New York Law Journal
A NEW YORK LAW JOURNAL SPECIAL SECTION
Corporate Restructuring & Bankruptcy
An ALM Publication
WWW.NYLJ.COM
MONDAY, JUNE 22, 2015

International Bankruptcy: Do **Principles of Comity** Exist In Parallel to Chapter 15?

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Approximately a year and a half ago, the district court for the Southern District of New York issued an opinion that raises important questions about the reach and applicability of the doctrine of international comity in a post-Chapter 15 world—in fact, the case appears to significantly extend the reach of comity in the context of foreign insolvency proceedings. See *Oui Financing v. Dellar*, 2013 WL 5568732 (S.D.N.Y. Oct. 9, 2013). Notwithstanding its significance and the passage of time, the opinion has received little attention; we believe it deserves careful consideration.

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Introduction

In a nutshell, the court in *Oui Financing* extended comity to a French bankruptcy proceeding and dismissed a suit brought to enforce a guaranty against the non-debtor guarantor, although the foreign debtor was not initially a party to suit, the district court's jurisdiction over the guarantor was undisputed and no Chapter 15 case was filed by the foreign debtor or the guarantor. The case raises an interesting and significant issue: May U.S. courts grant comity to foreign bankruptcy proceedings outside of the confines of Chapter 15 of the Bankruptcy Code, or stated differently, does Chapter 15 preempt comity as a basis for recognizing and enforcing foreign bankruptcy proceedings. While the court in *Oui Financing* dismissed the action in deference to a foreign bankruptcy proceedings based on comity alone, it never expressly analyzed the issue since it was not articulated as such by the parties.

A Short Overview of Chapter 15

Congress inserted Chapter 15—a new chapter titled "ancillary and other cross-border cases"—into the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, replacing §304 which previously governed cases ancillary to foreign proceedings; in doing so, Congress adopted the Model Law on Cross-Border Insolvency proposed by the U.N. Commission on International Trade Law in 1997. The Chapter 15 regime establishes a new and detailed frame-

work for U.S. bankruptcy courts to deal with and defer to international insolvency cases.[1]

A Chapter 15 case is commenced by the foreign representative of the debtor filing a petition for recognition of the foreign proceedings. A foreign proceeding may qualify as a foreign main proceeding (which is pending in a country where the foreign debtor's center of main interests are located) or a foreign non-main proceeding (which is pending in a country where the debtor has some ties but is not the debtor's center of main interests).[2] The Bankruptcy Code specifies the relief that the Bankruptcy Court may grant upon the filing of the petition for recognition, as well as upon the granting of recognition. The relief includes a stay of actions against the debtor, a stay of execution against its assets and entrusting the debtor's assets in the United States to the foreign representative.[3] If the Bankruptcy Court grants recognition of a foreign main proceeding, the automatic stay and certain other provisions of the Bankruptcy Code immediately go into effect.[4]

The recognition process, in other words, serves a gatekeeping function through which foreign representatives must pass before they receive the protection afforded by the Bankruptcy Code in connection with a pending foreign insolvency proceeding. Having adopted a detailed and elaborate scheme designed to deal with foreign insolvency proceedings and the effect of their recognition in the United States, did Congress intend to allow foreign debtors and their representatives to bypass this detailed scheme and seek to stay actions and proceedings in the United States (as well as other relief) based on comity divorced from the requirements and procedures of Chapter 15?

'Oui Financing'

On Aug. 27, 2010, Oui Financing LLC (OFI) made loans to Oui Management (OM), a French company with its principal place of business in Paris, pursuant to a loan agreement and promissory note (the loan agreement); contemporaneously, Steven Dellar, a citizen of the United Kingdom and both the president and a shareholder of OM, executed a separate agreement by which Dellar guaranteed the repayment of the loans (the guaranty). The guaranty contains a choice of law clause providing that disputes are to be determined under New York law. The loan agreement set Sept. 30, 2012 as the maturity date for the loans and a failure to repay by that date would constitute an event of default.

On Sept. 24, 2012, OM voluntarily commenced a procédure de sauvegarde (a "safeguard procedure")—an insolvency proceeding under French law—in the Paris Commercial Court.[5] The invocation of the safeguard procedure itself was an event of default under the loan agreement. On Oct. 2, 2012, OFI demanded that OM repay the loan, and on Oct. 4, 2012, OM responded and invoked the automatic stay on litigation activated by the safeguard procedure.

On Oct. 17, 2012, OFI filed a complaint in the District Court for the Southern District of New York asserting declaratory judgment and breach of contract claims against Dellar alone and Dellar moved to dismiss. Apparently in response to concerns regarding OM being an indispensable party, OFI filed an amended complaint against both Dellar and OM. Both Dellar and OM filed a joint motion to dismiss based on international comity in deference to the safeguard procedure underway in France.[6]

While Chapter 15 does not explicitly eliminate comity as a parallel process to Chapter 15, **the legislative history is fairly clear** that such was the intent.

