THE REVIEW OF
BANKING & FINANCIAL SERVICES
A PERIODIC REVIEW OF SPECIAL LEGAL DEVELOPMENTS AFFECTING LENDING AND OTHER FINANCIAL INSTITUTIONS

Vol. 32 No. 7 July 2016

PUBLIC POLICY LIMITATIONS OF CHAPTER 15 OF THE BANKRUPTCY CODE

Relief under chapter 15 of the Bankruptcy Code is subject to Section 1506, which allows a court to abstain from acting if such action would be "manifestly contrary" to U.S. policy. Courts have read this public policy exception narrowly and applied it sparingly. The authors review several of the many cases in which courts have declined to invoke the exception to deny recognition of a foreign proceeding or, post-recognition, to take other actions under chapter 15. They then turn to the relatively few cases in which the exception has been applied.

By Kimberly A. Posin and Adam E. Malatesta *

Chapter 15 of title 11 of the United States Code (the "Bankruptcy Code") was enacted in 2005 as part of a multinational effort to foster the orderly administration of cross-border bankruptcy cases. Based on the Model Law on Cross-Border Insolvency (the "Model Law"),[1] chapter 15 provides for and encourages unprecedented cooperation among courts of different jurisdictions to facilitate a coordinated approach to administering the assets of a debtor with operations in multiple countries.

A chapter 15 case is commenced by filing a petition for recognition of a foreign proceeding in a U.S. court in compliance with Sections 1515 and 1517.[2] While the filing of the petition, and, if appropriate, the granting of recognition, entitles the debtor and the foreign

[1] The Model Law was promulgated by the United Nations Commission on International Trade Law ("UNCITRAL") at its Thirtieth Session held in May 1997. *See* UNCITRAL Model Law on Cross Border Insolvency with Guide to Enactment and Interpretation, (2014) [hereinafter UNCITRAL Model Law and Guide], *available at* http://www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf. The Model Law "is designed to assist States to equip their insolvency laws with a modern, harmonized, and fair framework to address more effectively instances of cross-border insolvency. Those instances include cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place." *Id*., Part Two, ¶ 1. The

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UNCITRAL Model Law and Guide was drafted because it was believed that the Model Law "would be a more effective tool for legislators if it were accompanied by background and explanatory information." *Id*. at ¶ 9.

[2] *See* 11 U.S.C. §§ 1515, 1517. All Section references herein shall refer to Sections of the Bankruptcy Code unless otherwise specified.

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RSCR Publications LLC Published 12 times a year by RSCR Publications LLC. Executive and Editorial Offices, 2628 Broadway, Suite 29A, New York, NY 10025-5055. Subscription rates: $650 per year in U.S., Canada, and Mexico; $695 elsewhere (air mail delivered). A 15% discount is available for qualified academic libraries and full-time teachers. For subscription information and customer service call (937) 387-0473 or visit our website at www.rscrpubs.com. General Editor: Michael O. Finkelstein; tel. 212-876-1715; e-mail mofinkelstein@gmail.com. Associate Editor: Sarah Strauss Himmelfarb; tel. 301-294-6233; e-mail shimmelfarb@comcast.net. To submit a manuscript for publication contact Ms. Himmelfarb. ISSN: 1051-1741.

representative to certain relief, a court's decision to recognize a foreign proceeding, or take any other action in a chapter 15 case, is subject to an overriding public policy exception.[3] Section 1506 allows a court to abstain from acting under chapter 15 if such action would be "manifestly contrary" to U.S. public policy.[4]

Despite the potential breadth of this exception, courts have concluded that Congress's use of the word "manifestly" substantially limits the scope of the Section 1506 exception to the most fundamental policies of the United States.[5] Thus, "those courts that have considered the public policy exception . . . have uniformly read it narrowly and applied it sparingly."[6]

At least three principles guide courts in their analysis of Section 1506.[7] First, "[t]he mere fact of conflict between foreign law and U.S. law, absent other considerations, is insufficient to support the invocation of the public policy exception."[8] Second, "the public policy exception applies 'where the procedural fairness of the foreign proceeding is in doubt or cannot be cured by the adoption of additional protections[.]'"[9] Finally,

[3] *See* 11 U.S.C. § 1506; *accord* UNCITRAL Model Law and Guide, *supra* note 1, Part One, Art. 6; *see also Jaffé v. Samsung Elecs. Co.*, 737 F.3d 14, 24 (4th Cir. 2013) ("[A]ll of the actions authorized in Chapter 15 are subject to § 1506[.]"); *In re* Rede Energia S.A., 515 B.R. 69, 91 (Bankr. S.D.N.Y. 2014) ("[A]ll relief under chapter 15, including relief requested under either section 1521 or section 1507, is subject to the limits in section 1506, which permits a court to decline to take any action, including granting additional relief pursuant to section 1521 or additional assistance pursuant to section 1507 of the Bankruptcy Code, if such action would be 'manifestly contrary' to the public policy of this country.").

