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Chapter 15 and Avoidance Actions under Foreign Law

Article contributed by: Autumn Highsmith of Haynes and Boone, LLP

In a case of first impression, the United States Court of Appeals for the Fifth Circuit overruled the decisions of the United States Bankruptcy Court and the United States District Court for the Southern District of Mississippi and held that a chapter 15 proceeding may be used to pursue foreign law avoidance actions against defendants and assets in the United States.

Background

Condor Insurance Ltd. ("Condor") formerly operated an insurance and surety bond business in Nevis.¹ On November 27, 2006, one of Condor's creditors requested that the Eastern Caribbean Supreme Court in the High Court of Justice of St. Christopher and Nevis, Nevis Circuit ("Nevis Court") initiate a winding up proceeding ("Nevis Proceeding") against Condor.² On May 18, 2007, the creditor's winding up petition was granted, and Richard Fogerty and William Tacon were appointed as joint official liquidators ("Liquidators") by the Nevis Court.

On July 26, 2007, the Liquidators, as the foreign representative of Condor, filed a chapter 15 petition for recognition of a foreign main proceeding in the United States Bankruptcy Court for the Southern District of Mississippi, seeking recognition of the Nevis Proceeding. On August 21, 2007, the bankruptcy court entered its order recognizing the Nevis Proceeding as a foreign main proceeding pursuant to [11 U.S.C. § 1517](#).

After recognition, the Liquidators filed a complaint against Condor Guaranty, Inc. ("CGI"), Petroquest Resources, Inc., and other defendants (collectively, "Defendants") requesting relief for, among other things, the avoidance of fraudulent conveyances under Nevis law. Specifically, the Liquidators contended that over \$313 million in Condor's assets had been fraudulently transferred to or by the Defendants and that most of the transferred assets were located in the United States. The Liquidators alleged that the transfers had been made to prevent creditors from recovering the value of the assets in the Nevis Proceeding.

CGI filed a motion to dismiss the complaint in part on the grounds that the bankruptcy court lacked subject matter jurisdiction. CGI argued that [11 U.S.C. §§ 1521\(a\)\(7\)](#) and [1523\(a\)](#) prohibited a foreign representative under chapter 15 from bringing avoidance actions unless the foreign representative filed a bankruptcy case under either chapter 7 or chapter 11 of the Bankruptcy Code.³

Applicable Law

Section 1521(a)(7) provides that a bankruptcy court has the discretion to grant a foreign representative in a chapter 15 proceeding relief available to a trustee “except for relief available under [sections 522, 544, 545, 547, 548, 550, and 724\(a\)](#) [of the Bankruptcy Code].”

Section 1523(a) provides that when a foreign proceeding has been recognized, “the foreign representative has standing in a case concerning the debtor pending under another chapter of this title to initiate actions under [sections 522, 544, 545, 547, 548, 550, 553, and 724\(a\)](#) [of the Bankruptcy Code].”

The specific sections of the Bankruptcy Code referenced in §§ 1521(a)(7) and 1523(a) are those containing a trustee’s “avoidance powers,” *i.e.*, a trustee’s powers to avoid the transfer of the debtor’s property that would deplete the debtor’s estate at the expense of its creditors. Such powers, generally described, include: (1) those addressing exempt property (§ 522); (2) the “strong arm” power, which permits the trustee to act as a judicial lien creditor (§ 544); (3) the power to avoid statutory liens (§ 545); (4) the power to avoid transactions as “preferences” (§ 547); (5) the power to avoid fraudulent transfers (§ 548); and (6) the power to avoid liens that secure claims for compensatory fine, penalty, forfeiture, or punitive damages (§ 724(a)). Section 550 contains the rules that govern the mechanics of avoidance actions.

The issue in *Condor* is whether the exceptions to the relief available to a foreign representative in a chapter 15 ancillary proceeding listed in § 1521(a)(7) prohibit a foreign representative from bringing avoidance actions under applicable foreign law in the chapter 15 proceeding.

