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In the Gabay Chapter 15 Case, Attempt to Limit Foreign Representatives' Business Judgment in Section 363 Sale Fails

Maja Zerjal Fink, Partner, Clifford Chance, and Marjorie Carter, Associate, Arnold & Porter, New York, US¹

Synopsis

What is the process for the sale of assets in chapter 15 cases and what is the standard of approval? Much like in chapter 7 or chapter 11 cases, section 363 of the United States Bankruptcy Code (the 'Bankruptcy Code') applies – automatically upon recognition of a foreign main proceeding and upon further request for relief in foreign non-main proceedings. The standard of review is the deferential business judgment.

In *In re Isak Henry Gabay*, the limits of a foreign representatives' business judgment in a section 363 sale were tested. There, the debtor (an individual) attempted to curb the foreign representatives' discretion by imposing a deadline for the foreign representatives' sale of the debtor's assets in the U.S. The court denied the debtor's request, finding no convincing reason to question the foreign representatives' business judgment.

The use of section 363 in chapter 15 cases

Section 363(b) of the Bankruptcy Code provides for the use, sale or lease of property of the debtor's estate outside the ordinary course of business² upon notice, a hearing, and court approval.³ Pursuant to section 1520(a)(2) of the Bankruptcy Code, section 363 also applies in a chapter 15 case upon the recognition of a foreign main proceeding with respect '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 it would apply to property of an estate under the Bankruptcy Code.⁴ In the case of a foreign non-main proceeding, section 363 does not apply automatically, but can apply upon further request of the foreign representative pursuant to section 1521 of the Bankruptcy Code, which provides a mechanism to request additional relief necessary to effectuate the purpose of chapter 15 and protect the assets of the debtor or the interests of creditors.⁵

Section 363 is a useful tool for foreign representatives in a chapter 15 case to maximise value for creditors and has been used, for example, to obtain DIP financing,⁶

Notes

- 1 The views expressed herein are solely those of the authors and not necessarily the views of Arnold & Porter Kaye Scholer LLP or any of its attorneys.
- 2 What does 'ordinary course of business' mean? In *In re Ace Track Co., Ltd.*, 556 B.R. 887 (Bankr. N.D. Ill. 2016), the court considered the meaning of 'ordinary course' transactions and specifically whether section 1520 or section 363 permitted the debtor or the foreign representative to settle an arbitration or assign receivables without court approval. The court answered no because a settlement and/or assignment does not fall under 'ordinary course' under the 'vertical dimensions' test (also known as the 'reasonable expectations test'). Under this test, courts look at the prepetition conduct to determine creditors' expectations as well as the 'changing circumstances that are inherent in a debtor's efforts to operate its business under [title 11].' *In re Ace Track Co., Ltd.*, 556 B.R. at 916 (quoting *Martino v. First Nat'l Bank of Harvey (In re Garofalo's Finer Foods, Inc.)*, 186 B.R. 414, 425 (N.D.Ill.1995)). The court reasoned that, 'there is no question that the disposition of litigation that, in part, caused the chapter 15 filing and with it a major asset upon which both venue and jurisdiction of the chapter 15 case was predicated is something creditors would reasonably expect to come to the court given the pendency of the chapter 15 case.' See, e.g., *Shields v. Duggan (In re Dartco, Inc.)*, 197 B.R. 860, 870 (Bankr. D. Minn. 1996) (finding the vertical dimensions test is not satisfied where transactions were entered into in order to satisfy claims against the debtor).
- 3 11 U.S.C. § 363(b).
- 4 11 U.S.C. § 1520 ('Upon recognition of a foreign proceeding that is a foreign main proceeding 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.').
- 5 11 U.S.C. § 1521.
- 6 *In re Elpida Memory, Inc.*, Case No. 12-10947, Foreign Representative's Motion for Approval of Security Agreements in Connection with Obtaining Postpetition Financing, ECF No. 143; *In re Elpida Memory, Inc.*, Case No. 12-10947, Order Approving Security Agreements In Connection With Obtaining DIP Financing, ECF No. 250 (requesting the court approve the security agreement under 363(b)(1) and 1520(a)(2)).

secure the sale of limited partnership interests,⁷ transfer licensing agreements,⁸ and seek assignment of claims.⁹

