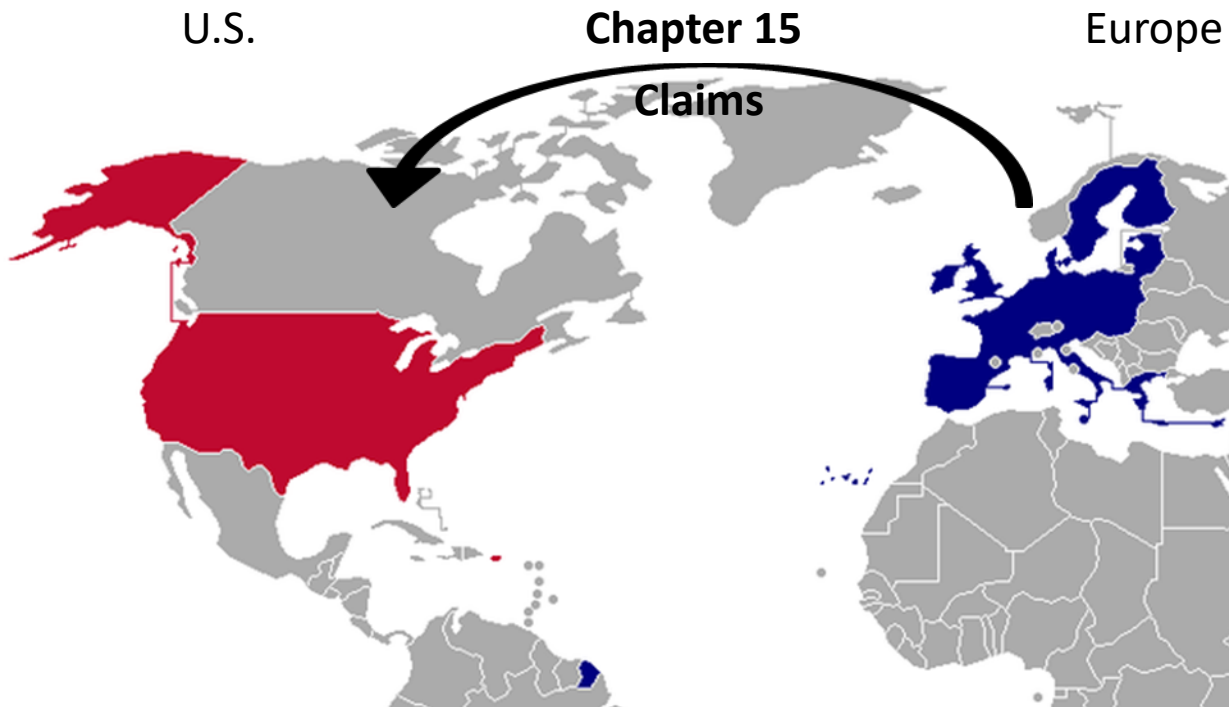
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