

### BANKRUPTCY

# Taking It Back—Recovering Transfers in Bankruptcy

Chapters 15, 7 and 11 allow foreign debtors to coordinate actions in U.S.

Representatives of foreign insolvency estates, typically trustees or court-appointed administrators, may access U.S. bankruptcy courts, among other reasons, for the purpose of bringing actions to avoid and recover payments and other transfers made before insolvency proceedings were commenced, for the benefit of their foreign estates. Recovery actions may be based upon the Bankruptcy Code<sup>1</sup> or the foreign law that is otherwise applicable. The precise remedies, and the paths to their pursuit, require navigation through various chapters and remedies of the Bankruptcy Code.

A duly recognized representative of the debtor in its foreign proceeding (“foreign representative”) may commence a bankruptcy case under chapter 15 of the Bankruptcy Code. Chapter 15 allows representatives of foreign insolvency proceedings to obtain relief in U.S. bankruptcy courts. By its plain language, chapter 15 does not allow a foreign representative to bring avoidance actions under provisions of the Bankruptcy Code. As chapter 15 has developed, however, foreign representatives have nonetheless met with some success in avoiding and recovering transfers for the benefit of foreign debtors, including by seeking relief under chapter 7 and chapter 11 of the Bankruptcy Code, which they are entitled to do under certain circumstances.

#### Chapter 15—Ancillary Cases

Chapter 15 was codified by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, known as BAPCPA. Chapter 15 cases are commenced by the foreign representative filing a “petition for recognition” for the purpose of coordinating actions in the United States with insolvency proceedings that are pending abroad.<sup>2</sup> In order for the foreign proceeding to be “recognized,” the foreign representative must not only show the presence and nature of a foreign proceeding, but that the foreign representative is the authorized representative in



the United States for such proceedings.<sup>3</sup>

While the recognition of the foreign proceeding itself is not discretionary if the factors are met, the type of recognition that is afforded is for the court to decide. The court may use its discretion to recognize the foreign proceeding as either a “main” or a “nonmain” proceeding. The deciding factor is the location of the “center of main interests” (COMI) of the foreign debtor, which is presumed to be its registered office. The main proceeding will ordinarily be where the COMI exists; all other proceedings will be nonmain.

If the foreign proceeding is recognized as neither a main nor nonmain proceeding, the foreign representative may nevertheless commence an involuntary plenary case (chapter 7 or chapter 11) against the debtor, if it can otherwise meet the statutory criteria for such cases. In addition, the foreign representative is expressly permitted (to the extent it is afforded standing by the courts in question), to bring suit in other courts in the United States to pursue a claim or collect property on behalf of the foreign debtor.<sup>4</sup>

#### Chapter 15 Recognition

Should the foreign proceeding be recognized as a main proceeding, section 1520 of the Bankruptcy Code causes certain relief to take effect automatically, including the stay of actions with respect to property within the United States. In addition, while section 1520 is not applicable in nonmain

chapter 15 cases, the foreign representative in either main or nonmain cases may seek relief under sections 1507 and 1521 of the Bankruptcy Code.

Sections 1507 and 1521 permit the bankruptcy court to grant additional relief as is necessary and appropriate, provided such relief is consistent with principles of comity and falls under the Bankruptcy Code or any other relevant laws of the United States.

Section 1521(a)(7) of the Bankruptcy Code, however, precludes from such additional relief allowing foreign representatives to bring actions to avoid and recover preferences and fraudulent conveyances. Nevertheless, this has not been interpreted to disallow avoidance actions under applicable foreign law. For example, in the *Condor* chapter 15 case,<sup>5</sup> the foreign representative of foreign main proceedings in Nevis in the Caribbean, was permitted to bring chapter 15 avoidance action under Nevis law contending that the debtor fraudulently transferred funds from Nevis to the United States.

#### Plenary Cases

As with domestic debtors, foreign debtors with a place of business or property in the United States are afforded the option of commencing a plenary case in the United States.<sup>6</sup> The two primary types of plenary relief available to commercial enterprises are found in chapters 7 and 11 of the Bankruptcy Code, respectively.

Chapter 7 is exclusively dedicated to liquidations, while chapter 11 may be used for either reorganization or liquidation. In a chapter 11 case, the debtor typically remains in control as the “debtor in possession” under the oversight of the court and various other parties. Conversely, in a chapter 7 case, a private trustee is appointed and the debtor’s business is liquidated.<sup>7</sup>

Commencement of a case under chapter 7 or chapter 11 is achieved by filing a voluntary petition (by the debtor itself) or an involuntary petition (generally by the debtor’s creditors). Upon commencement, a bankruptcy estate consists of all of the legal and equitable interests of the debtor “wherever located and by whomever held.”<sup>8</sup> As a result, all of the debtor’s assets—foreign and domestic—are subject to the jurisdiction of the U.S. bankruptcy courts once a plenary case has been commenced.