Approval of a section 363 sale in a chapter 15 case mirrors the same standards required in a section 363 sale in either a chapter 7 or chapter 11 case. The foreign representative is required to 'prove by a preponderance of the evidence that the transactions pertaining to assets located in the United States are a sound exercise of the business judgment.'¹⁰ Courts generally use a four-part test to determine whether the sale is a sound exercise of business judgment. To satisfy this standard, the foreign representative must show:

- (1) a sound business purpose for the sale;
- (2) the proposed sale price is fair;
- (3) the foreign representative provided adequate and reasonable notice; and
- (4) the buyer has acted in good faith.¹¹

Additionally, in section 363 sales generally, a court should consider other relevant factors to guide its analysis, such as the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganisation will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganisation, the proceeds to be obtained from the disposition, and whether the value of the assets has changed.¹²

The foreign representative's evidentiary burden to demonstrate its sound exercise of business judgment is relatively light.¹³ Once the foreign representative establishes the existence of sound business judgment, the burden shifts to the objecting party. The objecting

party is then required to produce evidence supporting its objections.¹⁴

The following cases illustrate the use of section 363 in chapter 15 cases. In *In re Elpida Memory, Inc.*, the foreign representatives in a chapter 15 case sought the court's approval of the sale of certain patents and licensing agreements previously approved by the foreign court. The foreign representatives argued the court should approve the sales out of deference to the foreign court pursuant to principles of comity. In an opinion laying out the applicable standard of review concerning the transactions, the court stated principles of comity were inapplicable here. The court explained that section 1520 is mandatory and nothing in the Bankruptcy Code, including the two provisions mentioning comity, provide the court with the authorisation to amend its application of section 1520 in a way that would render section 363 inapplicable.¹⁵

Using the guidance provided by the court, the steering committee of the ad hoc group of bondholders (the 'Steering Committee') objected to the sale on the basis that the foreign representatives had not exercised sound business judgment. Specifically, the Steering Committee took issue with the fact that the sale occurred privately without an auction, and further asserted that the assets were not adequately marketed, the sale price was not calculated based on an expert's evaluation, did not correlate with the actual value of the patents, and was reached based on intuition rather than market data or analysis. Finally, the Steering Committee argued the sale of the patents and the licensing agreements significantly lowered the value of the debtor company. The court found that the foreign representatives demonstrated sound business judgment and approved the

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- 7 *In re Grand Prix Assocs. Inc.*, No. 09-16545, 2009 WL 1850966 (Bankr. D.N.J. June 26, 2009) (requesting the court approve the sale of limited partnership interests under 363(b)(1), 11 U.S.C. § 1107, and 363(f)).
- 8 *In re Elpida Memory, Inc.*, Case No. 12-10947, Foreign Representative's Motion to Approve Sale of Certain Patents, ECF No. 163 (requesting the court approve the sale of certain patents under 363(b)(1) and 1520(a)(2)).
- 9 *In re Fairfield Sentry Ltd.*, 768 F.3d 239 (2d Cir. 2014) (requesting the court approve the assignment of claims under 363(b) and 1520(a)(2)).
- 10 *In re Elpida Memory, Inc.*, No. 12-10947 CSS, 2012 WL 6090194, at *9 (Bankr. D. Del. Nov. 20, 2012); see also *In re Fairfield Sentry Ltd.*, 768 F.3d 239, 246 (2d Cir. 2014) ('We have held that 'a judge determining a § 363(b) application [is required to] expressly find from the evidence presented before him at the hearing a good business reason to grant such an application.');
- 11 *In re Elpida Memory, Inc.*, No. 12-10947 CSS, 2012 WL 6090194, at *5 (Bankr. D. Del. Nov. 20, 2012) ('A debtor may sell assets outside the ordinary course of business when it has demonstrated that the sale of such assets represents the sound exercise of business judgment.');
- 12 *In re Grand Prix Assocs. Inc.*, No. 09-16545 (DHS), 2009 WL 1850966, at *4 (Bankr. D.N.J. June 26, 2009) ('[S]ince the proposed transaction is outside the ordinary course, [the foreign representative] must also prove that there is a sound business justification for the transaction pursuant to the seminal case of *In re Lionel Corporation* allowing a bankruptcy court to make findings of fact as to the sale.');
- 13 *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir. 2007) (Chapter 11 case where the Second Circuit stated, 'The sale of an asset of the estate under § 363(b) is permissible if the judge determining [the] § 363(b) application expressly find[s] from the evidence presented before [him or her] at the hearing [that there is] a good business reason to grant such an application.');
- 14 *In re Elpida Memory, Inc.*, No. 12-10947, 2012 WL 6090194, at *5 (Bankr. D. Del. Nov. 20, 2012) (citing *In re Delaware & Hudson Railway Co.*, 124 B.R. 169, 176 (D. Del. 1991)).
- 15 *In re Fairfield Sentry Ltd.*, 768 F.3d 239, 246 (2d Cir. 2014) (citing *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983)).
- 16 *In re Elpida Memory, Inc.*, Case No. 12-10947, Findings of Fact and Conclusions of Law, ECF No. 359 (citing *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 800 (Bankr. D. Del. 2007) (The threshold for 'establishing that the [trustee or debtor] made a business judgment in good faith upon a reasonable basis' is a 'relatively light evidentiary burden.');
- 17 'An objectant [to a use, sale or lease of estate property] is required to produce some evidence supporting its objections.' *In re Elpida Memory, Inc.*, Case No. 12-10947, Findings of Fact and Conclusions of Law, ECF No. 359 (citing *In re Montgomery Ward Holding Corp.*, 242 B.R. 147, 155 (D. Del. 1999)).
- 18 *In re Elpida Memory, Inc.*, No. 12-10947 CSS, 2012 WL 6090194, at *7-8 (Bankr. D. Del. Nov. 20, 2012).