The Liquidators argued that the plain language of chapter 15 only prohibits foreign representatives from utilizing the avoidance provisions of the Bankruptcy Code when seeking avoidance of transfers. The Liquidators further contended that chapter 15 does not prohibit a foreign representative from bringing avoidance actions under foreign law.

The Defendants contended that reading Bankruptcy Code §§ 1521(a)(7) and 1523(a) together with the legislative history of both sections prohibit a foreign representative from bringing avoidance actions under either the Bankruptcy Code or foreign law without filing either a chapter 7 or a chapter 11 bankruptcy case.

The Bankruptcy and District Court Decisions

Both the United States Bankruptcy Court and the United States District Court for the Southern District of Mississippi interpreted §§ 1521(a)(7) and 1523(a) to deny standing to the Liquidators to pursue avoidance actions based on Nevis law.

After considering the complimentary relationship between §§ 1521(a)(7) and 1523(a),⁴ the bankruptcy court concluded that “[c]hapter 15 was not designed to incorporate the law of the home court (here, Nevis) into the United States bankruptcy system” and granted CGI’s motions to dismiss. *Fogerty v. Condor Guaranty, Inc. (In re Condor Ins. Ltd. (In Official Liquidation))*, [Adv. No. 07-05049, 2008 BL 150978, at *5](#) (Bankr. S.D. Miss. July 17, 2008). The bankruptcy court adopted a portion of CGI’s brief in support of the motion to dismiss that argued:

[T]he Liquidators improperly ask this [c]ourt to go beyond the parameters of [c]hapter 15 by using this [c]ourt as a *de facto* Nevis Court, interpreting and applying the substantive law of Nevis against a non-United States entity. The Liquidators cannot use this [c]ourt as a hub from which to launch international litigation under foreign avoidance law. If the Liquidators believe they have valid claims, those claims should be asserted elsewhere - not here.

Id. at *3.

The district court affirmed the bankruptcy court’s dismissal, concluding that the bankruptcy court had correctly interpreted §§ 1521(a)(7) and 1523(a). *Fogerty v. Condor Guaranty, Inc. (In re Condor Ins. Ltd. (In Official Liquidation))*, [411 B.R. 314, 316](#) (S.D. Miss. 2009). The district court concluded that the plain language of chapter 15 does not specifically address the use of avoidance powers under foreign law, but that the legislative history of §§ 1521 and 1523(a) support the bankruptcy court’s decision. *Id.* 318–19.

The district court primarily relied upon a House of Representatives report that provides:

The Model Law is not clear about whether it would grant standing in a recognized foreign proceeding if no full case were pending. This limitation [in § 1523] reflects concerns raised by the United States delegation during the UNCITRAL debates that a simple grant of standing to bring avoidance actions neglects to address very difficult choice of law and forum issues. This limited grant of standing in [§ 1523] does not create or establish any legal rights of avoidance nor does it create or imply any legal rules with respect to the choice of applicable law as to the avoidance of any transfer or obligation. The courts will determine the nature and extent of any such action and what national law may be applicable to such action.

Id. (citing H.R. Rep. 109-31(l), 109th Cong., 1st Sess. (2005), U.S. Code Cong., & Admin. News 2005, p. 88). The district court concluded that §§ 1521(a)(7) and 1523(a) are intended to “exclude all of the avoidance powers specified, under either United States or foreign law, unless a [c]hapter 7 or 11 bankruptcy proceeding is instituted.” *Id.* at 319.

The district court went on to explain that the Liquidators’ interpretation of § 1521(a)(7) “would conflict with Congress’ expressed desire that courts make the choice of law determination in a full bankruptcy proceeding.” *Id.* The district court echoed the bankruptcy court’s suggestion that the Liquidators seek avoidance of the challenged transfers in a Nevis court and then seek recognition of any Nevis judgment in the United States. *Id.* at 318.

