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Is Chapter 15 a Prerequisite to Obtaining Comity from a US Court with Respect to Foreign Insolvency Proceedings?

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Synopsis

US courts have a long tradition of granting comity and enforcing orders of foreign courts. With the enactment of US Bankruptcy Code section 304 in 1978, and Chapter 15 in 2005, representatives in foreign bankruptcy cases generally sought relief in US courts through section 304 and later Chapter 15. It remains an open question, however, whether commencing a chapter 15 case is a prerequisite to obtaining comity with respect to a foreign insolvency proceeding. Based on two recent decisions, the answer may be that it depends on the US court deciding the issue.

Comity in the insolvency context

Comity has been defined as 'the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws.'[2] Prior to 1978 and the enactment of US Bankruptcy Code section 304, comity was the sole standard by which a foreign insolvency proceeding could be recognised by a court in the US. Through comity, United States courts generally recognised orders of foreign courts so long as (a) the foreign court had jurisdiction over the relevant parties and (b) the proceeding comported with United States notions of due process.[3] Comity was important to advance the principle of 'universalism', which provides that the country with the greatest interest in a bankrupt debtor administers all the debtor's assets.[4] Conversely, 'territoriality' advances the idea that each country distributes the assets located inside its borders.

Although recognition of orders and judgments based on comity was generally favoured, results were not always consistent.[5] With the enactment of US Bankruptcy Code section 304, foreign representatives[6] were provided a statutory basis to protect assets located within the territorial jurisdiction of the US by commencing an ancillary proceeding in the US.[7] Section 304 was repealed in 2005 with the adoption of Chapter 15, which incorporated into the US Bankruptcy Code the Model Law on Cross-Border Insolvency. US Bankruptcy Code section 1509(b) provides that, upon recognition of a foreign proceeding, the foreign representative may apply directly to another US court for appropriate relief, which 'shall be accompanied by a

Notes

1 The views expressed are solely those of Mrs. Zerjal Fink and Mr. Barrett, and not necessarily the views of Arnold & Porter Kaye Scholer or any of its attorneys.

2 *Hilton v Guyot,* 159 U.S. 113, 163–64 (1895).

3 *See, e.g., In re Waite*, 99 N.Y. 433, 448 (1885); *Clarkson Co. v Shaheen*, 544 F.2d 624, 629–30 (2d Cir. 1976); *In re Culmer*, 25 B.R. 621, 629 (Bankr. S.D.N.Y. 1982) ('[F]oreign-based rights should be enforced unless the judicial enforcement of such a [right] would be the approval of a transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense.') (citing *Cornfeld v Investors Overseas Servs., Ltd.*, 471 F. Supp. 1255 (S.D.N.Y. 1979) quoting *Intercontinental Hotels Corp. v Golden*, 15 N.Y.2d 9, 13, 254 N.Y.S.2d 527, 529, 203 N.E.2d 210, 212 (1964)).

4 'Outside the United States, two doctrines for determining whether to recognize foreign bankruptcies have emerged: the universality doctrine and the territoriality doctrine. Under the universality doctrine, one main adjudication over all the debtor's assets is held in a country with great interest in the debtor or the property, for example, the debtor's domicile or principal place of business … Under a territorial system, by contrast, each country distributes the portion of the debtor's property that is within that county's jurisdiction.' Todd Kraft & Allison Aranson, *Transnational Bankruptcies: Section 304 and Beyond*, 1993 Colum. Bus. L. Rev. 329, 336–37 (1993) (internal citations omitted).

5 *Compare, e.g., In re Banque de Financement, S.A.*, No. 75-B-764 (Bankr. S.D.N.Y. 1976), *rev'd*, 568 F.2d 911 (2d Cir. 1977) (dismissed U.S. bankruptcy petition of foreign bank so that preferential attachments of U.S. creditors could be protected (*i.e.*, territoriality doctrine)), *with In re Israel-British Bank (London) Ltd.*, No. 74-B-1322 (Bankr. S.D.N.Y. 1978) (ordered transfer of assets in U.S. to English liquidators for the benefit of all creditors (*i.e.*, universality doctrine)).

6 A foreign representative is effectively the equivalent of a United States bankruptcy trustee in the foreign bankruptcy proceeding.

7 Section 304 'provide[d] for the first time a bankruptcy remedy, in addition to comity, for dealing with issues related to foreign insolvencies.' *Iida v Kitahara (In re Iida)*, 377 B.R. 243, 254 (B.A.P. 9th Cir. 2007) (internal citations omitted). The fundamental purpose of Section 304 was to 'provide a statutory mechanism through which United States courts may defer to and facilitate foreign insolvency proceedings.' *The Bank of New York v Treco (In re Treco)*, 240 F.3d 148, 156 (2d Cir. 2001).

certified copy of an order granting recognition' under chapter 15, and such US Court 'shall grant comity or cooperation.' This provision seemingly reflects the intention that chapter 15 be the exclusive way for foreign debtors to seek assistance in the US.

