

# Client Alert

May 2013

## Second Circuit Issues Ruling Regarding Determination of a Debtor's Center of Main Interest Under Chapter 15

On April 16, 2013, the United States Court of Appeals for the Second Circuit (the "Second Circuit") issued its decision in *In re Fairfield Sentry Ltd.*,<sup>1</sup> in which the court held that (1) the relevant time for analyzing a debtor's center of main interest ("COMI") for purposes of recognizing a foreign proceeding is at or around the time a petition for recognition is filed; (2) the determination of COMI is dependent on the facts of each case, which may include insolvency proceedings in the foreign jurisdiction; and (3) the public policy exception to relief sought under Chapter 15 is to be narrowly interpreted, and is not met merely because pleadings in the foreign jurisdiction are sealed from public access. While the *Fairfield Sentry* decision suggests that each case will involve a fact-intensive inquiry, the decision provides important guidance for creditors seeking to challenge a Chapter 15 debtor's petition for recognition by establishing temporal guidelines for determining a debtor's COMI.

### Case Background

Fairfield Sentry Limited ("Fairfield") was organized in 1990 under the laws of the British Virgin Islands ("BVI"). Pursuant to its Memorandum of Association, Fairfield administered its business interests from the BVI, where its registered office, registered agent, registered secretary and corporate documents, among other things, were located. Fairfield's board of directors oversaw the management, with day-to-day operations handled by an investment manager, Fairfield Greenwich Group ("FGG"), based in New York. Fairfield's three directors, Walter Noel Jr., Jan Naess and Peter Schmid, resided in New York, Oslo and Geneva, respectively.

From 1990 to December 11, 2008, Fairfield was one of the largest "feeder funds" that invested with Bernard L. Madoff Investment Securities LLC. When Bernard Madoff was arrested, Naess and Schmid began winding down Fairfield's business. From December 2008 to July 2009 they participated in approximately 44 teleconference board meetings initiated by Fairfield's registered agent in the BVI. During this time, Naess and Schmid advised Fairfield's shareholders as to measures being taken in response to the Madoff scandal, with related correspondences issuing from Fairfield's address in the BVI.

In May 2009 Morning Mist Holdings Limited and Miguel Lomell (collectively, "Morning Mist"), Fairfield shareholders, filed a derivative action in New York state court, claiming that Fairfield's directors, management and service providers breached duties to Fairfield (the "New York Litigation").

On July 21, 2009, the High Court of Justice of the Eastern Caribbean Supreme Court (the "BVI Court") entered an order commencing Fairfield's liquidation proceedings under BVI law. The BVI Court appointed Kenneth Krys and Christopher Stride<sup>2</sup> as Fairfield's liquidators (the "Foreign Representative"). On June 14, 2010 (the "Petition Date"), the Foreign Representative petitioned the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") for recognition of the BVI

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<sup>1</sup> Case No. 11-4376, 2013 WL 1593348 (2d Cir. Apr. 16, 2013).

<sup>2</sup> Mr. Stride later resigned from the case.

liquidation proceedings as a foreign main proceeding under Chapter 15 of the Bankruptcy Code. Morning Mist opposed the Foreign Representative's petition, arguing that over the course of its operational history Fairfield's COMI was New York and, thus, the BVI proceeding should at most be recognized as a foreign non-main proceeding. If the BVI proceeding was recognized only as a foreign non-main proceeding, then Fairfield would not automatically receive a stay of all proceedings against Fairfield in the United States, including the New York Litigation.

### **Lower Court Decisions**

On July 22, 2010, the Bankruptcy Court granted the Foreign Representative's petition for recognition of the BVI proceeding as a foreign main proceeding, finding that pursuant to section 1502 of the Bankruptcy Code, Fairfield's COMI was in BVI. In arriving at its conclusion, the Bankruptcy Court examined Fairfield's operations between December 2008, when Fairfield ceased operations, and the Petition Date. Specifically, the Bankruptcy Court found that

[u]pon the revelation of the notorious Madoff fraud in December of 2008, the Debtors discontinued the transfer of funds for investment with BLMIS in New York, which comprised 95% of [Fairfield's] investments. The board of representatives at the Debtors' New York-based investment managers, [FGG], resigned shortly thereafter, and the Debtors' contracts with FGG were severed in 2009, still long before the filing of the Petition. As a result, the Debtors have no place of business, no management, and no tangible assets located in the United States. Rather, the Debtors' activities for an extended period of time have been conducted only in connection with winding up the Debtors' business .... The Court finds that the facts now extant provide a sufficient basis for finding that the Debtors' COMI for the purpose of recognition as a main proceeding is in the BVI, and not elsewhere.<sup>3</sup>

The Bankruptcy Court also found that, even though Fairfield had assets in other jurisdictions, the administration of its affairs from December 2008 to the Petition Date was orchestrated from the BVI.<sup>4</sup> Finally, the Bankruptcy Court did not find bad-faith COMI manipulation.