The Fifth Circuit Decision

The United States Court of Appeals for the Fifth Circuit reversed the decisions of the bankruptcy court and the district court. *Fogerty v. Petroquest Res., Inc. (In re Condor Ins. Ltd. (In Official Liquidation))*, 601 F.3d 319 (5th Cir. 2010). The Fifth Circuit held that bankruptcy courts have authority to offer avoidance relief under foreign law in chapter 15 ancillary proceedings. *Id.*

The Fifth Circuit explained that “[w]hile it is plain that relief under the listed sections [in § 1521(a)(7)] is excluded, the statute is silent regarding proceedings that apply foreign law, including any rights of avoidance such law may offer.” *Id.* The court referenced the maxim *expressio unius est exclusio alterius* (in construing statutes, this has come to mean the mention of one thing within the statute implies the exclusion of another thing not so mentioned), and concluded that § 1521(a)(7) “provides for ‘any relief’ and excepts only actions under sections 522, 544, 545, 547, 548, and 724(a) of the [Bankruptcy] Code and includes no other language suggesting that other relief might be excepted.” *Id.* The court explained that “[i]f Congress wished to bar all avoidance actions whatsoever their source, it could have stated so; it did not.” *Id.*

The Fifth Circuit rejected the lower courts’ interpretation of the legislative history of § 1521(a)(7), writing:

Congress did not intend to restrict the powers of the [United States] court to apply the law of the country where the main proceeding pends. Refusing to do so would lend a measure of protection to debtors to hide assets in the United States out of the reach of the foreign jurisdiction, forcing foreign representatives to initiate much more expansive proceedings to recover assets fraudulently conveyed, the scenario [c]hapter 15 was designed to prevent.

Id. at 6. The court of appeals also rejected the bankruptcy and the district courts’ suggestion that the Liquidators should

instead bring their claims in Nevis, explaining that full relief in Nevis might not be available if the Nevis courts cannot exercise jurisdiction over all of the Defendants. *Id.*

Additionally, the Fifth Circuit determined that its conclusion was consistent with prior case law under [11 U.S.C. § 304](#), the predecessor to chapter 15. *Id.* Indeed, the court reasoned that chapter 15 might well have been a codification of case law under § 304 that held that “avoidance actions under foreign law were permitted when foreign law applied and would provide for such relief.” *Id.* Finally, the court concluded that its holding would create settled expectations of the rules that will govern domestic businesses efforts in foreign territories. *Id.*

Implications

As a result of the Fifth Circuit’s decision in *Condor*, assets transferred from the situs of a foreign main proceeding to the United States can be collected and distributed to creditors in the same manner as other assets. In the Fifth Circuit, this decision is a powerful tool for foreign representatives attempting to protect a foreign debtor’s assets in the United States.

The bankruptcy court, the district court, and the Fifth Circuit did not address § 544, one of the provisions listed in § 1521(a)(7), which provides that a bankruptcy trustee may avoid any transfer “that is voidable under applicable law” by a judgment creditor. If “applicable law” under § 544(b) is interpreted by other circuits to include foreign law, the question of whether § 1521(a)(7) bars foreign avoidance actions could be resolved differently. In short, the Fifth Circuit’s decision in *Condor* will not be the last word on whether a foreign representative can pursue avoidance actions based on foreign law in a chapter 15 ancillary proceeding.⁵

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¹ Nevis is an island in the Caribbean. Along with Saint Kitts, it forms the Federation of Saint Kitts and Nevis.

² A “winding up proceeding” is similar to a chapter 7 bankruptcy case under United States law.

³ In this case, *Condor* was not eligible for relief under chapters 7 or 11 because *Condor* was a foreign insurance company. Foreign insurance companies are not permitted to file chapter 7 or chapter 11 cases. See [11 U.S.C. §§ 109\(b\)](#) and [\(d\)](#).

⁴ The bankruptcy court wrote that [11 U.S.C. § 1521\(a\)\(7\)](#) delineates that a bankruptcy court does not have the power to provide relief in the form of avoidance powers to a foreign representative under chapter 15; instead, [11 U.S.C. § 1523\(a\)](#) affirmatively states that avoidance powers are available to a foreign representative if (and only if) those powers are exercised in a companion case under