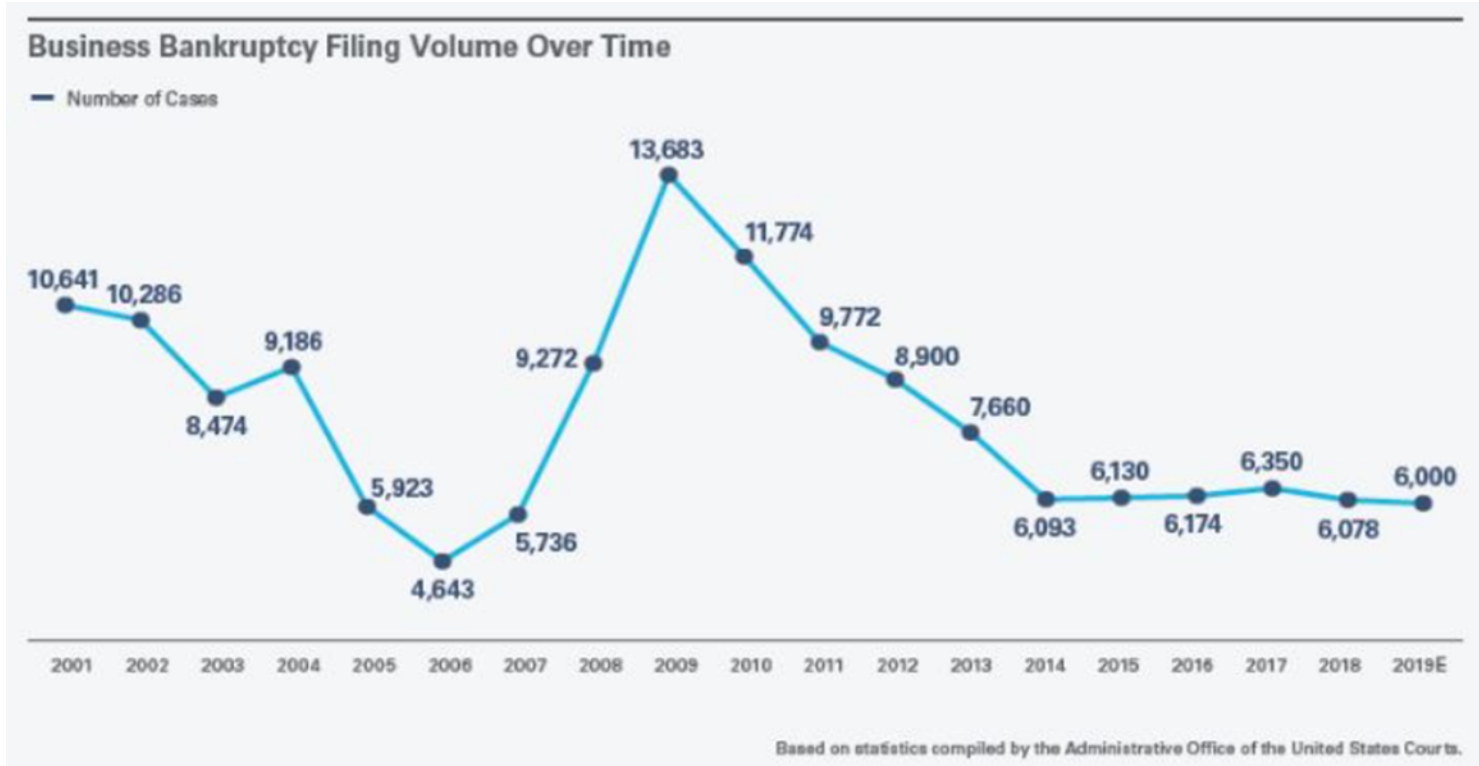
# Chapter 11

