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US CORNER

Voluntary 'Wind-Ups' and Eligibility for Chapter 15

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Chapter 15 of the Bankruptcy Code – the Code's 'cross-border' provision – was enacted in 2005 to protect US-based assets and preserve US-based claims for administration overseas whenever a foreign debtor finds itself in insolvency proceedings outside the US. Though many of Chapter 15's 'core' concepts are the same as those that existed under prior US cross-border bankruptcy law, some differences exist. A decision earlier this year by Nevada Bankruptcy Judge Bruce Markell highlights an important one of those differences: The test for Chapter 15 eligibility. This article reviews Judge Markell's recent decision in *In re Betcorp Limited (In Liquidation)*,[2] compares its result to prior law, then draws some comparisons and contrasts between the two.

1. Current law: *BetCorp*

The facts presented to Judge Markell in *Betcorp* were straightforward: Betcorp was an Australian-based on-line betting operation whose customers were located in the US. From about 2002 through 2006, the company grew its operations into a purported 'one-stop shop' for on-line gamblers. In the process, it allegedly infringed on an Internet data-transmission technology patent held by US-based 1st Technology LLC. Despite threats of litigation and offers to settle, Betcorp and 1st Technology could never come to terms.

Meanwhile, Betcorp's business was effectively terminated in late 2006 when the US enacted the *Unlawful Internet Gambling Enforcement Act*[3] and effectively cut off gambling revenues from the company's US customers. At an extraordinary directors' meeting the following year, the company appointed two Australian liquidators and began a voluntary 'winding up' under Australian insolvency law.

A voluntary 'winding up' is essentially a private liquidation authorised by the Australian Corporations Act, conducted by company-retained liquidators under the auspices of the Australian Securities & Investments Commission (ASIC), and reviewable on appeal by Australian courts.[4] It has statutory analogues in many countries whose civil law derives from the old British Commonwealth system, and is very generally analogous to an American 'assignment for the benefit of creditors' (ABC).[5] ABC's are recognised under the laws of virtually every state in the United States, and – in jurisdictions such as California – are commonly used as a very quick and inexpensive means of winding up an insolvent company's affairs and disposing of its assets.

Undeterred by Betcorp's Australian voluntary winding up, 1st Technology commenced a patent infringement action against Betcorp in Nevada's US District Court. After further, unsuccessful efforts to amicably resolve the infringement claims, the liquidators sought recognition under Chapter 15 to administer the dispute through the Australian winding-up process. 1st Technology disputed the request, arguing that Betcorp's (essentially) private 'winding up' was not a 'foreign proceeding' to which Chapter 15 relief applies.

Notes

1 This article provides a more detailed treatment of a prior post that appeared on the author's website, www.southbaylawfirm.com, under the heading, 'An Out-of-Court "Winding Up" Entitled to Recognition Under Chapter 15? You Bet!' Please direct questions or comments regarding this article to <mgood@southbaylawfirm.com>.

2 400 B.R. 266 (Bankr. D. Nev. 2009) ('*Betcorp*').

3 31 U.S.C. §§ 5361-67.

4 400 B.R. at 278-79, n.17.

5 A difference between the Australian voluntary winding up procedure and the American assignment for the benefit of creditors is that, while the American procedure is commonly used to liquidate and distribute the assets of an *insolvent* firm, the Australian procedure applies to companies that are *solvent*. If it develops that an Australian company in wind-up is insolvent, the appointed liquidator has a number of options available to him or her. See 400 B.R. at 279-80 (quoting *Lofthouse v Austl. Sec. Invs. Comm'n*, (2004) 82 A.L.D. 481, paras 50-52, 2004 WL 674816 (Austl.) ('Subject to its being solvent and a Court's not having ordered that it be wound up in insolvency, a company may resolve by special resolution that it be wound up [CA §§ 490, 491]. ... If it should transpire that the company is insolvent, the liquidator may choose to apply to the Court under [CA § 459P] for the company to be wound up in insolvency, appoint an administrator of the company under [CA § 436B] or convene a meeting of the company's creditors [CA § 496(1)] ...')).

1.1. BetCorp *and the prerequisite for recognition*

In a 39-page decision, Judge Markell granted recognition to the liquidators. To do so, he gave extensive discussion to the establishment of Australia as Betcorp's 'centre of main interests' (COMI) – an important element in gaining relief under Chapter 15 and the subject of a number of prior, published decisions in the US.[6] Of interest for this article, however, Judge Markell first delved into the amended meaning of the term 'foreign proceeding.'

