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Upside Down in Chapter 15

Can U.S. Entities Qualify as "Foreign" Debtors in the U.S.?

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Most lawyers familiar with chapter 15 cross-border insolvency proceedings might assume that "foreign" debtors in chapter 15 cases must be foreign entities — that is, entities not organized under the laws of U.S. states. For example, the idea of a Delaware corporation filing a chapter 15 bankruptcy petition, as opposed to filing a chapter 7 or 11 petition, might seem fanciful at first blush. However, what if that U.S. entity is part of a larger corporate family that conducts the bulk of its business in another country and commences insolvency proceedings for that business outside the U.S.?

This is precisely the scenario presented by the chapter 15 case of *Karhoo Inc*., filed in late 2016 in the U.S. Bankruptcy Court for the Southern District of New York.[1] Karhoo, a Delaware corporation, was the parent to several U.K. subsidiaries. Together, the Karhoo companies provided electronic ride-comparison services in the U.K. and, to a lesser extent, in the U.S. After encountering financial challenges, the U.K. subsidiaries commenced administration proceedings in the U.K., and administrators were appointed. Shortly after, the U.K. administrators were also appointed as administrators of the U.S. parent, which was also placed in U.K. administration, on the basis that the U.S. operations were managed out of the U.K.

All of that may seem unnoteworthy, but what happened next was unusual. The administrators for Karhoo U.K. and Karhoo U.S. initiated chapter 15 cases in the U.S., not just for Karhoo U.K. but also for Karhoo U.S. The administrators petitioned the U.S. bankruptcy court for recognition of those entities' U.K. proceedings as "foreign main proceedings" of both "foreign" debtor entities. The bankruptcy court granted recognition, and the chapter 15 cases proceeded in the U.S.

Karhoo's winding road to the U.S. bankruptcy court may at first glance seem to turn chapter 15 on its head. After all, Karhoo U.S. is without doubt a "domestic" U.S. entity as a matter of corporate organization, but in its chapter 15 case in the U.S., it is a "foreign" debtor in its "home" country. Yet in many respects, based on Karhoo's particular circumstances, the result is arguably consistent with chapter 15's primary objectives of centralized administration and respect for the expectations of creditors, and in any event highlights the flexibility that chapter 15 can provide in complex multinational-debtor situations.

1 *In re Karhoo Inc.*, No. 16-13545 (Bankr. S.D.N.Y. 2016).

Relevant Provisions and Background

One of chapter 15's principal objectives is to foster cooperation among the U.S. and foreign courts as they address the insolvency of multinational companies and corporate groups.[2] Chapter 15 generally embraces the "universalist" theory of international insolvency, which posits that a single court — in the jurisdiction where the debtor has its principal place of business — should have primary adjudicatory responsibility for the insolvency proceedings of a multinational companies and corporate groups.[3] While the representatives of the foreign entity can seek assistance from "auxiliary" courts in other jurisdictions as needed, the intention is that those courts will, for the most part, defer to the law of the debtor's primary or "main" jurisdiction.[4] Consistent with this view, chapter 15 allows for the recognition of a foreign insolvency proceeding in the U.S. and, in many respects, defers to the primary authority of those proceedings.[5] Chapter 15 affords considerable flexibility in effectuating these goals.[6]

Notwithstanding its generally flexible and universalist approach, chapter 15 poses its own barriers to entry. For one, not every entity with an insolvency proceeding pending in a foreign jurisdiction qualifies to be a debtor in a chapter 15 case. Courts, including the Second Circuit Court of Appeals, have held that § 109, which imposes limitations on the sorts of entities that may be debtors under the U.S. Bankruptcy Code, applies equally in chapter 15.[7] Thus, to be eligible for chapter 15 relief, a prospective debtor must, according to those courts, have a place of business or assets in the U.S. (although the threshold for assets sufficient to satisfy this requirement is low).[8]

Even if an entity with a pending foreign insolvency proceeding qualifies as a chapter 15 debtor,

2 *See* 11 U.S.C. § 1501; *In re SPhinX Ltd.*, 351 B.R. 103, 112 (Bankr. S.D.N.Y. 2006).
3 *See* Daniel M. Glosband and Christopher T. Katucki, "Claims and Priorities in Ancillary Proceedings Under Section 304," 17 *Brook. J. Int'l L.* 477, 481 (1991).
4 *Id.*; *see also* George W. Shuster, Jr. and Benjamin W. Loveland, "Will Chapter 15 Be the 'Exclusive Destination' for Foreign Debtors?," XXXIV *ABI Journal* 12, 42-43, 90, December 2015, *available at* abi.org/abi-journal.
5 11 U.S.C. §§ 1517 (regarding recognition) and 1519 (regarding relief deferring to foreign proceedings).
6 *See SPhinX*, 351 B.R. at 112.
7 *See, e.g., In re Barnet*, 737 F.3d 238 (2d Cir. 2013); *but see In re Bemarmara Consulting AS*, No. 13-13037, Docket No. 38 (Bankr. D. Del. Dec. 17, 2013).
8 *See In re Berau Capital Res. Pte.*, 540 B.R. 80 (Bankr. S.D.N.Y. 2015) (noting that indenture governed by New York law represented property in New York).