# Affiliates of U.S. Companies



Claims  
Judgments

# I. Global Insolvency Trends



- Business Chapter 11 filings have been flat since 2014



- Large public company Chapter filings increased by about 45% between 2018 and 2019.



### Real GDP: Percent change from preceding quarter

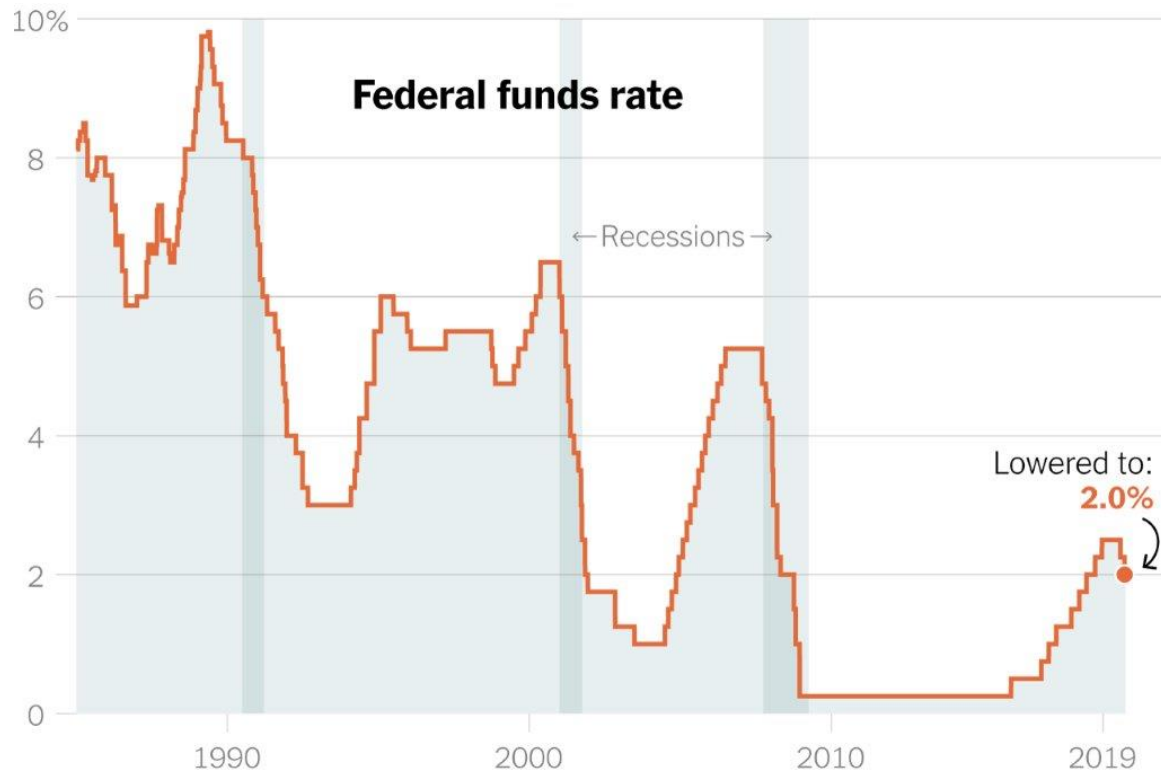


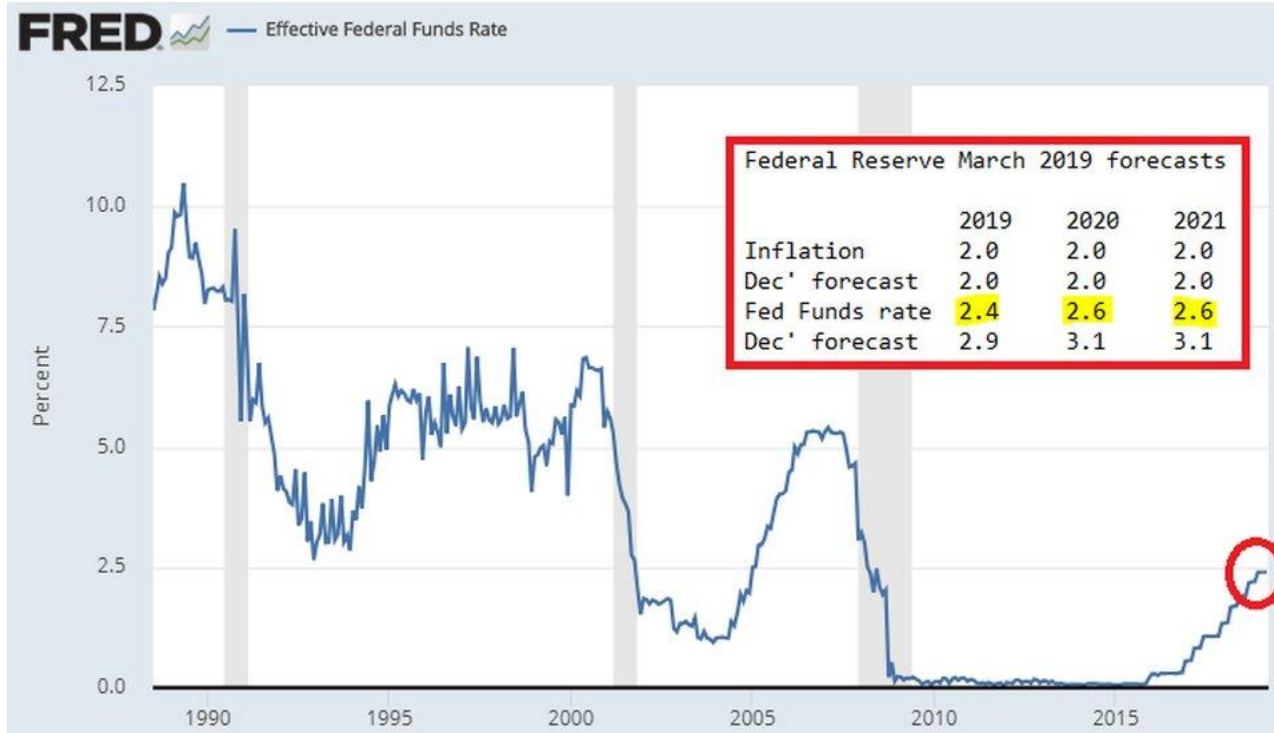
U.S. Bureau of Economic Analysis

Seasonally adjusted at annual rates

- U.S. economic growth slowed to 2.1% in Q3 2019.
- Trade wars between the U.S. and China, Brexit and fluctuating energy prices.