Morning Mist appealed the Bankruptcy Court's decision to the district court. The district court affirmed, holding that the Bankruptcy Court properly considered Fairfield's administrative activities in its COMI analysis, and correctly considered Fairfield's COMI as of the filing of the Chapter 15 petition (not over its 18-year operational history).<sup>5</sup> In addition to its arguments concerning Fairfield's COMI, Morning Mist also argued that recognition of the BVI liquidation would be manifestly contrary to U.S. public policy, and was therefore barred by section 1506 of the Bankruptcy Code, because the court records in the BVI liquidation were sealed. The district court rejected Morning Mist's argument on the basis that the right of public access to court records is not absolute in the United States.

### **Second Circuit Decision**

On appeal to the Second Circuit, Morning Mist argued that (1) the Bankruptcy Court should have considered Fairfield's entire operational history when determining its COMI; (2) the Bankruptcy Court erred in considering the BVI liquidation proceedings when determining COMI; and (3) the BVI proceeding was against U.S. public policy because the records in the proceeding were sealed. The Second Circuit rejected each of Morning Mist's arguments and affirmed the district court and Bankruptcy Court decisions.

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<sup>3</sup> *In re Fairfield Sentry Ltd.*, 440 B.R. 60, 64 (Bankr. S.D.N.Y. 2010).

<sup>4</sup> *Id.* at 65.

<sup>5</sup> *Id.*

**a. Relevant Time Period**

In determining the relevant time period to use when determining a debtor's COMI, the Second Circuit examined the statutory text of Chapter 15, the way in which Chapter 15 has been interpreted by other courts, and international sources.<sup>6</sup> With regard to the text of Chapter 15, the court noted that while Chapter 15 does not define COMI, section 1517 provides that a "foreign proceeding shall be recognized ... as a foreign main proceeding if it is pending in the country where the debtor has the center of main interests." 11 U.S.C. § 1517(b). The Second Circuit concluded that the present tense language used in the statute requires the use of the filing date of the Chapter 15 petition to "anchor the COMI analysis."<sup>7</sup> The Second Circuit further noted that the majority of courts that have examined the issue have held the filing date of the Chapter 15 petition to be determinative.<sup>8</sup> Lastly, the Second Circuit noted that Congress instructed that "[i]n interpreting [Chapter 15], the court shall consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions."<sup>9</sup> In order to keep the provisions of Chapter 15 consistent with similar international provisions, the Second Circuit desired a time period that is "regular and ascertainable," such as the date the Chapter 15 petition was filed.<sup>10</sup>

Based on the foregoing, the Second Circuit found the relevant time period for determining a debtor's COMI to be at or around the date the Chapter 15 petition is filed but that a court may consider the period between the commencement of the foreign proceeding and the filing of the Chapter 15 petition to ensure that a debtor has not manipulated its COMI in bad faith.<sup>11</sup> Addressing the Bankruptcy Court's decision, the Second Circuit found that the Bankruptcy Court had erred in considering a longer period of time, by beginning with Madoff's arrest instead of the Petition Date or the commencement of the BVI liquidation proceeding, but that the error was immaterial.<sup>12</sup>

**b. COMI Factors**

The Second Circuit held that any relevant activities, including liquidation activities and administrative functions, may be considered in the COMI analysis, with no one factor or factors being determinative in all cases.<sup>13</sup> Accordingly, the Second Circuit found that the Bankruptcy Court's factual findings regarding Fairfield's COMI were not clearly erroneous and, thus, the Second Circuit affirmed the Bankruptcy Court's decision.

