



BANKRUPTCY PRACTICE

Expert Analysis

Recognition of Multinational Non-Judicial Foreign Insolvency

In a recent decision by the U.S. Bankruptcy Court for the District of Nevada (the “Bankruptcy Court”) in *In re Betcorp Ltd.*,¹ the Bankruptcy Court recognized the voluntary winding up of an Australian company as a “foreign main proceeding” under chapter 15 of the U.S. Bankruptcy Code, which entitles the foreign debtor to certain protections of the U.S. Bankruptcy Code, even though no petition or application was filed with an Australian court by the company’s Australian shareholders or its liquidators.

Although this decision may seem counterintuitive to those familiar only with the judicial bankruptcy process under the Bankruptcy Code, the holding in *Betcorp* demonstrates both the commonalities and distinctions in the applicable law governing bankruptcy and insolvency in the United States and certain foreign jurisdictions. In the case of *Betcorp*, Australian law provides for the option of liquidating a corporate entity under statutory corporate law in a largely administrative process, with the supervision of an Australian court invoked only upon request of an interested party to review an action taken during the wind-up process.

Recognition Analysis

Chapter 15 was added to the Bankruptcy Code in 2005 to reflect the U.S. adoption of the Model Law on Cross-Border Insolvency (the “Model Law”),² which promotes a uniform and coordinated legal regime for cross-border insolvency cases.

One of the core goals of chapter 15 is to provide effective mechanisms for cooperation between U.S. courts and parties in interest and foreign courts and other competent foreign authorities involved in cross-border insolvency cases. This principle of cooperation permits the establishment of greater legal certainty for trade and investment, fair and efficient administration

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of cross-border insolvencies, protection and maximization of the value of the debtor’s assets, and the facilitation of the rescue of troubled businesses in the interest of protecting investment and preserving employment.

A foreign debtor invokes the Bankruptcy Code’s protections by filing a petition under chapter 15 for recognition of its primary insolvency proceeding in its home country. Recognition of a foreign insolvency proceeding as a “foreign main proceeding” permits a foreign debtor to obtain the protections of the U.S.

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bankruptcy process, such as the automatic stay, which prevents creditors from seeking repayment of their claims and commencing or continuing litigation to the disadvantage of creditors in the debtor’s home country.

The recognition of an insolvency proceeding as a foreign main proceeding requires a two-part analysis. The first consideration is whether the insolvency proceeding is a “foreign proceeding” within the meaning of §101(23) of the Bankruptcy Code, which provides that a “foreign main proceeding” is “a collective or 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 reorganization or liquidation.”³

If the insolvency proceeding is not a “foreign proceeding,” the analysis stops there. However, if the insolvency proceeding is a “foreign proceeding,” the second part of the analysis requires a determination of whether the insolvency proceeding is entitled to recognition as a “foreign main” or “foreign nonmain” proceeding under §1517 of the Bankruptcy Code.

A determination that the foreign proceeding is a “foreign main proceeding” requires (i) the proceeding to be pending in the country where the debtor has the “center of its main interests” (also known as COMI); (ii) the foreign representative seeking recognition is a “person” or “body”; and (iii) a petition for recognition has been filed with the bankruptcy court by the foreign representative appointed in the foreign proceeding.⁴

In order to obtain recognition as a “foreign nonmain proceeding” the foreign representative seeking recognition must prove that the foreign debtor has an establishment in the foreign jurisdiction under §1502(5) of the Bankruptcy Code, which generally means any place of operations where the debtor carries out nontransitory economic activity.

A foreign debtor would generally prefer recognition as a foreign main proceeding, as opposed to a foreign nonmain proceeding, because such a designation triggers valuable relief under §1520(a) of the Bankruptcy Code, including application of the automatic stay and avoidance powers.

Factual Background

Betcorp Ltd. was formed and registered under Australian law in 1998 as a publicly traded company regulated by the Australian Securities and Investments Commission (ASIC). Betcorp was a holding company for its subsidiaries in Australia and the West Indies that offered online and telephone gaming to end-users around the world. Initially, its customer base consisted predominately of U.S. citizens. In October 2006, changes in U.S. law made it illegal for U.S. citizens to transfer funds and for companies like Betcorp to receive such funds if they were related to gaming activities. This change in law made Betcorp’s business model unworkable, and it ceased operations shortly thereafter.

Betcorp’s shareholders voted to liquidate the company through a voluntary winding up process under the Australian Corporations Act

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of 2001.⁵ Pursuant to the act, Betcorp appointed two liquidators to liquidate the business and distribute the proceeds to its creditors.

Betcorp's liquidators sought recognition from the Bankruptcy Court in order to stay a patent infringement lawsuit in the U.S. District Court of Nevada by 1st Technology LLC, Betcorp's sole U.S.-based creditor. 1st Technology opposed Betcorp's petition for recognition in order to continue litigating its claims in federal court rather than be forced to have those disputed claims administered in Betcorp's Australian liquidation. 1st Technology objected on the ground that Betcorp's winding up did not qualify as a "foreign proceeding" under §101(23) of the Bankruptcy Code because there was no lawsuit or in-court legal proceeding pending in Australia, Betcorp was not a financially distressed company that needed the protections of Australian insolvency law, and there was no judge or judicial officer directly supervising the actions of Betcorp's liquidators in the wind-up.

The Decision

The Bankruptcy Court determined that Betcorp's winding up process under the Australian Corporations Act was entitled to recognition under chapter 15, thereby staying 1st Technology's U.S. lawsuit.