## Federal Funds Rate (FFR)

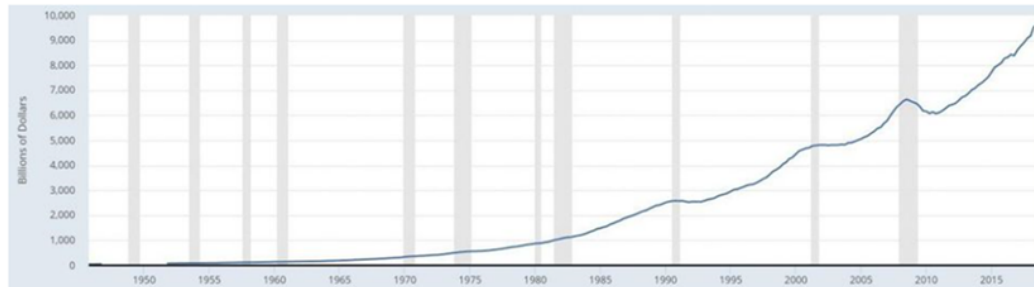




- As of January 1, 2019, FFR was 2.5%
- FFR lowered to 1.75% in October, 2019.
- Currently, FFR is 1.75%.

## Corporate Debt GDP Ratio

U.S. nonfinancial corporate debt of large companies now stands at about \$10 trillion dollars, 48% of GDP. This represents a rise of 52% from its last peak the third quarter of 2008, when corporate debt was at \$6.6 trillion, about 44% of 2008 GDP.



Nonfinancial corporate business; debt securities and loans: liability FRED ST. LOUIS  
FEDERAL RESERVE

- Large U.S. companies owed \$10 trillion in corporate debt, 47% of U.S. GDP.
- This is a 52% rise from its last peak in 2008, at \$6.6 trillion.
- \$5 trillion or 50% of corporate will come due in 5 years.
- Highly leveraged conditions.
- Loan covenant quality is weak, with a rating of 3.9 out of 5 (1 means covenants are strong/5 means covenants are extremely weak, in borrowers' favor).

## II. Chapter 15: A Sword and a Shield

### A. Chapter 15 Background



1. UNCITRAL (United Nations Commission on International Trade Law) Model Law on Cross-Border Insolvency – adopted May 30, 1997
2. U.S.'s version of the Model Law is Chapter 15

3. Chapter 15 adopted into the Bankruptcy Code in 2005. Currently 46 countries have adopted the Model Law.

4. UNCITRAL's goal:

“modernize and harmonize the rules on international business and to enhance predictability in cross-border commercial transactions.”

5. Chapter 15 Key Concepts

- Ancillary Proceeding

- Dually proceeding with a plenary, foreign insolvency proceeding
  
- Comity
  - Respect and recognize a Voluntary Proceeding in another country
  
  - Provide assistance in U.S. Courts in support of the debtor's foreign proceeding
  
- COMI (Center of Main Interests)

## COMI: Why is it Important?

- COMI is a key procedural requirement of a Chapter 15 petition
- If the COMI of the foreign debtor is where the foreign proceeding is pending, **application of the automatic stay is automatic**
- It's game over for claims against the foreign debtor or its assets in the U.S. if the automatic stay applies
- Because the location of COMI is subject to interpretation, where COMI is has been the source of much litigation
- Effectively, attacking COMI is creditor strategy to avoid the injunction of the automatic stay



## B. Chapter 15 as a Sword for the Foreign Debtor

### 1. File claims against U.S. companies

a) Avoidance actions

b) Preferences/fraudulent conveyances under the  
Bankruptcy Code

c) Avoidance actions under foreign law

- Condor Insurance

d) Avoidance actions under U.S. state law:

- Uniform Fraudulent Transfer Act
- Uniform Voidable Transactions Act

2. Obtain Discovery from U.S. companies

3. Enforce Orders and Judgments rendered “the foreign proceeding”
  - Vitro Glass (Mexico)
4. Terminate contracts
  - Qimonda AG exception

## C. Chapter 15 as a Shield

### 1. Automatic Stay

- Mahabis example

### 2. Chapter 11 Worldwide Automatic Stay

- Yukos Oil (SDNY)
- Dean Foods (Houston)

