Key U.S. Appellate Court Clarifies Timing of "Center of Main Interests" Analysis for Foreign Insolvency Proceedings

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Earlier this year, the United States Court of Appeals for the Second Circuit, the appellate court with jurisdiction over New York and widely regarded as the preeminent intermediate appellate court for business issues, issued an important decision concerning the recognition of foreign insolvency proceedings by the United States courts. Chapter 15 of the U.S. Bankruptcy Code ("Chapter 15") provides the mechanism for representatives of insolvent foreign debtors ("foreign representatives") to seek U.S. recognition, comity, and judicial assistance. Recognition of a foreign representative under Chapter 15 is not automatic; the bankruptcy court must make certain findings, including that the debtor has sufficient connection with the situs of the foreign insolvency proceedings to warrant recognition of that jurisdiction's representative.

Recognition is vital to foreign representatives if they are to obtain full access to the U.S. courts, but courts had diverged on a key component of the Chapter 15 analysis: the relevant timeframe for analyzing the debtor's connection with the foreign country in which the insolvency proceedings had been commenced. While most courts considering the issue have focused on the debtor's activities in the foreign country as of the time the Chapter 15 petition is filed – thus including post-insolvency, liquidation-related activities in the analysis – at least one recent decision from the Bankruptcy Court for the Southern District of New York had focused on the debtor's activities as of the time when the foreign insolvency proceeding commenced (thus excluding post-insolvency-petition activity).

This split among the U.S.federal courts had raised concerns and generated considerable critical commentary, because the minority view made it likely that foreign representatives would not gain recognition where there had been insufficient brick-and-mortar business activity by the debtor prior to insolvency in the jurisdiction where the insolvency proceedings had been commenced, even when there is extensive post-insolvency liquidation activity in that jurisdiction. The Second Circuit's decision resolves the issue squarely in favor of the majority view, concluding that the relevant timeframe for analyzing a debtor's connection with the foreign jurisdiction is at the time of the filing of the Chapter 15 petition.

Background to the Decision

Chapter 15 provides for recognition of foreign insolvency proceedings if they are found to be "main" or "non-main" proceedings, with the most generous protections available for "main" proceedings. Chapter 15 provides only limited guidance as to what this term means, defining a "main proceeding" as "a foreign proceeding pending in the country where the debtor has the center of its main interests," or COMI. There is a rebuttable presumption that a debtor's COMI will be in the country where it has its registered office, but courts have made it clear that this presumption does not relieve the petitioner of its burden of proof. Moreover, the determination of the debtor's COMI is required even where the relevant foreign insolvency process is the only one pending – *i.e.*, where there is no competing insolvency process that has been launched in another jurisdiction.

It is not unusual for a debtor's principal business activities to take place in one country and its insolvency proceedings in another – typically the country of incorporation. In some cases, as with the Chapter 15 petition considered by the Second Circuit, months or even years may pass between the foreign insolvency petition and the Chapter 15 petition, and the period of the liquidation activity may exceed the life of the insolvent company as a going concern. In these cases, the equities may strongly favor recognition of the foreign representative. The minority approach, however, seems to compel non-recognition in these circumstances where there was insufficient pre-insolvency activity in the jurisdiction where the insolvency proceedings were commenced. This would be the case even in the absence of a competing insolvency process, raising the possibility that *no one* would be in a position to secure assets and otherwise address the legal interests of the debtor in the United States.

The Second Circuit's Decision

In *In re Fairfield Sentry Ltd*., Appeal No. 11-4376-cv (2d Cir. Apr. 16, 2013), the Second Circuit affirmed two lower court proceedings, upholding U.S. recognition of a British Virgin Islands ("BVI") insolvency proceeding involving the largest of the feeder funds that invested with Bernard Madoff Investment Securities LLC. The feeder fund, Fairfield Sentry Limited ("Sentry"), which operated from 1990 until Madoff's arrest in 2008, administered its business interests from the BVI, where its registered office, registered agent, registered secretary, and corporate documents (among other things) were located. Sentry's Board of Directors oversaw the management of the company, and day-to-day operations were handled by an investment manager based in New York. Sentry's three directors were located in New York, Oslo, and Geneva. Liquidation proceedings were commenced in the BVI in 2009. At the time of filing of the Chapter 15 petition, Sentry's assets were located in Ireland, the UK, and the BVI.

Morning Mist, a Sentry shareholder, opposed recognition, arguing that Sentry's COMI was not in the BVI, but rather in New York. Morning Mist argued that the lower court should have focused on Sentry's operational history in determining its COMI and that liquidation activities are not the type of business activities that should be considered as part of the COMI analysis. Morning Mist also argued that inclusion of post-insolvency activity invites strategic behavior and forum shopping. Finally, Morning Mist argued that the confidentiality of the BVI proceeding offends U.S. public policy, requiring a denial of recognition.

Sentry's liquidator argued that, as a matter of statutory construction, the court should focus on Sentry's activities

at the time of filing of the Chapter 15 petition. The operative provision of Chapter 15 requires recognition where the foreign proceeding "is pending in the country where the debtor has the center of its main interests." The tense of the verbs "is" and "has" suggests a focus on the present, and that focus best ensures recognition of the person(s) presently controlling the insolvent estate.