the foreign proceeding itself must meet the requirements for recognition under chapter 15. Chapter 15 recognizes two types of foreign proceedings: "main" and "non-main."[9] The recognition requirements can be rigid, and a foreign proceeding that does fit the definition of a main or non-main proceeding (*e.g.*, an entity subject to a non-U.S. insolvency proceeding that has nearly all of its business operations in the U.S.) cannot be recognized under chapter 15.[10]

A foreign main proceeding is one that is "pending in the country where the debtor has the center of its main interests [COMI]."[11] A foreign non-main proceeding is any other proceeding "pending in a country where the debtor has an establishment."[12] Recognition carries with it certain advantages, including mandatory imposition of the automatic stay.[13]

Chapter 15 presumes that a debtor's COMI is the location where it maintains its registered office (or place of incorporation).[14] However, even with this presumption, the burden of establishing COMI remains with the foreign representative seeking recognition, and courts can (and do) find that the COMI and place of incorporation are not synonymous, even in the absence of any objections by other stakeholders. The concept of COMI is sometimes described as "the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties."[15] In determining a debtor's COMI, courts consider the following set of facts:

> ... the location of the debtor's headquarters; the location of those who actually manage the debtor (which, conceivably could be the headquarters of a holding company); the location of the debtor's primary assets; the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes.[16]

A debtor's COMI is usually determined based on its activities at the time the chapter 15 petition for recognition is filed, though courts may consider actions taken by the debtor that may indicate it has manipulated its COMI in bad faith.[17] Early chapter 11 precedent makes it clear that even a non-U.S. entity might be ineligible as a "foreign debtor" under chapter 15 if its operations are primarily U.S.-based.

In *Bear Stearns*, notwithstanding the lack of any objection to recognition of Bear Stearns' Cayman insolvency proceeding as a foreign main proceeding, the bankruptcy court held that the case was not eligible for recognition at all. While its registered office was in the Cayman Islands (thus giving rise to a presumption of COMI there), Bear Stearns had almost no other connections to the Cayman Islands. Conversely, its management — and all of its liquid assets — were located in the U.S. On that basis, the bankruptcy court concluded that Bear Stearns' COMI was the U.S.; therefore, its Cayman proceeding was not eligible for recognition as a foreign main proceeding. The bankruptcy court also denied recognition as a non-main proceeding because the only economic activity that Bear Stearns conducted in the Cayman Islands related to its offshore business.

Karhoo's Road to Chapter 15

The chapter 15 case of *Karhoo Inc*. presents a somewhat unique situation in the chapter 15 landscape: a U.S. company as a chapter 15 foreign debtor. As previously noted, the Karhoo enterprise, consisting of a U.S. parent and several U.S. and U.K. subsidiaries, offered a "ride-comparison" technology that gave customers access to local dispatchers and transportation providers. Karhoo was founded in London and had operations in the U.K. and U.S. It offered its services primarily in England and was in the pilot stages of offering services in New York.

Karhoo encountered technical and operational difficulties and ultimately decided to cease operations, and the Karhoo U.K. entities entered into a U.K. administration proceeding in November 2016. About a week later, the Karhoo U.S. entities joined the administration proceeding — something that was appropriate as a matter of U.K. law, because from a U.K. perspective, most of the U.S. business was operated from the U.K. In December 2016, Karhoo's U.K. administrators filed a chapter 15 petition for the U.S. entity (and its U.K. subsidiaries) in the New York Bankruptcy Court and sought recognition of the U.K. administration proceeding as a foreign main proceeding.

In its first-day papers, Karhoo stated that "notwithstanding that the company is incorporated under the laws of the State of Delaware, the place where the company conducts the administration of its interest on a regular basis and is therefore ascertainable by third parties is in England."[18] Karhoo explained that its combined corporate headquarters and the C-level management for its corporate family were in the U.K. On the other hand, it acknowledged that its only funded debt — $18 million in secured convertible notes — was issued by the U.S. debtor and governed by U.S. law. Moreover, many of the Karhoo enterprise's critical contracts had been entered into by the U.S. entity. Nevertheless, Karhoo indicated that the negotiations with those creditors and counterparties had taken place in London, and those creditors would have therefore been able to ascertain the enterprise's place of strategic control as being in the U.K. Relying on precedent viewing corporate enterprises as a whole for COMI purposes, Karhoo argued that the component parts of its enterprise formed an economic whole based in the U.K.[19]