## III. Chapter 11's Extraterritorial Reach: Avoidance Actions and Automatic Stay without Borders

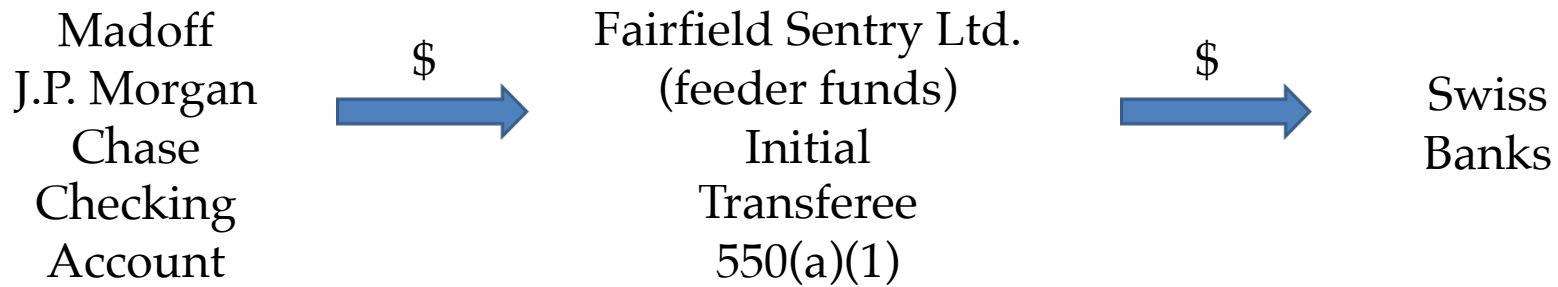
### A. Madoff Investment Securities, LLC ("Madoff") – Chapter 11 Fairfield Sentry Ltd. – Chapter 15 (Madoff feeder fraud)

#### 1. Madoff Ponzi Scheme

- Solicited investors to buy into investment funds that would generate well above market returns
- Commingled investors' funds into a JP Morgan Chase checking account

- When investors sought to withdraw funds, Madoff used the JP Morgan Chase checking account “robbing Peter to pay Paul”
  - The scheme worked until 2008 when the markets collapsed after the Lehman Bros. Chapter 11 filing in September 2008
2. Madoff filed Chapter 11 on December 15, 2008

# Madoff Ponzi Scheme



3. Chapter 11 Trustee sought to avoid payments made to investors as “**fraudulent conveyances**” under Section 548(a)(1)(A) of the Bankruptcy Code
  
4. 88 of the lawsuits involved
  - Initial transfers to the feeder funds, which were foreign entities, and
  
  - Subsequent transfers from the feeder funds to investors, all of whom were foreign entities



## 5. Bankruptcy Code Fraudulent Conveyance Provisions:

- Section 548(a)(1)(A):

The trustee may avoid any transfer ... of an interest of the debtor in property, or any obligation ... incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily ... made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted ...

- Section 550(a):

Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from ... (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or ... (2) any immediate or mediate transferee of such initial transferee.

6. Madoff Trustee asserted claims against:

- “initial transferees”

and

- “subsequent transferees”

all of whom were foreign entities.

7. The Bankruptcy Court dismissed the claims against the foreign “subsequent transferees”.
  - International comity
  - Presumption against extraterritoriality of U.S. laws
8. February 25, 2019, the 2<sup>nd</sup> Circuit Court of Appeals reversed.

a) Court “unpacked” Sections 548 and 550.

Step 1 – avoid the transfer

Step 2 – recover from

“initial transferee”

and

“subsequent transferee”

- b) Presumption against extraterritorial application of U.S. laws:
- No extraterritorial application absent clear Congressional intent otherwise.
  - No question Congress intended initial transfer to be covered, regardless of location or nationality of defendant.
  - The initial transfer was the operative transfer that depleted the estate.

- Unless the subsequent transfer is also covered, the ability to recover the initial transfer is a nullity.

Any other outcome would “open a loophole” to allow parties to “recovery-proof” transfer by a two-step transfer using foreign entities.

c) International Comity

- Interests of the U.S., the interest of the foreign state, and the mutual interests of the family of nations.

- U.S.'s clear interest to recover funds for the benefit of the estates.
- No existing foreign parallel proceedings regarding the Madoff transfers.

## 9. Appealed the U.S. Supreme Court



# III. Chapter 11's Extraterritorial Reach: Avoidance Actions and Automatic Stay without Borders (continued)

## B. Export of Chapter 11 Avoidance Actions

### 1. Advance Watch Company, Ltd.

- Default judgments on preference claims valid and enforceable against Hong Kong companies with no assets or presence in the U.S.
- Trustee filed adversary proceedings against two Hong Kong companies

- Proper service of process – Rule 4(f) of the Federal Rules of Civil Procedure.