Comity is a principle of abstention by which courts decline to exercise their otherwise valid jurisdiction in deference to the sovereignty of foreign nations and their independent courts. Over a hundred years ago, the Supreme Court defined comity 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."[7]

In support of their argument, the defendants cited to a number of bankruptcy cases holding that U.S. courts should, under ordinary circumstances, decline to adjudicate creditor claims that are the subject of a foreign bankruptcy proceeding. Thus, they argued that the safeguard procedure should be granted deference by the district court, resulting in dismissal of the action.

OFI argued in response that the cases cited by the defendants involved actual debtors—not guarantors—and that this key distinction makes those cases distinguishable with respect of its claims against Dellar. Further, OFI argued that French insolvency law does not trump its rights against Dellar under New York law, which was the governing law, specified in the Guaranty, and that in any event, the safeguard procedure itself fell short of the required procedural guarantees of fairness required for comity to apply.

The court dismissed OFI's complaint on comity grounds. The court described, in great detail, the methodology and aims of the French safeguard procedure, which is similar in many respects to a proceeding under Chapter 11 of the Bankruptcy Code (and which the safeguard procedure was "modeled after" and to which it is "frequently compared").[8] Following an analysis of the various comity elements that a court must analyze in deciding whether to grant or deny comity, the court concluded:

> The issue here is properly framed not as whether Dellar seeks an impermissible 'end-run' around his contractual obligations, but rather … whether [Oui Financing's] attempt to sue Dellar here constitutes the sort of end run around a parallel foreign bankruptcy proceeding of which [the Second Circuit has] repeatedly disapproved.

Id. at *10. Without ever mentioning Chapter 15 in its decision, the court deemed comity to be warranted and granted the motion to dismiss.

Analysis

While Chapter 15 does not explicitly eliminate comity as a parallel process to Chapter 15, the legislative history is fairly clear that such was the intent: "[C]hapter 15 is intended to be the exclusive door to ancillary assistance to foreign proceedings. The goal is to concentrate control of these questions in one court."[9] Congress recognized that prior to the enactment of Chapter 15, while a petition under the former §304 was an appropriate method for deferring to foreign proceedings, "some cases in state and Federal courts … have granted comity suspension or dismissal of cases involving foreign proceedings without requiring a §304 petition or even referring to the requirements of [§304.] Even if the result is correct in a particular case, the procedure is undesirable, because there is room for abuse of comity."[10]

Furthermore, where Congress deemed the use of comity relevant in Chapter 15, it incorporated it explicitly. Under §1507, if recogni-

tion is granted the court may grant the foreign representative additional assistance, and in determining whether to grant such assistance the court must consider whether it is consistent with principles of comity.

In *U.S. v. J.A. Jones Constr. Group*, the receiver appointed in the Canadian bankruptcy proceedings of one of the defendants sought a stay of the action. The magistrate judge, after analyzing Chapter 15, held that "[i]n the absence of recognition under Chapter 15, this court has no authority to consider [the receiver's] request for a stay."[11]

The argument that Chapter 15 eliminated a parallel application of comity to obtain relief ancillary to foreign bankruptcy proceedings has not been considered by the court in *Oui Financing*. It remains to be seen how future courts will rule on this issue in light of the conflict between *Oui Financing* and *Jones Constr.* as well as the legislative history to Chapter 15.[12]

Are There Exceptions?

Even if one accepts the argument that in general Chapter 15 eliminated the application of comity as a source of relief, some difficult issues remain. First, consider a case where the U.S. court refuses to recognize the foreign proceedings under Chapter 15. Is no relief available, or should comity afford a source for relief in such a case?

Section 1509(d) of the Bankruptcy Code provides that "[i]f the court denies recognition …, the court may issue any appropriate order necessary to prevent the foreign representative from obtaining comity or cooperation from courts in the United States." This section seems fairly clear on its face; absent an order to the contrary, the foreign representative may seek relief based on comity. The legislative history on this point is somewhat inconclusive. On the one hand it notes that this section was "added to ensure that a foreign representative cannot seek relief in courts in the United States after being denied recognition by the court under [Chapter 15],"[13] but on the other it also specifies that an application to other courts "could be made after denial of the a petition under [Chapter 15]."[14]

Second, consider a situation where a debtor, not the foreign representative, seeks relief ancillary to a foreign proceeding. Recall that under Chapter 15 only a foreign representative may seek recognition. When the debtor is a corporate entity, the foreign representative normally acts for and in its name. But when the debtor is an individual, it is possible that either no foreign representative is appointed, or the foreign representative and the individual debtor co-exist.[15] Can the individual debtor seek relief based on comity when there is no foreign representative, or the foreign representative refuses to seek recognition under Chapter 15?