• **Determination of "Foreign Proceeding."** The Bankruptcy Court rejected 1st Technology's argument that Betcorp's winding up is not a "foreign proceeding" under §101(23) of the Bankruptcy Code because the winding up process is not an in-court process that qualifies under the definition. Instead, the Bankruptcy Court analyzed the elements of the definition of a "foreign proceeding," and relied in part on the Model Law, which defines broadly a foreign insolvency proceeding to be one that is premised upon an insolvency-related law in the country of origin, involves creditors collectively, provides for the debtor's assets and affairs to be under the control or supervision of a court or another official body, and has as its purpose the reorganization or liquidation of the debtor.

The *Betcorp* court noted that the word "proceeding" required a broad definition in the context of chapter 15, reasoning that it does not necessarily require the intervention of a judicial authority but simply comprises certain acts and formalities set down in law so that courts, merchants, and creditors can know them in advance and apply them evenly in practice. The Bankruptcy Court held that the *Betcorp* wind-up was appropriately considered a "foreign proceeding" because the Australian Corporations Act governed the termination of businesses through the appointment of an administrator or liquidator and established a process for the voluntary winding up of an Australian company, a view which was consistent with Australian case law.

Moreover, the Bankruptcy Court noted that the Australian Corporations Act is primarily administrative in character as demonstrated by its provisions providing for the appointment of a liquidator, service of notices of liquidation,

filing of proofs of debt, and payment of creditors' claims. However, the Bankruptcy Court did note that the act's insolvency provisions do have a judicial component because the actions of liquidators are subject to the review by the Australian courts upon application of a party in interest. Hewing to the Model Law's guidelines, the Bankruptcy Court found that Betcorp's wind-up was collective in nature and preserved the rights and obligations of Betcorp's creditors because it permitted a high degree of creditor involvement in the compulsory process and the creation of a creditors' committee under certain circumstances.

Further, the *Betcorp* court found that the Australian process was authorized or conducted under a law related to insolvency or the adjustment of debts because the Australian Corporations Act is structured as a comprehensive regime regulating the life cycle of an Australian corporation and includes several subparts on corporate insolvency. The Bankruptcy Court found persuasive the Australian Parliament's enactment of the act's insolvency provisions in the context of Australia's adoption of the Model Law.

Finally, the Bankruptcy Court concluded that Betcorp's wind-up was subject to the control and supervision of a foreign court because of ASIC's supervision over Betcorp's liquidators and the authority of Australian courts to review the liquidators' conduct and hear controversies raised by the liquidators or creditors that arise from the voluntary winding up process.

• **Foreign Main Versus Nonmain Proceeding.** The Bankruptcy Court then determined whether Betcorp's winding up process was a "foreign main proceeding" or "foreign nonmain proceeding" under §1517 of the Bankruptcy Code and thus the ultimate forms of relief to which Betcorp would be entitled. Even though Betcorp derived significant revenue from customers around the world and had subsidiaries outside of Australia, the Bankruptcy Court held that Betcorp's wind-up was a "foreign main proceeding" because all three elements under §1517 of Bankruptcy Code for such a proceeding were met.

First, the Bankruptcy Court found that Betcorp's COMI was in Australia because that is where Betcorp's headquarters, shareholders, management, and assets were located and the jurisdiction whose laws would apply in most disputes. Second, the court found that Betcorp's liquidators qualified as foreign representatives applying for recognition. The third prong was satisfied because the appointed liquidators properly filed a petition for recognition and provided evidence from ASIC of their appointment pursuant to the Australian Corporations Act.

Analysis

The *Betcorp* decision reflects the need for U.S. creditors to closely monitor the insolvency processes of foreign corporations with which they do business in light of the fact that many foreign insolvency processes may not be conducted in a formal judicial setting. This decision underscores

the point that, although many distinctions exist among the various foreign insolvency regimes, a U.S. bankruptcy court will most likely recognize a non-judicial foreign insolvency process when the process complies with the flexible definition of a "foreign proceeding" set forth in the Model Law. As such, creditors must be on guard that they may be forced to shoulder the additional expense and administrative burden of vindicating their U.S.-based rights, such as those derived from U.S.-based contracts or U.S.-sited litigation, in a foreign insolvency process.

Interestingly, the *Betcorp* court found that the facts weighed heavily in favor of finding that the debtor's COMI was in Australia even though the company derived income from business conducted outside of Australia. The Bankruptcy Court noted that its decision does not extinguish 1st Technology's rights. Rather, the recognition of Betcorp's wind-up vested in Betcorp's liquidators the right to determine where 1st Technology's claim will be liquidated. Although the parties could agree to allow the lawsuit to proceed in the United States, the greater likelihood is that 1st Technology would have to yield to the interests of the majority of Betcorp's Australian creditors and pursue its claim in Australia with recourse only to Australian courts.

Conclusion

The *Betcorp* decision reflects the highly evolved global economy in which more businesses conduct regular activity in several countries, and presages the increasing importance of understanding the relationship of the bankruptcy or insolvency laws of multiple jurisdictions to one another and to the Model Law.

While foreign companies doing business in the United States will be expected to be familiar with the insolvency laws of their countries of origin, the globalization of commerce also requires such entities to have a sophisticated understanding of chapter 15 and the Model Law. In that vein, such companies—especially those with significant overseas revenue or operations—that seek recognition pursuant to chapter 15 must be prepared to undergo a case-specific, individualized analysis as was performed in *Betcorp* in order to ensure they obtain the valuable protections of the Bankruptcy Code to administer their insolvency processes in an orderly fashion.

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1. No. 08-21594 (BAM), 400 B.R. 266 (Bankr. D. Nev. Feb. 9, 2009).

2. United Nations Commission on International Trade Law, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment ¶23 at 10, U.N. Gen. Assembly, UNCITRAL 30th Sess., U.N. Doc. A/CN.9/442 (1997).

3. 11 USC §101(23).

4. Id. §1517.

5. Australian Corporations Act (Cth) 2001.