The Second Circuit's *Sentry* decision squarely adopted the majority approach, concluding that a debtor's COMI is determined as of the time of the filing of the Chapter 15 petition, that liquidation activities may be considered in the COMI analysis, and that Sentry's COMI was therefore in the BVI. The court also stated that it is appropriate for courts to consider the time period between the initiation of the foreign liquidation proceeding and the filing of the Chapter 15 petition in order to address any strategic behavior in respect of forum. Finally, the court rejected Morning Mist's argument that the sealing of the BVI proceedings was a basis for non-recognition, dismissing Morning Mist's assertion that the proceedings were "shrouded in secrecy" as "overwrought."

The Second Circuit's decision not only overrules the bankruptcy court decision that had been the primary authority for the minority approach, but also puts the weight of the nation's preeminent intermediate-appellate court for business issues behind the majority approach (along with the only other circuit court to decide the issue), making it highly likely that other circuits will follow suit. In practice, this means that, where the center of main interests at the time of the Chapter 15 petition is in the jurisdiction of the insolvency proceedings, the representative(s) of those proceedings will have a good prospect of obtaining main recognition from the U.S. courts.

"Centre of Main Interests" and the Directors' Responsibilities in the Twilight Zone: Update on the Current and Future Work of UNCITRAL Working Group V (Insolvency Law)[1]

Prepared by the UNCITRAL Secretariat

On 18 July 2013, at its forty-sixth annual session, UNCITRAL adopted two new texts on insolvency law and noted the updating of a third. The first text, a revision of the 1997 Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law), provides more information and guidance on the interpretation and application of selected aspects of the Model Law relating in particular to the concept of the debtor's "centre of main interests" or, more commonly, "COMI", but also including various elements of the definition of "foreign proceeding". These revisions do not in any way affect the text of the Model Law as drafted. The second text, a new part (four) of the 2004 UNCITRAL Legislative Guide on Insolvency Law, addresses directors' obligations in the period approaching insolvency. These two texts were developed between 2010 and 2013 by UNCITRAL's Working Group V (Insolvency Law). The Commission also noted updates to the UNCITRAL Model Law on Cross-Border Insolvency: the Judicial Perspective to include cases decided after adoption of the text in 2011, as well as the revisions to the Guide to Enactment. Updating of the text was undertaken by the Secretariat in consultation with an editorial board of judges and insolvency experts from a number of countries.

Revision of the Guide to Enactment

The topic of the COMI of a debtor has for many years been a fruitful source of debate, particularly as to the factors relied upon by courts to rebut the presumption that the debtor's COMI is the location of its registered office, the test used by both the UNCITRAL Model Law and the EU insolvency regulation. UNCITRAL's work on this topic was based upon a 2010 proposal by the United States to address the lack of predictability in the interpretation and application of COMI by providing specific guidance on various aspects of that concept as it is used in the Model Law. The revisions adopted in what is now referred to as the "Guide to Enactment and Interpretation" of the Model Law:

(a) Provide a shorter, more focused introduction to the Model Law and its key concepts;
(b) Clarify the use of the term "insolvency" in the Model Law; and
(c) Provide more information on (i) the elements of what constitutes a "foreign proceeding" for the purposes of article 2, (ii) the characteristics of "main" and "non-main" proceedings, and (iii) the articles dealing with recognition of a foreign proceeding, in particular article 16 and the factors that are relevant to rebuttal of the presumption that the debtor's centre of main interests is its place of registration.

The word "insolvency" is used in the Model Law to refer to various types of collective proceedings commenced with respect to debtors that are in severe financial distress or insolvent. The revisions confirm that a judicial or administrative proceeding to wind up a solvent entity where the goal is simply to dissolve the legal entity is not regarded as likely to fall within the definition of a foreign proceeding in article 2(a). Where a proceeding serves several purposes including the winding up of a solvent entity, it would fall under article 2(a) only if the debtor was insolvent or in severe financial distress and the other requirements of the definition were satisfied.[2]

A key consideration in evaluating whether a particular proceeding is a collective proceeding within article 2(a) is whether substantially all of the assets and liabilities of the debtor are to be dealt with in that proceeding, subject to local priorities and statutory exceptions and exclusions and the manner in which creditors are treated. That treatment might include, for example, providing adversely affected creditors with a right to submit claims, to participate in the proceedings and to receive notice of the proceeding.[3]

With respect to article 16, it was agreed that two principal factors will tend to indicate whether the location in which the foreign proceeding commenced is (or was at the time the proceeding commenced) the debtor's centre of main interests:

(a) The location is where the central administration of the debtor takes place, and
(b) The location is readily ascertainable by creditors.

When these principal factors do not yield a ready answer, the court may consider any number of additional factors, some

[1] All documents and legislative texts referred to in this article are available from : http://www.uncitral.org
[2] Guide to Enactment and Interpretation, para. 48.
[3] Ibid, para. 70.