[4] *Id.*; *see also Morning Mist Holdings Ltd. v. Krys* (*In re Fairfield Sentry Ltd.*), 714 F.3d 127, 139 (2d Cir. 2013) ("Section 1506 does not create an exception for any action under Chapter 15 that may conflict with public policy, but only an action that is 'manifestly contrary.'").

[5] *In re ABC Learning Ctrs. Ltd.*, 728 F.3d 301, 309 (3d Cir. 2013) ("The purpose of the expression 'manifestly' . . . is to emphasize that public policy exceptions should be interpreted restrictively and that [the exception] is only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting State.") (quoting U.N. Comm'n on Int'l Trade Law, *Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency*, ¶ 89, U.N. Doc. A/CN.9/442 (1997)); *see also In re Fairfield Sentry Ltd.*, 714 F.3d at 139 ("Section 1506 does not create an exception for any action under Chapter 15 that may conflict with public policy, but only an action that is '*manifestly contrary.*'*"); Ad Hoc Grp. of Vitro Noteholders v. Vitro SAB de CV* (*In re Vitro SAB de CV*), 701 F.3d 1031, 1069 (5th Cir. 2012) ("The narrow public policy exception contained in § 1506 'is intended to be invoked only under exceptional circumstances concerning matters of fundamental importance for the United States.'") (quoting *Lavie v. Ran* (*In re Ran*), 607 F.3d 1017, 1021 (5th Cir. 2010)).

[6] *In re* Toft, 453 B.R. 186, 195-96 (Bankr. S.D.N.Y. 2011); *see also In re* Ashapura Minechem Ltd., 480 B.R. 129, 139 (S.D.N.Y. 2012) ("While Title 11 does not define what is 'manifestly contrary' to U.S. public policy, case law prescribes that this public policy exception should be construed narrowly."); *In re* Qimonda AG, 470 B.R. 374, 387 (E.D. Va. 2012) ("[T]hose courts that have addressed [Section 1506] . . . have made one thing very clear: it should be invoked only in extremely narrow circumstances."); H.R. REP. NO. 109-31, pt. 1, at 109 (2005) ("[Section 1506] follows the Model Law article 5 exactly, is standard in UNCITRAL texts, and has been narrowly interpreted on a consistent basis in courts around the world."); *see also* UNCITRAL Model Law and Guide, *supra* note 1, Part Two, ¶ 89 (stating that the exception should be read "restrictively" and invoked only "under exceptional circumstances concerning matters of fundamental importance for the enacting State").

[7] *In re Qimonda AG Bankr. Litig.*, 433 B.R. 547, 570 (E.D. Va. 2010).

[8] *Id.* at 568, 570 ("[T]he fact that application of foreign law leads to a different result than application of U.S. law is, without more, insufficient to support § 1506 protection. This purely results-oriented approach has been rejected on the ground that '[w]e are not so provincial as to say that every solution of a problem is wrong because we deal with it otherwise at home.'") (quoting *In re Ephedra Prods. Liab. Litig.*, 349 B.R. at 336; 11 U.S.C. § 1506); *In re Qimonda AG*, 462 B.R. 165, 183 (Bankr. E.D. Va. 2011), *aff'd Jaffé v. Samsung Elecs. Co.*, 737 F.3d at 24 ("[T]he fact that application of foreign law leads to a different result than application of U.S. law is, without more, insufficient to deny comity. There can be little doubt that the whole purpose of chapter 15 would be defeated if local or parochial interests routinely trumped the forum law of the main proceeding.").

[9] *In re ABC Learning Ctrs. Ltd.*, 728 F.3d at 309 (quoting *In re Qimonda AG Bankr. Litig.*, 433 B.R. at 570)); *see also In re*

(i) a foreign proceeding should not be recognized and an action in a chapter 15 case should not be taken if recognizing such a proceeding or taking such an action "would impinge severely a U.S. constitutional or statutory right" and (ii) an action should not be taken in a chapter 15 case if taking such action would frustrate a U.S. court's ability to administer the chapter 15 case.[10]

DECLINING TO INVOKE THE PUBLIC POLICY EXCEPTION

A. Recognition of a Foreign Proceeding

When considering whether to recognize a foreign proceeding, courts have generally declined to invoke the public policy exception to deny recognition.