A New York court concludes the foreign automatic stay can be enforced in the US based on comity – without the need to commence a chapter 15 case

In February 2019, David Moyal sued German company Munsterland Gruppe GMBH & Co. KG ('MGKG') in New York County Supreme Court, seeking damages from MGKG for breach of a distribution agreement.[8] The case was then removed to the District Court for the Southern District of New York.[9] On March 12, 2020 the parties jointly sought a default with MGKG conceding liability because it lacked the financial resources to defend against the action and a judgment enforcement it anticipated Moyal would commence.[10]

On March 11, 2021, MGKG commenced an insolvency case under the German Insolvency Act.[11] Shortly thereafter, MGKG filed a motion to dismiss or stay the Moyal action. In the MTD, MGKG provided notice that it had commenced an insolvency case in Germany and indicated that German law mandated a stay of all existing litigation.[12] Moyal opposed MGKG's request, asserting, among other things, that it never received notice of the German insolvency case and that accordingly, the German insolvency case was not procedurally fair.[13]

On May 17, 2021, Judge Stewart D. Aaron issued an opinion dismissing Moyal's action. The Judge recognised two different doctrines of international comity: (i) a 'canon of construction [that] might shorten the reach of a statute'; and (ii) 'comity among courts, which is a discretionary act of deference by a national court to decline to exercise jurisdiction in a case properly adjudicated in a foreign state'.[14] Judge Aaron identified the relevant issue as one of comity among courts, or abstention comity, essentially 'whether a U.S. court should enforce a foreign bankruptcy court's order relating to the debtor's assets or the adjudication of a creditors' claims.'[15] Furthermore, Judge Aaron noted that foreign bankruptcy proceedings, in particular, are entitled to particular respect and deference so long as they are procedurally fair and 'do not contravene the laws or public policy of the United States'.[16]

Applying the doctrine of abstention comity to the facts of the Moyal action, Judge Aaron found that MGKG met its burden to prove that comity was appropriate because the German insolvency case was procedurally fair and did not contravene the laws or US public policy.[17] This finding was primarily based on the German policies of: (i) equal distribution of assets; (ii) the issuance of a stay; and (iii) equal treatment of creditors of different nationalities.[18]

The Court proceeded to summarily reject Moyal's objections to the MTD based on 'suspect' motives, lack of notice, and lack of authority.[19] Notably, Judge Aaron also expressly disregarded Moyal's suggestion that a chapter 15 case had to be commenced in order to seek a stay of the Action as 'absurd', and noted that '[C]ourts regularly rule that chapter 15 recognition is not a prerequisite to grant comity to foreign proceedings'.[20]

The ruling is consistent with prior decisions within the Second Circuit that granted comity to foreign bankruptcy orders and/or judgments despite the absence of a chapter 15. For example, in *Trikona Advisors Ltd. v Chugh*, 846 F.3d 22 (2d Cir. 2017), the United States Court of Appeals for the Second Circuit determined that the district court properly granted comity to findings of fact made in a Cayman Islands winding-up proceeding without requiring a chapter 15 case. In that case, plaintiffs sued defendants for alleged breaches of fiduciary duty, among other claims. In moving for summary judgment, defendants asserted that the court in the Cayman Islands made findings of fact in favour of the defendants. The Second Circuit dismissed the plaintiff's argument that chapter 15 preempted the district court's ability to give preclusive effect to a foreign court's findings, stating that 'Chapter 15 does not apply when a court in the United States simply gives

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8 *Moyal v Münsterland Gruppe GmbH & Co. KG*, No. 1:19-cv-04946 (SDA), 2021 U.S. Dist. LEXIS 93398, at *1 (S.D.N.Y. May 17, 2021).
9 *Id.*
10 *Id.* at *2.
11 *Id.* at *3.
12 *See Defendant's Notice of Bankruptcy Filing and Motion to Dismiss or Stay This Action*, No. 1:19-cv-04946 (S.D.N.Y. March 26, 2021) [Docket No. 99].
13 *See Plaintiff's Memorandum of Law in Opposition to Defendant's Notice of Bankruptcy Filing and Motion to Stay This Action*, No. 1:19-cv-04946 (S.D.N.Y. Apr. 21, 2021) [Docket No. 112].
14 *Moyal v Münsterland Gruppe GmbH & Co. KG*, No. 1:19-cv-04946 (SDA), 2021 U.S. Dist. LEXIS 93398, at *4-*5.
15 *Id.* at *5 (citing *In re SunEdison, Inc.*, 577 B.R. 120, 131 (Bankr. S.D.N.Y. 2017)).
16 *Id.* at *6 (internal citations omitted).
17 *Id.* at *7.
18 *Id.*
19 *Id.* at *8.
20 *Id.* at *8 n. 1 (citing 8 Collier on Bankruptcy ¶ 1509.02 (16th ed. 2021) ('[C]ourts regularly rule that chapter 15 recognition is not a prerequisite to grant comity to foreign proceedings on the request of a party other than a foreign representative.').