STEVEN J. REISMAN, L.P. HARRISON III and JERROLD L. BREGMAN are partners and members of the restructuring and insolvency practice group at Curtis, Mallet-Prevost, Colt & Mosle. They can be reached at [sreisman@curtis.com](mailto:sreisman@curtis.com), [lharrison@curtis.com](mailto:lharrison@curtis.com) and [jbregman@curtis.com](mailto:jbregman@curtis.com). TIMOTHY A. BARNES, a partner at the firm, contributed to this article.

## Mixing and Matching Relief

As discussed herein, it may be advantageous for a foreign representative to access chapter 15 as well as plenary chapters of the Bankruptcy Code. There are two ways in which the combination of both an ancillary and plenary case within the United States can arise: (1) the foreign representative, after being recognized, commences a plenary chapter 7 or 11 case, which is permissible provided the debtor has assets in the territorial jurisdiction of the United States; or (2) the plenary case is already pending in the United States at the time the foreign representative files a petition for chapter 15 recognition.

In both cases, the far-reaching nature of the bankruptcy estate creates the potential for conflict with disparate international insolvency regimes in cross-border matters. This conflict is anticipated by the Bankruptcy Code, which creates rules of reconciliation. Section 1529 of the Bankruptcy Code provides that any relief that was granted under sections 1519, 1520 and 1521 in the chapter 15 ancillary case must be reviewed by the court and either modified or terminated if inconsistent with the plenary case.<sup>9</sup>

## Avoidance and Recovery

Avoidance and recovery actions under the Bankruptcy Code are primarily governed by sections 547 (avoidance of preferential transfers), 548 (avoidance of fraudulent transfers) and 550 (recovery of avoided transfers). Sections 547 and 548 set forth the requirements for challenging pre-petition transfers as preferential or fraudulent, respectively.<sup>10</sup> Once a transfer is avoided, section 550 provides a mechanism for the trustee (or debtor in possession; the two are interchangeable in this context) to recover either the transfer itself, or the monetary loss to the bankrupt's estate caused by such transfer.

While courts are split on whether actions to avoid and recover preferences or fraudulent conveyances are available for application in an extraterritorial fashion,<sup>11</sup> it is clear that these are powerful remedies when invoked domestically by foreign debtors in plenary cases in the United States.

## Preferential Transfers

In general, a "preference" is when a creditor is favored (or "preferred") over other similarly situated creditors by receiving a pre-bankruptcy transfer of the debtor's property while the debtor was insolvent, which allows the creditor to receive more than it would have otherwise received in a liquidation of the debtor's estate. The purpose of the avoidance doctrines is to effect the bankruptcy policy of equality of distributions among similarly situated creditors.<sup>12</sup> While intent plays a large role in fraudulent transfers (as addressed below), the debtor's intent is not material in determining whether a transfer was preferential.

Specifically, section 547(b) of the Bankruptcy Code provides that, unless one of the exceptions under section 547(c) is met, the trustee may avoid as preferential any transfer of an interest of the debtor in property:

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt (i.e., previously existing obligation);
- (3) made while the debtor was insolvent;
- (4) made on or within 90 days before the

date of the filing of the petition, or within one year if the creditor was an insider; and (5) that enables the creditor to receive more than it would have received in a chapter 7 case.

All five elements must be established for the *prima facie* preference case. Nevertheless, section 547(c) specifies that certain transfers are not preferential, most notably: (1) contemporaneous exchanges for new value; (2) payments made in the "ordinary course" of business relations; and (3) transfers that are subsequently offset by new value.<sup>13</sup>

While the trustee has the burden of proving all five elements under section 547(b), the preference defendant has the burden of proving any of the available defenses under section 547(c).

## Fraudulent Conveyances

While a fraudulent transfer may also be preferential (and a preferential transfer may be fraudulent), the concepts are subject to different gating criteria and time periods, and should be analyzed independently (though the actions are not mutually exclusive).

Transfers made within two years before the bankruptcy filing date that may be avoided as "fraudulent transfers" under section 548 of the Bankruptcy Code come in two varieties.<sup>14</sup> First, there are "actual" fraudulent transfers, where the debtor has the actual intent to "hinder, delay or defraud" existing or future creditors by making the transfer. Second, there are "constructive" fraudulent transfers, where the debtor received "less than reasonably equivalent value" in exchange for the

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transfer, plus either (a) the debtor was insolvent or became insolvent as a result of the transfer; (b) the debtor was engaged in a business, or about to be, for which the debtor's remaining capital was "unreasonably small"; (c) the debtor intended to incur debts that were or were likely to be beyond the debtor's ability to repay them as they matured; or (d) the transfer was to or for the benefit of an insider or an employee outside of the ordinary course of business.

## Recovery of Avoided Transfers

A key distinction, often the source of confusion, is that avoiding a transfer as either preferential or fraudulent is different than recovering the property.<sup>15</sup> Once a trustee is able to avoid a preference or fraudulent transfer, if recovery is desirable, the trustee must then look to section 550 of the Bankruptcy Code to determine whether and to what extent such avoided transfers may be recovered.<sup>16</sup>

Generally, section 550 of the Bankruptcy Code allows the trustee to recover the property, or value thereof, from the initial recipient of the transfer. The recovery right is restricted against a subsequent transferee, however, who receives the property "for

value," including satisfaction of an existing debt, and "in good faith," in which case the trustee will be unable to recover despite having avoided the transfer.

