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Examining Chapter 15 Jurisdictional Eligibility in New York and Delaware After *Octaviar II*



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Recent case law from the United States Court of Appeals for the Second Circuit in *Drawbridge Special Opportunities Fund LP v. Barnet* (“*Octaviar I*”)¹ has made the threshold question of whether jurisdiction exists in the United States to commence a Chapter 15 case a more involved process for foreign representatives and their counsel, at least if wishing to commence the case within the Second Circuit (26 BBLR 5, 1/2/14). The Second Circuit’s reasoning and holding has been expressly rejected by at least one Delaware bankruptcy judge, creating a split regarding the requirements for availability of Chapter 15 relief. In late June, the United States Bankruptcy Court for the Southern District of New York somewhat narrowed the gap created by this split while on remand (“*Octaviar II*”) (26 BBLR 861, 6/26/14).² Nevertheless, a significant difference – and uncertainties – remain.

¹ *Drawbridge Special Opportunities Fund LP v. Barnet* (*In re Barnet*), 2013 BL 341634, 737 F.3d 238 (2d Cir. 2013), hereinafter referred to as “*Octaviar I*.”

² *In re Octaviar Administration Pty. Ltd.*, 2014 BL 171081, Case No. 14-10438 (SCC) (Bankr. S.D.N.Y. June 19, 2014) [Docket No. 18], hereinafter referred to as “*Octaviar II*.”

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This article details the Chapter 15 jurisdictional requirements resulting from the Second Circuit’s ruling in *Octaviar I* and the contrasting requirements set forth by the United States Bankruptcy Court for the District of Delaware in *In re Bemarmara Consulting a.s.*³ The article will also detail the holding of *Octaviar II*, and conclude with an analysis and summary of the jurisdictional requirements and considerations currently in place following these various decisions for those who may be seeking Chapter 15 relief in New York or Delaware.

Octaviar I

Octaviar I presented an Australian company, Octaviar Administration Pty Ltd. (“OA”), in an Australian liquidation proceeding. The foreign representatives of the Australian entity sought recognition of the Australian proceeding as a foreign main proceeding in the United States in accordance with Chapter 15 of the Bankruptcy Code.⁴

In the Australian proceeding, various Australian affiliates of Drawbridge Special Opportunities Fund LP (“Drawbridge”) had been investigated and a lawsuit was commenced in Australia against certain of those affiliates seeking 210 million Australian dollars. Recognizing that Chapter 15 recognition was being sought by the foreign representatives to pursue certain other Drawbridge affiliates in the United States, Drawbridge objected to the petition for Chapter 15 recognition, claiming that OA was ineligible to be a debtor under Chapter 15 of the Bankruptcy Code because it was not eligible to be a debtor under the Bankruptcy Code’s general jurisdictional provision, 11 U.S.C. § 109(a).⁵

Section 109(a) provides that “[n]otwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.”⁶ Drawbridge’s argument hinged on the fact that the “title” referenced in Section 109 is Title 11 of the United States Code, which is all chapters of the Bankruptcy Code, including Chapter 15 of the Bank-

³ *In re Bemarmara Consulting a.s.*, Case No. 13-13037 (KG) (Bankr. D. Del. Dec. 17, 2013) (bench ruling) [Docket No. 38].

⁴ *Octaviar I*, 737 F.3d at 241.

⁵ See *id.*

⁶ 11 U.S.C. § 109(a).

ruptcy Code.⁷ OA was, obviously, not a municipality. The foreign representatives of OA did not assert OA had a residence, domicile or place of business in the United States. In briefing, the foreign representatives did argue that OA had property in the United States in the form of potential litigation claims against Americans, but Drawbridge argued that even if any claims materialized, they would be assets located in the domicile of the Australian plaintiff and not the American defendants.⁸

In an oral transcript ruling, the bankruptcy court did not rule on the question of whether OA had property in the United States. Instead, relying on the rulings of other bankruptcy judges in the Southern District of New York, the bankruptcy court concluded that the jurisdictional requirements of Section 109(a) did not have to be met with respect to a prospective Chapter 15 debtor. The Court concluded that the references to a “debtor” in Chapter 15 just required that there be a “debtor” in a foreign proceeding – and went on to grant recognition of OA’s foreign proceeding.⁹ Drawbridge appealed and the United States Court of Appeals granted a certification for direct appeal, bypassing the U.S. District Court for the Southern District of New York.¹⁰