Rule 4(f) requires compliance with the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters (1965).

The Hague Service Convention requires service that complies with the laws of Hong Kong.

- Hong Kong companies ignored the complaints.
- Trustee filed motions for default judgments.

The Hague Service Convention is only applicable to service of the summons and complaint, not subsequent pleadings.

Per FRCP 5(b)(2)(c), Trustee mailed the motions to the defendants' last known addresses.

- Defendants did not respond.

Bankruptcy Court entered default judgments.<sup>1</sup>

- Exporting U.S. judgments abroad.
  - The U.S. is not a party to any bilateral or multilateral treaty on the reciprocal enforcement of judgments.

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<sup>1</sup>Note Hong Kong Blues by Hoagy Carmichael, covered by George Harrison on Somewhere in England.

- Foreign countries often view U.S. money judgments as excessive.

Foreign countries bristle at the extraterritorial exercise of jurisdiction by U.S. courts.

- International Comity
- Is the foreign entity insulated as a practical matter?

2. Heritage Home Group Furniture Chapter 11 Cases.  
(Broyhill, Lane, Thomasville, Drexel Heritage)
  - Vietnamese suppliers
3. These issues apply to foreign affiliates of U.S. companies.

## III. Chapter 11's Extraterritorial Reach: Avoidance Actions and Automatic Stay without Borders (continued)

### C. Export of U.S. Automatic Stay Against Foreign Entities

#### 1. Chapter 11 First Day Motions.

- Generally
- Motion to Confirm the Application of the Statutory Protections of the Bankruptcy Code

- Dean Foods Company Chapter 11 (Houston)
- Section 362 Automatic Stay

Stay applicable to all persons (and all those acting for or on their behalf) and all foreign or domestic Governmental Units, including sheriffs, marshals, constables, etc.



- Section 365 Executory Contracts

Notwithstanding any provision in an executory contract or any applicable law, an executory contract may not be terminated or modified.

- Vendors' rights under Uniform Commercial Code 2-609 and 2-702?

What about foreign vendors' rights under foreign law?

- Objection to Motion

Notwithstanding anything to the contrary in this Order, nothing in this Order expands, enlarges or limits the substantive rights of any party.

- Vendors' rights under Uniform Commercial Code 2-609 and 2-702?

What about foreign vendors' rights under foreign law?

## IV. UNCITRAL Model Laws on the Horizon

- A. UNCITRAL Model Law on Recognition and Enforcement of Insolvency
  - 1. Adopted July, 2018
  - 2. Legal background
    - Rubin v. Eurofinance SA (UK Supreme Court)

U.S. Bankruptcy Court Default Judgment for fraudulent conveyance NOT enforceable in the U.K., under English common law or UK's Foreign Judgments (Reciprocal Enforcement) Act 1933.

Defendants did not submit to jurisdiction of U.S. courts.

A departure from the “universalism” trend in favor of territorialism.

- Vitro S.A.B. de CV

U.S. 5<sup>th</sup> Circuit Court of Appeals denied enforcement of a 3<sup>rd</sup> party release provision in Vitro's reorganization plan (concurso) approved by a Mexican court.

Vitro's affiliates released from guarantees of Vitro's obligations to U.S. bondholders.

Violates public policy and 5<sup>th</sup> Circuit prohibits non-consensual 3<sup>rd</sup> party releases.

### 3. Insolvency – related judgments (IRJ) regarding:

- Sales of assets
- Avoidance recoveries
- Plan confirmation orders
- Director liability

#### 4. Procedure for Recognition of IRG

- Application
- Certified Copy of IRJ
- Order for Recognition

- Grounds for refusal to recognize IRJ
  - Defendant did not receive notice
  - IRJ obtained by fraud
  - IRJ inconsistent with a judgment in receiving country involving the same parties
  - Originating court lack of jurisdiction
  - Public policy violation



## IV. UNCITRAL Model Laws on the Horizon (continued)

- B. UNCITRAL Model Law for Enterprise Group Insolvency  
(the EGI Model Law)
  - 1. Compliment the Model Law on Cross-Border Insolvency
  - 2. EGI Model focuses on multiple insolvency proceedings involving multiple debtors in the same enterprise group.

### 3. Key Concepts

- Group insolvency solution
- Foreign planning proceeding
- Representative for the member group of companies oversees the formulation and implementation of an insolvency plan

- Potential relief includes:
  - Injunctive relief to preserve assets
  - Discovery
  - financing

Thank you for your attendance.

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