Both of these issues were addressed in decisions emanating from the bankruptcy of Paul Kemsley. Kemsley's U.K. foreign representative filed a petition for recognition under Chapter 15. The bankruptcy court for the Southern District of New York denied recognition.[16] Subsequently, Barclays Bank filed an action against Kemsley in New York state court. Kemsley sought summary judgment in his favor arguing that international comity mandated that the New York court recognize the discharge granted to him in the U.K. proceedings.

Barclays responded by filing a motion in the bankruptcy court for clarification of the effect of the earlier order denying recognition, and asked the bankruptcy court to prohibit Kemsley from seeking recognition based on comity in the state court. The bankruptcy court denied the motion without prejudice to the parties arguing the issue in the state court. The bankruptcy court denied the motion since §1509(d) authorizes the court to issue such orders with respect of a foreign representative, not the debtor.[17] But more fundamentally, the bankruptcy court seemed to believe that there is a difference between recognition for Chapter 15 purposes, which deals with assisting the administration of the foreign case, and giving effect to a foreign discharge.[18]

Returning to the state court, the parties renewed their arguments. The state court rejected Barclays' argument that New York's common law comity doctrine is preempted by Chapter 15, although it did so in a narrow holding: "There is no mention of individual debtors in Chapter 15, nor any indication that Chapter 15 is applicable to foreign bankruptcy discharge orders issued to individual debtors … . [C]hapter 15 of the Bankruptcy Code does not preempt New York common law principles of international comity as applied to foreign bankruptcy discharge orders issued to individual foreign debtors."[19]

Conclusion

As the world get smaller through the ever increasing level of connectedness among world regions and economies, and as investments by U.S. firms in foreign enterprises escalate, and vice versa, international bankruptcy cases are likely to increase. *Oui Financing* and *Kemsley* expose some serious issues and ambiguities in Chapter 15 and may lead to unintended consequences. While Chapter 15 is clearly an important step forward towards the goal of streamlining the treatment of cases ancillary to foreign proceedings, ambiguities and gaps in coverage may prove fertile grounds for litigation, increased costs and uncertainty.

1. Chapter 15 itself lists five specific objectives: (1) to promote cooperation between the U.S. courts and parties of interest and the courts and other competent authorities of foreign countries involved in cross-border insolvency cases; (2) to establish greater legal certainty for trade and investment; (3) to provide for the fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested entities, including the debtor; (4) to afford protection and maximization of the value of the debtor's assets; and (5) to facilitate the rescue of financially troubled businesses, thereby protecting investment and preserving employment. 11 U.S.C. §1501.
2. If a bankruptcy court determines that a foreign insolvency proceeding is neither a foreign main nor nonmain proceeding, the foreign proceeding cannot be recognized. See *In re Kemsley*, 489 B.R. 346 (Bankr. S.D.N.Y. 2013) (finding a foreign insolvency proceeding to be neither); but see *Barclays Bank v. Kemsley*, 992 N.Y.S.2d 602 (N.Y. Sup. Ct. 2014) (affording comity to that same foreign proceeding at the request of the foreign debtor over Barclays' objection).
3. See 11 U.S.C. §§1519, 1521.
4. See 11 U.S.C. §1520.
5. On May 13, 2013, the Paris Commercial Court approved OM's restructuring plan, which provides for repayment of the company's debts over the course of seven years.
6. OM also invoked forum non conveniens in its motion to dismiss; that argument was not addressed in the court's opinion and is not relevant to this discussion.
7. *Hilton v. Guyot*, 159 U.S. 113, 164 (1895).
8. *Oui Financing*, 2013 WL 5568732 at *9.
9. See H.R. REP. No. 108-40(I), pt. 1, at 214 (2003).
10. Id.
11. 333 B.R. 637, 639 (E.D.N.Y. 2005).
12. The issue could also be analyzed under preemption principles pursuant to which federal law preempts conflicting state and common law. Preemption may be express or implied. Discussion of preemption principles, however, is beyond the scope of this paper.
13. See id., n.9 at 215.
14. Id.
15. Such is the case in the United States in an individual Chapter 7 case. The debtor is the filing individual and the Chapter 7 trustee acts for the Chapter 7 estate.
16. *In re Kemsley*, 489 B.R. 346 (Bankr. S.D.N.Y. 2013).
17. *In re Kemsley*, Case No. 12-13570, June 5, 2013 Tr., at p. 29 [Dkt. No. 30].
18. Id., at pp. 7-8.
19. *Barclays Bank v. Kemsley*, 992 N.Y.S.2d 602, 606 (N.Y. Sup. Ct. 2014).