On appeal, the Second Circuit reversed and remanded the bankruptcy court. The Second Circuit reasoned that Chapter 1 of the Bankruptcy Code applies to Chapter 15 cases, per Section 103 of the Bankruptcy Code, and Section 109(a) is in Chapter 1, thus limiting the entity that may be a Chapter 15 debtor.¹¹ In so ruling, the Second Circuit dismissed the fact that its holding is inconsistent with a different federal statute, 28 U.S.C. § 1410(2), which states that a Chapter 15 case “may be commenced” in the District Court where litigation against the foreign debtor is pending “if the debtor does not have a place of business or assets in the United States.” Specifically, the Second Circuit found this conflict to be immaterial, characterizing 28 U.S.C. § 1410(2) as “merely procedural.”¹²

Consequently, any Chapter 15 case to be filed in the Southern District of New York or elsewhere within the Second Circuit must be for an entity that satisfies the requirements of Section 109(a), such as by having a bank account or other property in the United States.

Bemarmara Consulting

Six days after the Second Circuit’s ruling in *Octaviar I*, then-Chief Judge Kevin Gross of the United States Bankruptcy Court for the District of Delaware reached

⁷ See *In the Matter of Octaviar Administration Pty Ltd*, Case No. 12-13443 (SCC) (Bankr. S.D.N.Y. Sept. 13, 2012) (bench ruling), at pp. 16-18, hereinafter referred to as “*Octaviar I Bankruptcy Court Ruling*.”

⁸ See *Objection of Drawbridge Special Opportunities Fund LP To Alleged Foreign Representatives’ Verified Petition Under Chapter 15 For Recognition Of Foreign Main Proceeding*, Case No. 12-13443 (SCC) (Bankr. S.D.N.Y. Aug. 30, 2012) [Docket No. 13] and *Petitioners’ Response To Objection Of Drawbridge Special Opportunities Fund LP To Verified Petition Under Chapter 15 For Recognition Of A Foreign Main Proceeding*, Case No. 12-13443 (SCC) (Bankr. S.D.N.Y. Sept. 5, 2012) [Docket No. 16].

⁹ See *Octaviar I Bankruptcy Court Ruling*, at pp. 29-31.

¹⁰ See *Octaviar I*, 737 F. 3d at 241.

¹¹ See *id.* at 247-51.

¹² See *id.*

the opposite conclusion in *Bemarmara Consulting*. Like the bankruptcy court in *Octaviar I*, *Bemarmara Consulting* held that the debtor entity in a Chapter 15 case does not need to meet the jurisdictional requirements set forth in Section 109(a) of the Bankruptcy Code.¹³

In *Bemarmara Consulting*, the foreign representative in a Czech Republic insolvency proceeding sought recognition of that proceeding under Chapter 15. A plaintiff in litigation against *Bemarmara Consulting* in the United States District Court for the District of Delaware objected to recognition of the Czech proceeding, arguing that the debtor did not have assets located in the United States and was therefore not eligible to be a debtor in Chapter 15. The Delaware bankruptcy court, noting that the Second Circuit’s ruling in *Octaviar I* was not controlling on it, rejected arguments that Section 109(a) required a Chapter 15 debtor to have assets in the United States.¹⁴

The Delaware bankruptcy court reasoned that Section 109(a) provides requirements for debtors, but that in Chapter 15 the foreign representative, not the debtor, petitioned the court for relief. The Delaware bankruptcy court also relied upon Section 1502’s separate definition of “debtor” for the purposes of Chapter 15. This definition provides that, for purposes of Chapter 15, “‘debtor’ means an entity that is the subject of a foreign proceeding.”¹⁵ The Delaware bankruptcy court also noted that commentators have reflected on the possibility that the potential application of Section 109(a) was a “scrivener’s error and that the intent was that 109(a) would not apply.”¹⁶ Although not mentioned in the Delaware bankruptcy court’s ruling, this ruling is also consistent with 28 U.S.C. § 1410(2), unlike the Second Circuit’s ruling in *Octaviar I*.

Octaviar II

On remand from the Second Circuit, Drawbridge and OA’s foreign representatives renewed their fight over whether OA has property in the United States. OA’s foreign representatives once again argued that OA has property in the United States in the form of litigation claims against Americans, and Drawbridge again maintained its position that potential or asserted causes of action are assets located in the domicile of the plaintiff foreign representatives, not the American defendants.¹⁷

On June 19, 2014, the bankruptcy court issued a written opinion on the matter, holding that OA “has property in the United States in the form of claims or causes of action against Drawbridge and other U.S. entities” and thus is eligible to be a Chapter 15 debtor under Section 109(a) of the Bankruptcy Code and the Second Circuit’s ruling in *Octaviar I*.¹⁸ In reaching this holding, the bankruptcy court rejected Drawbridge’s argument that causes of action are *per se* property in the country of the domicile of the plaintiff and factually distinguished other recent precedent from the Southern District of New York, *In re Fairfield Sentry Ltd.*,¹⁹ where a

¹³ See *Bemarmara Consulting*, at pp. 8-9.