1.2. What is a 'foreign proceeding' under US law?

What is a 'foreign proceeding' under the amended Bankruptcy Code? Judge Markell devoted nearly 15 pages – over half his analysis – to this question of apparent first impression and found, in the end, that Betcorp's private 'winding up' was, in fact, a 'foreign proceeding' eligible for recognition under US cross-border law.

To reach this conclusion, *Betcorp* examines closely a definitional statute that has received only scant attention since its amendment in 2005. Bankruptcy Code Section 101(23) defines a 'foreign proceeding' as:

> 'a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation.'[7]

Betcorp parses this definition into seven separate elements:

(i) a proceeding;

(ii) that is either judicial or administrative;

(iii) that is collective in nature;

(iv) that is in a foreign country;

(v) that is authorised or conducted under a law related to insolvency or the adjustment of debts;

(vi) in which the debtor's assets and affairs are subject to the control or supervision of a foreign court; and

(vii) which proceeding is for the purpose of reorganisation or liquidation.[8]

Of these, the critical determination was whether Betcorp's voluntary winding up was a 'judicial or administrative' 'proceeding' under the 'control or supervision of a foreign court.'

1.2.1. 'Proceeding'

The Bankruptcy Code's definition of a 'foreign proceeding' betrays a subtle circularity: A 'foreign proceeding' is defined as a 'collective judicial or administrative proceeding in a foreign country,' but the essential term – *proceeding* – is defined by itself. To resolve the ambiguity of this term, Judge Markell looked to the European Union Regulation on Insolvency Proceedings (European Regulation), in which 'proceedings' are understood to be 'acts and formalities set down in law' so that courts, merchants and creditors can know them in advance, and apply them evenly in practice.

Under the European Regulation, and in the context of corporate insolvencies, the hallmark of a 'proceeding' is a statutory framework that constrains a company's actions and regulates the final distribution of a company's assets.[9] Using this construction, Judge Markell then looked to the Australian *Corporations Act (Cth) 2001* under which Betcorp's liquidation was commenced and found it a sufficiently comprehensive statutory framework that constrains a company's actions and that regulates the final distribution of a company's assets such that Betcorp's voluntary winding up was a 'proceeding' for purposes of the US Bankruptcy Code.[10]

1.2.2. 'Judicial or Administrative'

The US Bankruptcy Code's 2005 amendments added the qualification that a 'foreign proceeding' be 'subject to control or supervision by a foreign court' – thereby suggesting an intent that such proceedings be

Notes

6 400 B.R. at 287-288 (citing *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 389 B.R. 325, 335-336 (S.D.N.Y.2008), *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122, 128 (Bankr.S.D.N.Y.2007)) (in turn quoting *In re SPhinX, Ltd.*, 351 B.R. 103, 117 (Bankr.S.D.N.Y.2007)). *In re Tradex Swiss AG*, 384 B.R. 34, 42-43 (Bankr.D.Mass.2008); *In re Ernst & Young, Inc.*, 383 B.R. 773, 779 (Bankr.D.Colo.2008); *In reBasis Yield Alpha Fund (Master)*, 381 B.R. 37, 47 (Bankr.S.D.N.Y.2008); *In re Loy*, 380 B.R. 154, 162 (Bankr.E.D.Va.2007)).

7 11 U.S.C. § 101(23).

8 400 B.R. at 277.

9 400 B.R. at 278 (citing Council Regulation 1346/2000, 2000 O.J. (L 160), at 2, available at <eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:EN:PDF>).

10 *Id.* See also 400 B.R. at 280 ('The fact that commencing this type of external administration terminates the authority of the company's directors, combined with the fact that the winding up cannot be stopped by the equity interest holders once they have passed the special resolution, lends further support to a finding that this Australian legal process is a proceeding.').

essentially judicial in nature. For Judge Markell, however, the key criterion was whether the proceeding was *either* judicial *or* administrative in nature. For purposes of the US statute, Betcorp's voluntary winding up was predominantly 'administrative' (but could, depending upon circumstances, require additional 'judicial' involvement).[11] Therefore, the Australian proceeding met the 'judicial or administrative test.'

1.2.3. 'Control or Supervision'

Judge Markell's treatment of the judicial 'control or supervision by a foreign court' necessary to satisfy US recognition is interesting. Reversing accepted rules of statutory construction set forth in the US Bankruptcy Code, he imported Chapter 15's specialised definition of a 'foreign court' into the more general provisions of Section 101(23) so as to understand a 'foreign proceeding' to be one under the control of a 'judicial or other authority competent to control or supervise a foreign proceeding.'[12] Finding that the appointed liquidators acted under the auspices of the ASIC – and that under the *Corporations Act*, liquidators and creditors have recourse to Australian courts – Judge Markell found that Betcorp's voluntary winding up had the indicia of judicial 'control or supervision' necessary to qualify for US recognition.