## Conclusion

A foreign debtor seeking redress in the United States is faced with a fundamental choice: To invoke the domestic, plenary bankruptcy laws of the United States; to seek relief within the United States ancillary to that available in a foreign jurisdiction; or to seek a combination of both.

That choice is complicated if the foreign debtor requires the avoidance and recovery powers of the bankruptcy courts. To pursue relief under sections 547, 548 or 550 of the Bankruptcy Code directly, the foreign representative must file a plenary petition under chapter 7 or 11.<sup>17</sup> While it may not use such powers in an ancillary case, the foreign representative may pursue avoidance actions that are available under applicable foreign law in a chapter 15 case.

Accordingly, in designing the appropriate strategy, it is important for foreign representatives to be mindful of the remedies available under the Bankruptcy Code. Care must be taken in selecting the type of case that is filed in order to maximize the prospect of achieving the debtor's particular avoidance and recovery objectives in light of the law, whether foreign or domestic, that may be invoked.

1. The term "Bankruptcy Code," as used herein, refers to title 11 of the U.S. Code, codified as amended at 11 U.S.C. §§101-1532.

2. For more general information about chapter 15, including requirements for commencing a case, see L.P. Harrison 3rd & J.L. Bregman, "Chapter 15 of the U.S. Bankruptcy Code: a Hands-on Guide to the New World Order of Ancillary and Cross-Border Cases," 14-5 J. OF BANKR. LAW & PRACTICE (October 2005).

3. 11 U.S.C. §1515. It is possible, though uncommon, for a foreign debtor to be its own representative in commencing a chapter 15 case.

4. The bankruptcy court in denying recognition, however, may prohibit comity or cooperation by any court in the United States but may not block the foreign representative from accessing the court in the United States as a direct participant. 11 U.S.C. §§1509(d) (f). See L.P. Harrison 3rd & J.L. Bregman, *Bankruptcy—Ancillary and Cross-Border Cases*, in *THE LAW OF DISTRESSED REAL ESTATE* (September 2010).

5. *Tacon v. Petroquest Res. Inc. (In re Condor Ins. Ltd.)*, 601 F.3d 319, 329 (5th Cir. 2010). *Id.* at 326. See also T.A. Barnes, "Race to the Courthouse—BAPCPA May Spur International Forum Shopping," in *JOURNAL OF CORPORATE RECOVERY* (2006).

6. 11 U.S.C. §109(a).

7. See 11 U.S.C. §§701, 702 & 703.

8. 11 U.S.C. §541(a).

9. 11 U.S.C. §1529.

10. Unauthorized transfers made after the filing of the petition are avoidable under section 549 of the Bankruptcy Code, and are beyond the scope of this article. 11 U.S.C. §549.

11. Compare *French v. Liebmann (In re French)*, 440 F.3d 145, 140 (4th Cir. 2006), cert. denied, 549 U.S. 815 (2006) (holding that because the defendant and the victims of the fraudulent transfer were in the United States, the trustee was permitted to avoid the recordation of the deed in the Bahamas as a fraudulent transfer under section 548), with *In re Maxwell Commc'n Corp.*, 170 B.R. 800, 814 (Bankr. S.D.N.Y. 1984), *aff'd* on other grounds, 93 F.3d 1036 (2d Cir. 1996) (holding that section 547 could not be applied in an extraterritorial fashion); *Barclay v. Swiss Fin. Corp. Ltd. (In re Bankr. Estate of Midland Euro Exch. Inc.)*, 347 B.R. 708, 718 (Bankr. C.D. Cal. 2006) (holding that "allegedly fraudulent transfers do not become property of the estate until they are avoided," and as such, is not property of the estate under section 541).

12. *In re Dornholt Inc.*, 224 F.3d 871, 873 (8th Cir. 2000).

13. The "new value" exception has particularized accounting requirements which may result in the less than full credit for new value provided.

14. The trustee or debtor in possession may also invoke state avoidance law as needed, which may have a look-back period greater than two years. 11 U.S.C. §544(b). See Timothy A. Barnes and Mark R. Bernstein, Sections 548 and 550—Recent Developments in the Law of Fraudulent Transfers and Recoveries, in Norton's 2009 Year in Review.

15. *Suhar v. Burns (In re Burns)*, 322 F.3d 421, 427 (6th Cir. 2003). For an instructive case on avoidance versus recovery, see *Shapiro v. Art Leather Inc. (In re Connolly North Am., LLC)*, 340 B.R. 829 (E.D. Mich. 2006).

16. While recovery actions, including their limitations and defenses, have significant nuance which is beyond the scope of this article, it can be noted that with certain avoidable actions of purely legal effect, avoidance may be the only remedy that is necessary.

17. 11 U.S.C. §1523(a).