¹⁴ See *id.*, at pp. 3-9.

¹⁵ 11 U.S.C. § 1502.

¹⁶ See *Bemarmara Consulting*, at pp. 8-9.

¹⁷ *Octaviar II*, at pp. 7-13.

¹⁸ See *id.*, at pp. 10-14.

¹⁹ See *In re Fairfield Sentry Ltd.*, 2013 BL 8090, 484 B.R. 615 (Bankr. S.D.N.Y. 2013). As noted in *Octaviar II*, this *Fairfield Sentry* decision is not the *Fairfield Sentry* decision af-

cause of action was found to be property within the country of domicile of the plaintiff (25 BBLR 215, 2/14/13). In so doing, the bankruptcy court considered itself to be adopting the same test for determining situs of a cause of action as in *Fairfield Sentry*, which is “a ‘common sense appraisal of the requirements of justice and convenience’ in the particular circumstance at issue.”²⁰ But on the facts of this case, the bankruptcy court found that this flexible test merited a situs within the United States. The key facts cited by the bankruptcy court were that the foreign representatives had “asserted claims under U.S. law that involve defendants located in the United States and include allegations that certain funds were wrongfully transferred by Drawbridge and other U.S. entities to the United States” and that the American litigation did not involve the same parties as litigation commenced by the foreign representatives overseas.²¹

The bankruptcy court also concluded that a second form of property existed in the United States: an undrawn retainer in the possession of the foreign representatives’ U.S. counsel in a U.S. bank. The bankruptcy court concluded that the funds were placed in the United States in good faith and to fulfill an “obvious legitimate economic function,” and not in an attempt to manufacture jurisdiction.²²

firmly by the Second Circuit in *Morning Mist Holding Ltd. v. Krys* (*In re Fairfield Sentry, Ltd.*), 2013 BL 102426, 714 F.3d 127 (2d Cir. 2013). Rather, this decision was affirmed by the District Court (see Order Affirming Decision of Bankruptcy Court, *Kenneth Krys v. Farnum Place, LLC* (*In re Fairfield Sentry Ltd.*), Case No. 13-Civ. 1524 (AKH) (S.D.N.Y. July 3, 2013) [Docket No. 15]) and remains pending in the Second Circuit. (See Notice of Appeal, *Kenneth Krys v. Farnum Place, LLC* (*In re Fairfield Sentry Ltd.*), Case No. 13-Civ. 1524 (AKH) (S.D.N.Y. Aug. 2, 2013) [Docket No. 19].

²⁰ *Octaviar II*, at p. 13 (quoting *Fairfield Sentry*, 484 B.R. at 624).

²¹ *Octaviar II*, at pp. 10-14.

²² *Octaviar II*, at pp. 14-17.

Implications for Invoking Chapter 15

Following *Octaviar I*, *Bemarmara Consulting* and *Octaviar II*, the law regarding eligibility for commencing Chapter 15 cases is decidedly unsettled.

What is clear is that any Chapter 15 case to be commenced within the Second Circuit must be for a debtor that meets the jurisdictional requirements set forth in Section 109(a) of the Bankruptcy Code. Thus, within the Second Circuit, any prospective Chapter 15 debtor must either have property in the United States or have a residence, domicile or place of business in the United States. What is less clear is when an intangible asset, such as a cause of action, will be deemed a U.S. asset, or whether an undrawn retainer held by U.S. counsel will generally be deemed a good faith basis for jurisdiction. For the time being, *Octaviar II*, like *Fairfield Sentry* before it, sets forth a test for determining the situs of a cause of action or other intangible asset in the Chapter 15 jurisdictional context. But it is uncertain the extent to which other bankruptcy courts will adopt this same test and, to the extent they do, the equitable and fact-specific nature of the test makes predicting the situs of an intangible asset such as a cause of action very difficult. Likewise, the determination of whether a retainer was placed in the United States in good faith or to manufacture jurisdiction can also become a subjective determination.

By contrast, *Bemarmara Consulting* sets a clear, bright-line test for determining whether an entity is eligible to be a debtor in Chapter 15 – whether the prospective debtor is a debtor in a foreign proceeding. *Bemarmara Consulting* is not binding on the other Delaware bankruptcy judges, but presents a persuasive precedent nonetheless, and at a minimum creates a split of authority regarding whether the jurisdictional requirement of Section 109(a) for a debtor to have a domicile, place of business or assets in the United States applies in Chapter 15 recognition proceedings.