Betcorp's analysis is testament to the old adage that, though commonly overlooked, definitions are often dispositive. Whether an insolvency matter is a 'foreign proceeding' under US law is a potentially critical one for lawyers looking to strategise the preservation of assets and administration of claims in a multi-national case. Judge Markell's treatment of that definition in *Betcorp* is therefore important – and all the more so since a brief review of prior case law reveals significant ambiguity.

2. Prior law: *In re Tam*? *In re Ward*? Or something else?

Aside from *Betcorp*, there appears to be no published decisional authority on what constitutes a 'foreign proceeding' under the 2005 US law. As a result, it is premature to forecast exactly how most courts will construe the amended statute. However, Chapter 15's statutory framework and Congress' efforts to incorporate much of the UNCITRAL cross-border provisions into the 2005 Code suggest that the new law's interpretation and application will differ from that under prior law. Judge Markell's analysis in *Betcorp* certainly differs from the prior law's analytical approach, which is illustrated by a pair of cases – authored by the same Judge – each of which addressed the prior definition of 'foreign proceeding' in the context of very similar voluntary winding ups, but reached results exactly opposite from one another.

2.1. In re Tam

In re Tam[13] concerned the liquidation, through voluntary wind up, of Asian Oceanic Holdings Limited (AOHL), a corporation organised under the laws of the Cayman Islands with its principal place of business in Hong Kong. A contractual dispute between AOHL and one of its former executives (one Mr. Hunnewell) spawned litigation in New York, which resulted in attachment proceedings against AOHL's interest in a cooperative apartment located in New York City. To sell the co-op and distribute the proceeds to creditors without interference from Mr. Hunnewell, AOHL's liquidators sought ancillary relief under former Section 304 of the US Bankruptcy Code and a concurrent injunction against the New York litigation. Hunnewell objected and moved for discovery regarding the sale process, arguing that the Cayman Islands winding up was not a 'foreign proceeding.'

Bankruptcy Judge James Garrity, Jr. agreed with Mr. Hunnewell and denied ancillary relief on the basis that AOHL's voluntary winding up was not a 'foreign proceeding.' To do so, Judge Garrity appeared to focus on the absence of direct judicial involvement in the Cayman winding up. After obtaining Mr. Tam's concession that the voluntary winding up was not a '*judicial* proceeding,' he then went on to note the apparent lack of direct judicial or administrative involvement in the voluntary winding up process[14] and observed further that under his own reading of Cayman law, creditors did not have ongoing, direct access to the winding up proceedings but were instead required to wait as long

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11 400 B.R. at 280-281.

12 Judge Markell's defence of this construction is set forth at a lengthy footnote 23 on p.283. Though unconventional, it reaches a result consistent with other US case law. See *id.* at 284 (citing *In re Tradex Swiss AG*, 384 B.R. 34, 42 (Bankr.D.Mass.2008) (Swiss Federal Banking Commission held to be a foreign court under chapter 15 because it controls and supervises liquidation of entities, such as debtor, that are in brokerage trade)).

13 170 B.R. 838 (Bankr. S.D.N.Y. 1994).

14 170 B.R. at 843-844 ('The liquidators are conducting the voluntary winding up without oversight from the Registrar, or any other Cayman governmental agency, instrumentality or authority.').

as one year before holding a general meeting regarding the company's liquidation.[15] It did not appear to matter, at least for Judge Garrity's analysis, that liquidators under a voluntary winding up under Cayman law have fiduciary duties to general unsecured creditors[16] and must present an accounting to creditors, or that more active supervision is available to creditors should they desire it.[17]

2.2. In re Ward

Little more than two years later, in *In re Ward*,[18] Judge Garrity again opined on the viability of a voluntary winding up as a 'foreign proceeding,' this time in connection with the liquidation of Zambia Airways Corporation Limited (ZAC). Under a provision of the Zambian Companies Act very similar to the Cayman provisions at issue in *Tam*, ZAC's directors resolved to commit the airline to a voluntary liquidation and appointed liquidators to do so. As in *Tam*, ZAC also faced litigation in New York and efforts by creditors in that litigation to appropriate US-based assets in satisfaction of their claims. The liquidators petitioned for ancillary relief under Section 304 and the creditors moved to dismiss – again, on the grounds that the Zambian voluntary winding up, like the Cayman voluntary winding up in *Tam*, was not a 'foreign proceeding' entitled to relief.