preclusive effect to factual findings from an otherwise unrelated foreign liquidation proceeding.'[21] Similarly, in *EMA Garp Fund v Banro Corp.*, 2019 U.S. Dist. LEXIS 27387 (S.D.N.Y. Feb. 21, 2019), a Canadian company commenced reorganisation proceedings under the Canada's Companies' Creditors Arrangement Act ('CCAA'). The company did not seek chapter 15 relief. Certain equity holders filed a complaint in the US district court, alleging false and misleading statements, as well as material omissions of fact, in communications from the company and its former CEO to shareholder. While plaintiffs conceded they were aware of the CCAA proceeding, they decided to commence the action instead of participating in the CCAA. The court granted the company's motion to dismiss based on comity, which included comity to releases granted to the defendants in the CCAA.[22]

A Texas court concludes recognition of a foreign proceeding is a prerequisite to obtaining comity from a US court with respect to foreign insolvency proceedings

Shortly after the *Moyal* decision was issued, the United States District Court for the Southern District of Texas reached the opposite conclusion.[23] There, a lawsuit was commenced as a result of an incident at the Houston Ship Channel. The defendants included a German ship, which was under the control of an insolvency administrator after its owner commenced insolvency proceedings in Germany. The foreign debtor filed a motion for summary judgment, arguing that all claims asserted against it should be dismissed because it had commenced German insolvency proceedings, and under German law, any action commenced against the debtor must be directed against the insolvency administrator.[24] Plaintiffs, in turn, argued that while comity may be appropriate, the insolvency administrator was required to first seek chapter 15 recognition before comity could be granted.[25]

The court agreed with the plaintiffs and concluded that it was 'clear from the structure of Chapter 15 that recognition is a prerequisite to obtaining comity from any U.S. court with respect to foreign insolvency proceedings'.[26] The court noted such conclusion was 'supported by ample caselaw'.[27] The foreign debtor argued that chapter 15 does not afford the foreign debtors, like himself – as opposed to a foreign representative – such relief, but the court was unpersuaded, noting that it is then the foreign debtor's job to ensure the foreign representative commences a chapter 15 case.[28]

Conclusion

As shown by these two decisions, foreign debtors and representatives seeking comity without commencing a chapter 15 case may be better off in the Second Circuit than the Fifth Circuit. The safer (and perhaps faster) route is to commence a chapter 15 case, even when the foreign debtor may not immediately need any of the plethora of relief (and the speed of it) available in chapter 15.

Notes

21 *Id.* at 31.

22 *EMA Garp Fund v Banro Corp.*, 2019 U.S. Dist. LEXIS 27387 (S.D.N.Y. Feb. 21, 2019); *see also Oui Financing v Dellar,* 2013 U.S. Dist. LEXIS 146214 (S.D.N.Y. Oct. 9, 2013) (with no mention of chapter 15, granting comity to a stay entered in a French safeguard proceeding).

23 HFOTCO LLC v. Zenia Special Mar. Enter., No. H-19-3595, 2021 U.S. Dist. LEXIS 126127 (S.D. Tex. July 7, 2021).

24 *Id.* at 7-8.

25 *Id.* at 8.

26 *Id.* at 10.

27 *Id.* at 11, citing *In re Ran,* 607 F.3d 1017, 1026 (5th Cir. 2010) ('The plain language of Chapter 15 requires a factual determination with respect to recognition before principles of comity come into play. By arguing comity without first satisfying the conditions for recognition, Lavie urges this court to ignore the statutory requirements of Chapter 15.' (citation omitted)); *In re Loy,* 380 B.R. 154, 165 (Bankr. E.D. Va. 2007) ('Chapter 15 recognition is required before a foreign representative seeks to enlist the comity or cooperation of a court in the United States.'); *In re Bear Sterns*, 389 B.R. 325, 333 (Bankr. S.D.N.Y. 2008) ('Requiring recognition as a condition to nearly all court access and consequently as a condition to granting comity distinguishes Chapter 15 from its predecessor section 304.'); *Fed. Trade Comm'n v. Educare Ctr. Servs., Inc.*, 611 B.R. 556, 562 (Bankr. W.D. Tex. 2019) ('Thus, the bankruptcy court proceeding, initiated when Defendant's foreign representative filed a Chapter 15 Petition for Recognition, was a prerequisite to Defendant's raising a stay of proceedings argument in this Court.'); *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1042 (5th Cir. 2021) ('Because recognition of a proceeding under Chapter 15 is a precondition for the more substantive relief Vitro seeks in the Enforcement Motion, we will resolve the recognition issue first.').

28 *HFOTCO LLC v. Zenia Special Mar. Enter.*, No. H-19-3595, 2021 U.S. Dist. LEXIS 126127 at *13.