Karhoo's first-day request for provisional relief in the form of applying the automatic stay until recognition could take place sheds light on its motivation for commencing a chapter 15 case. Karhoo explained that imposition of the

9 *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd.*, 374 B.R. 122, 126 (Bankr. S.D.N.Y. 2007).
10 *Id.* Chapter 15 also provides an exception to recognition if doing so would "be manifestly contrary to the public policy of the United States." 11 U.S.C. § 1506.
11 11 U.S.C. § 1502(4).
12 11 U.S.C. § 1502(5). "Establishment" is defined as "any place of operations where the debtor carries out a nontransitory economic activity." 11 U.S.C. § 1502(2).
13 11 U.S.C. § 1520(a).
14 11 U.S.C. § 1516(c).
15 *In re Bear Stearns*, 374 B.R. at 129 (citations omitted).
16 *In re Fairfield Sentry Ltd.*, 714 F.3d 127, 137 (2d Cir. 2013) (citing *In re SPhinX Ltd.*, 351 B.R. at 117).
17 *Fairfield Sentry Ltd.* at 137.
18 Declaration of Paul Cooper in Support of Verified Petition for Entry of an Order Recognizing Foreign Main Proceeding and Granting Additional Relief, and Other Relief and First Day Pleadings, *In re Karhoo Inc.*, No. 16-13545, Docket No. 4, at 12 (Bankr. S.D.N.Y. Dec. 20, 2016).
19 Memorandum of Law in Support of Chapter 15 Petition for Recognition of Foreign Main Proceeding and Related Relief, *In re Karhoo Inc.*, No. 16-13545, Docket No. 6, at 11 (Bankr. S.D.N.Y. Dec. 21, 2016) (citing *In re OAS SA*, 533 B.R. 83 (Bankr. S.D.N.Y. 2015)).

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stay was critical to stave off lawsuits by its numerous U.S.-based creditors and termination by counterparties under various contracts, as those actions would be detrimental to Karhoo's business and its creditors at large. Without objection by stakeholders in the case, the bankruptcy court recognized Karhoo's U.K. administration as a foreign main proceeding and allowed the chapter 15 case to move forward in the U.S.

In one sense, this result does not seem different from other scenarios where holding companies for operating companies in foreign jurisdictions filed U.S. chapter 15 cases. For example, in the *Suntech* case, a Chinese operating company that manufactured solar panels had a holding company issue debt to finance those operations. Following a default on that debt, the holding company commenced a non-U.S. insolvency proceeding and then a chapter 15 case in the U.S.[20] However, Suntech's holding company was organized under Cayman Islands law and it filed its foreign insolvency proceeding in the Cayman Islands. Moreover, Suntech's holding company did not conduct any real business in the U.S. By contrast, Karhoo is a U.S.-organized corporation that did conduct some business operations in the U.S.; therefore, its chapter 15 filing is more novel than that of *Suntech*.

Conclusion

The *Karhoo* case, for its uniqueness, remarks upon the current state of chapter 15 proceedings. First, it underlines the "universalist" theoretical underpinnings of chapter 15 by showing that rather than jealously guard their parochial interests, U.S. courts will (when the circumstances warrant) open the doors of chapter 15 to foreign representatives and defer to the primary authority of a foreign jurisdiction, even when concretely U.S. interests are at stake.

Second, the case demonstrates that chapter 15 might be a more flexible tool than sometimes envisioned. By pursuing its novel strategy, Karhoo could take advantage of the insolvency laws of both the U.K. and U.S. in an effort to achieve its goal of maximizing value through the most cost-efficient sale of its business. While not an apparent motivation in Karhoo's case, the choice of a chapter 15 (and not a chapter 7 or 11) for a U.S.-organized entity can also make a difference in the application of bankruptcy laws and outcomes for creditors. For example, by filing a chapter 15 case, Karhoo U.S. could not avail itself of U.S. avoidance actions because of the limitations of § 1521(a)(7), although avoidance actions would have been available to it under chapter 7 or 11.

Third, *Karhoo* emphasizes that in the area of cross-border insolvency, it might be difficult to draw neat borders among national jurisdictions, and, in addition to large corporate families with entities organized in multiple nations, practitioners might encounter singular entities whose organization and business activities are divided among nations. Like the rules for domestic bankruptcy venue — where an entity organized in one state may well file a bankruptcy case in a different state where its headquarters are located — creditors should not necessarily assume that a U.S.-organized member of a corporate family will enter bankruptcy through a "plenary" chapter 7 or 11 case in the U.S. These more complex cross-border situations might test the limits of the chapter 15 statute and, in some cases, create results that seem "upside down" — like a U.S. entity being considered a "foreign debtor" in a U.S. bankruptcy proceeding. abi

20 *In re Suntech Power Holdings Co. Ltd.*, 520 B.R. 399 (Bankr. S.D.N.Y. 2014).