sale. The court held that the negotiations leading to the eventual sale price and terms were fair and reasonable based on the foreign representatives' experience with similar transactions in the industry and therefore, an exercise of sound business judgment.¹⁶

In *Fairfield Sentry*, the Second Circuit considered whether the bankruptcy court was required to review a prospective sale of the debtor's customer claim against a bankrupt securities broker-dealer under section 363. The Second Circuit responded in the affirmative.¹⁷ The Second Circuit first focused on whether the customer claim fell under the territorial jurisdiction of the United States, a point disputed by both parties. The Second Circuit found the customer claim qualified as a transfer of the debtor's property located within the United States for purposes of section 1520(a)(2) because the claim was deemed property subject to attachment or garnishment that may be properly seized or garnished by an action in a U.S. court.¹⁸ The Second Circuit next reviewed whether the foreign court, which had already approved of the sale, should be given deference under principles of comity. The Second Circuit noted deference to the foreign court was not appropriate because the language of section 1520(a)(2) requires the bankruptcy court to conduct a section 363 review when the debtor seeks a transfer of property located within the territorial jurisdiction of the United States.

On remand, the bankruptcy court refrained from approving the transaction as proposed because the claim's value had increased and therefore the transaction would not be an exercise of sound business judgment.¹⁹ The prospective purchaser of the claim appealed and claimed the issuance of a previous order entrusting the administration of the debtors' assets to the foreign representative under section 1521(a)(5)²⁰ voided the need for a review of the sale under section 363. The prospective buyer argued that under section 1521(a)(5), 'an entrustment order gives the foreign representative the unfettered ability to convert the debtor's non-cash assets into cash, including by selling them, even though the statute does not address the need (or lack thereof) to seek further approval for asset sales.'²¹ In its 2017 decision, the Second Circuit affirmed the bankruptcy and district courts' disapproval of the sale. The

Second Circuit found that when the foreign representative seeks approval of a sale of assets outside of the ordinary course of business, section 1520(a)(2) applies and thus requires a section 363 analysis. Whether the court exercises its discretion by issuing an entrustment order is irrelevant.