Perhaps surprisingly for ZAC's American creditors, Judge Garrity this time ruled in the liquidators' favour. In so doing, he relied upon the same basic interpretive approach but distinguished his prior ruling in *Tam*:

> 'Although there are many similarities between Zambian and Cayman law, we do not understand those laws to be identical. Significantly, under Zambian law, there is active court supervision of the voluntary winding up, and ready access to the High Court and appellate courts by creditors and contributories. Equally important is that the right of creditors and contributories to participate and be heard in proceedings is virtually identical in judicial and voluntary liquidations. The Zambian winding up is conducted for the collective benefit of all creditors and contributories in accordance with procedures that are not at odds with our notions of due process. We did not find any of these factors present in *Tam*.'[19]

This type of analysis, which required procedural distinctions between the laws of foreign jurisdictions – even when those jurisdictions followed the same general statutory schemes, as did the Commonwealth jurisdictions of Zambia and the Cayman Islands – surely posed challenges for American bankruptcy judges. For example, Judge Garrity appeared in *Ward* to rely heavily on the apparent 'ready access' of creditors to Zambian courts and the 'right of creditors . . . to participate and be heard.' Yet his decision was rendered in the case of an American creditor who, ironically, had been *denied* access to creditors' meetings by the Zambian liquidators[20] – and who, therefore, would have been in little better (and perhaps worse) practical position than creditors in *Tam*'s comparable Cayman proceeding.

3. Old law and new law: comparative analysis

For convenience, the differing statutory definitions and approaches to statutory interpretation under the pre-2005 and the amended 2005 Bankruptcy Code, and demonstrated by *Tam* and *Betcorp*, are summarised in the table below.

By contrast to prior law, the approach adopted in Judge Markell's recent *BetCorp* decision, if followed by other US courts, suggests that private liquidations in foreign jurisdictions are now more likely entitled to the very same level of recognition and protection in the US as are more formal, judicial insolvency proceedings. If so, such recognition permits foreign debtors the possibility of relying with greater certainty upon private liquidations to exert control over the disposition of US-based assets and resolution of US-based claims.

Notes

15 170 B.R. at 843 ('The liquidators are under no obligation to report to creditors unless the proceeding continues for more than one year. Then they must conduct a general meeting of the company at the end of that year (and each succeeding year thereafter) and "lay before such meeting an account showing their acts and dealings and the manner in which the winding up has been conducted during the preceding year." Companies Law § 141.')

16 170 B.R. at 842 (acknowledging that '[L]iquidators appointed in a voluntary winding up are fiduciaries who must act in the best interest of the creditor body as a whole.').

17 170 B.R. at 844 ('The Companies Law does provide that creditors can petition the Cayman Court and request that the winding up be conducted pursuant to court supervision. *Id.* §§ 147, 150. If such a petition is filed and the Cayman Court finds that the rights of the petitioning creditors will be prejudiced by a voluntary winding up, the court may direct either that the company be wound up by the court or be wound up subject to the supervision of the court. *Id.* §§ 147, 149, 151.').

18 201 B.R. 357 (Bankr. S.D.N.Y. 1996).

19 201 B.R. at 361-362.

20 201 B.R. at 358 ('BONY representatives appeared at the meeting but were not admitted. According to petitioners, they failed to bring appropriate proxies or identification. BONY contends that its representatives were wrongfully excluded from the meeting.').

	In re Tam	*In re Betcorp*
'Foreign Proceeding' Under 11 U.S.C. § 101(23)	• *Foreign Proceeding*: 'A proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganisation.'	• *Foreign Proceeding*: '[A] collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation.'
What is a 'Proceeding'?	• *Proceeding*: '[T]he form and manner of conducting juridical business before a court or judicial officer. Regular and orderly progress in form of law, including all possible steps in an action from its commencement to the execution of judgment. Term also refers to administrative proceedings before agencies, tribunals, bureaus, or the like.'	• *Proceeding*: '[A]cts and formalities set down in law so that courts, merchants and creditors can know them in advance, and apply them evenly in practice.'
Interpretation	• *Interpretation*: 'The term 'proceeding' is not defined by the Code. Because there is no evidence to the contrary, we presume that Congress intended that it be given its ordinary meaning.'	• *Interpretation*: Courts are to 'consider [the] international origin of [US cross-border law], and the need to promote an application of … chapter [15] that is consistent with the application of similar statutes adopted by foreign jurisdictions.' 11 U.S.C. § 1508.

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