**c. Scope of the Public Policy Exception**

The Second Circuit also addressed Morning Mist's assertions that the BVI proceeding should not be recognized under Chapter 15 because pleadings in the proceeding were sealed, which is fundamentally

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<sup>6</sup> *In re Fairfield Sentry Ltd.*, Case No. 11-4376, 2013 WL 1593348, at \*4 (2d Cir. Apr. 16, 2013).

<sup>7</sup> *Id.* at \*5.

<sup>8</sup> *Id.* at \*5-6.

<sup>9</sup> *Id.* at \*6.

<sup>10</sup> *Id.* at \*6-8.

<sup>11</sup> *Id.* \*8.

<sup>12</sup> *Id.* at \*9.

<sup>13</sup> *Fairfield Sentry*, 2013 WL 1593348, at \*8-9.

against U.S. public policy regarding access to court records. The Second Circuit addressed this issue by looking to section 1506, which provides: “Nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States.”<sup>14</sup> The Second Circuit concluded that the wording of section 1506 requires a narrow reading of the exception. The Second Circuit’s narrow interpretation is consistent with other courts that have addressed the question of whether U.S. public policy prohibits the enforcement of a foreign judgment in Chapter 15 proceedings.<sup>15</sup>

The Second Circuit examined whether open access to court records is a fundamental right such that infringing on such right would be against public policy. The Second Circuit first examined the facts surrounding the BVI proceeding, noting that while certain relevant pleadings were sealed, public summaries of the documents were available and a party seeking to review the documents could request access from the court. The Second Circuit then examined its prior precedent on the matter and concluded that “the right to access court documents is not absolute and can easily give way to ‘privacy interests’ or other considerations.”<sup>16</sup> Accordingly, the Second Circuit rejected Morning Mist’s argument that the BVI liquidation proceeding was against public policy, holding instead that Morning Mist failed to establish that “unfettered public access to court records is so fundamental in the United States that recognition of the BVI constitutes one of those exceptional circumstances contemplated in section 1506.”<sup>17</sup>

The Second Circuit’s analysis mirrors the fact-specific approach other courts have employed when determining whether to enforce a foreign order that has been challenged on public policy grounds. For example, in *In re Vitro, S.A.B. de C.V.*<sup>18</sup> the U.S. Court of Appeals for the Fifth Circuit affirmed a bankruptcy court’s ruling declining to enforce a plan of reorganization approved by a Mexican court because the plan provided for third-party releases that are prohibited as against public policy in the Fifth Circuit.<sup>19</sup>

## **Conclusion**

The *Fairfield Sentry* decision establishes the relevant time period for courts in the Second Circuit to examine when determining a debtor’s center of main interest for the purpose of recognizing a foreign insolvency proceeding under Chapter 15. The decision establishes that there are no bright-line rules, factors or tests for determining a debtor’s COMI. Finally, consistent with the rulings of other courts, the *Fairfield Sentry* decision establishes that the public policy exception to requests for relief under Chapter 15 is to be narrowly interpreted.

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<sup>14</sup> *Id.* at \*10.

<sup>15</sup> See also, *In re Vitro, S.A.B. de C.V.*, 473 B.R. 117 (Bankr. N.D. Tex. 2012) *aff’d* 701 F.3d 1031 (5th Cir. 2012); *In re Ephedra Prods. Liability Litig.*, 349 B.R. 333 (S.D.N.Y. 2006); *In re Toft*, 453 B.R. 186, 189 (Bankr. S.D.N.Y. 2011); *In re Qimonda AG*, 462 B.R. 165 (Bankr. E.D. Va. 2011).

<sup>16</sup> *Id.* (quoting *Lugosh v. Pyramid Co. of Onondaga*, 435 F.3d 110, 120 (2d Cir. 2006)).

<sup>17</sup> *Id.*

<sup>18</sup> *In re Vitro, S.A.B. de C.V.*, 701 F.3d 1031 (5th Cir. 2012)

<sup>19</sup> See also, *Ephedra*, 349 B.R. at 335-337 (enforcing foreign proceeding’s order regarding claim resolution process that did not provide access to jury trial as a jury trial was not absolutely necessary to have a fair and impartial verdict). *But see, Toft*, 453 B.R. at 196 (declining to enforce foreign order granting foreign representative access to debtor’s email accounts stored on U.S. servers as a violation of privacy rights and constitutional principles and thus, against U.S. public policy); *Qimonda*, 462 B.R. at 185 (declined to enforce German law to the extent it allowed for cancellation of U.S. patent licenses)

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