In *In re Isak Henry Gabay*, the application of section 363 in chapter 15 cases and its standard of approval – business judgment – are reconfirmed

Background

Isak Henry Gabay (the 'Debtor'), is a resident of the United Kingdom. He co-founded a global investment holding company, Duet Group Ltd., which was charged with engaging in a scheme allowing individuals to exploit an alleged flaw in the German tax code. The German authorities brought criminal charges against the Debtor for his involvement in the scheme. The Debtor subsequently failed to pay his creditors and was placed into bankruptcy in the United Kingdom. The court appointed three individuals as the joint trustees and entrusted them with investigating the Debtor's assets and liabilities. While exercising their duties as joint trustees, they discovered the Debtor owned an apartment in New York with valuable artwork. On 27 November 2023 the joint trustees, acting as the foreign representatives, commenced a chapter 15 case in the United States Bankruptcy Court for the Southern District of New York and sought recognition of the UK proceeding as a foreign main proceeding. The foreign representatives also requested the court grant all the relief afforded pursuant to section 1520, which includes the automatic application of section 363. In turn, the Debtor filed a limited objection. In the objection, the Debtor requested the court impose restrictions regarding the foreign representatives' ability to take discovery and clarify that the property to be sold did not include 'excluded assets' under UK law.²² Additionally, the Debtor requested an expeditious sale process to protect

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16 *In re Elpida Memory, Inc.*, Case No. 12-10947, Findings of Fact and Conclusions of Law, ECF No. 359 at 33.

17 *In re Fairfield Sentry Ltd.*, 768 F.3d 239 (2d Cir. 2014).

18 *Id.* at 244.

19 *In re Fairfield Sentry Ltd.*, No. 10-13164, 2016 WL 6892739, at *4 (Bankr. S.D.N.Y. Nov. 22, 2016).

20 11 U.S.C. § 1521(a)(5) ('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 – 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.').

21 *In re Fairfield Sentry Ltd.*, 690 F. App'x 761, 768 (2d Cir. 2017).

22 The Debtor cites section 306 of the Insolvency Act 1986, which states that certain property is excluded from the bankruptcy estate including tools, books, vehicles, clothing, furniture and 'household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankruptcy and his family.' See *In re Isak Henry Gabay*, Declaration of Frank Edwards John Brumby in Support of the Limited Objection of Isak Henry Gabay to the Motion for Order Granting Recognition of a foreign Main Proceeding Pursuant to Sections 1515 and 1517 of the Bankruptcy Code, ECF No. 20.

the interest of the Debtor and his creditors.²³ To that end, the Debtor sought modification to the recognition order imposing ‘reasonable constraints’ including requiring the foreign representatives to complete the sale of the Debtor’s assets within sixty days of entry of the recognition order.

Court decision

On 4 January 2024, the court held a recognition hearing and heard arguments regarding the Debtor’s objections. During the hearing, Debtor’s counsel pointed out that an offer for the New York property had been received and rejected by the Foreign Representatives and argued the need to proceed promptly under the circumstances.²⁴ Debtor’s counsel further argued certain assets should be withheld from the sale process. The

foreign representatives argued the requested sixty-day limit was arbitrary, explaining the original offer was rejected because it was below the property’s market value. Furthermore, the sale required additional lead time to market since it included unique artwork.²⁵

Judge Wiles ruled in favor of the foreign representatives. He commented that a request to set a deadline for a foreign representative to sell assets was ‘unusual’ and something he had never previously encountered.²⁶ Judge Wiles remained unconvinced that he should depart from the foreign representatives’ business judgment regarding the sale. On 19 January 2024, the court entered an order granting recognition of the foreign main proceeding and denying the Debtor’s limited objection.²⁷ The decision is timely confirmation that section 363 sales in chapter 15 and their business judgment standard are alive and well.

Notes

- 23 *In re Isak Henry Gabay*, Limited Objection of Foreign Debtor Isak Henry Gabay to the Motion for Order Granting Recognition of Foreign Main Proceeding Pursuant to Sections 1515 and 1517 of the Bankruptcy Code, ECF No. 19.
- 24 Transcript of Jan., 4, 2024 Recognition Hearing at 10-11, *In re Isak Henry Gabay* (At the hearing, the Debtor did not argue for the sale to occur within sixty days of the entry of the recognition order. However, Judge Wiles addressed the sixty-day time limitation that the Debtor requested in his objection.).
- 25 Transcript of Jan., 4, 2024 Recognition Hearing at 14-16, *In re Isak Henry Gabay*.
- 26 Transcript of Jan., 4, 2024 Recognition Hearing at 10 and 17, *In re Isak Henry Gabay*.
- 27 *In re Isak Henry Gabay*, Order Granting Recognition of Foreign Main Proceeding Pursuant to Section 1515 and 1517 of the Bankruptcy Code, ECF No. 25.

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