1. Sealed Court Records

In *Morning Mist Holdings Ltd. v. Krys*, the Second Circuit considered, among other things, whether recognition of a foreign liquidation proceeding would be manifestly contrary to U.S. public policy, and thus barred under Section 1506, because court records in the foreign proceeding had been sealed.[11]

Fairfield Sentry Limited ("Sentry"), an international business company organized under the laws of the British Virgin Islands (the "BVI"), had been the largest of the feeder funds that invested with Bernard L. Madoff Investment Securities LLC ("BLMIS"). Following the collapse of BLMIS, Sentry commenced liquidation proceedings in the BVI. The court-appointed liquidator then petitioned the Bankruptcy Court for the Southern District of New York for recognition of the BVI liquidation proceedings under chapter 15.

A Sentry shareholder, who had filed a derivative action in New York state court alleging that Sentry's directors, management, and service providers had breached duties to Sentry, opposed recognition of the BVI proceedings, in part, on grounds that recognition would be manifestly contrary to U.S. public policy because the BVI proceedings were "cloaked in secrecy."[12]

Considering the application of Section 1506 for the first time, the Second Circuit held that the confidentiality of the BVI liquidation proceedings did not offend U.S. public policy. The Second Circuit first found that "Section 1506 does not create an exception for any action under Chapter 15 that may conflict with public policy, but only an action that is '*manifestly* contrary.'"[13] While the BVI court had sealed certain applications and orders, public summaries had been made available and non-parties were permitted to apply to the court for access to sealed documents. As a result, the Second Circuit considered the contesting shareholder's assertion that the proceeding was "shrouded in secrecy" to be "overwrought."[14]

The Second Circuit also concluded that the contesting shareholder could not establish that unfettered public access to court records was so fundamental in the U.S. that recognition of the BVI liquidation constitutes one of those exceptional circumstances in which the exception in Section 1506 should be applied, noting that:

> The right to access court documents is not absolute and can easily give way to "privacy interests" or other considerations. Important as public access to court documents may be, it is not an exceptional and fundamental value. It is a qualified right; and many proceedings move forward in U.S. courtrooms with some documents filed under seal, including many cases in this Court.[15]

As a result, the Second Circuit found no basis on which to hold that recognition of the BVI liquidation proceedings was manifestly contrary to U.S. public policy.

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Ashapura Minechem Ltd., 480 B.R. at 139 ("[D]eference to a foreign proceeding should not be afforded in a [c]hapter 15 proceeding where the procedural fairness of the foreign proceeding is in doubt or cannot be cured by the adoption of additional protections.") (quoting *In re Qimonda AG Bankr. Litig., supra*).

[10] *In re Qimonda AG Bankr. Litig.*, 433 B.R. at 570; *see also In re Qimonda AG*, 462 B.R. at 183 ("[T]his court must determine . . . whether the application of foreign law or the recognition of a foreign main proceeding would 'severely impinge' a U.S. statutory or Constitutional right in a way that would offend 'the most fundamental policies and purposes' of such right.").

[11] *Morning Mist Holdings Ltd. v. Krys* (*In re Fairfield Sentry Ltd.*), 714 F.3d 127, 138-40 (2d Cir. 2013).

[12] *Id.* at 139.

[13] *Id.* (emphasis in original).

[14] *Id.* at 140 (noting that "restricted access to court documents is not unusual in the BVI . . . because only certain limited records are typically available to non-parties").

[15] *Id.* (citing Lugosch v. Pyramid Co. of Onondaga, 435 F.3d 110, 120 (2d Cir. 2006)).

2. *Egregious Bad Faith*

In *In re Creative Fin.*, the Bankruptcy Court for the Southern District of New York concluded that the debtors' chapter 15 case had been "brought as one of the several steps in a scheme by the Debtors' principal . . . to exploit a BVI liquidation proceeding as a device to thwart enforcement of a $5 million judgment against the Debtors that [the Debtors' only non-insider creditor] won in the courts of England — *and the most blatant effort to hinder, delay, and defraud a creditor this Court has ever seen*."[16]

Notwithstanding the bankruptcy court's finding of "egregious bad faith" and its conclusion that anything it "might do to facilitate the Debtors' conduct could legitimately be said to be contrary to U.S. public policy," the court concluded that it was inappropriate to invoke Section 1506.[17] The bankruptcy court provided the following rationale:

> [W]hile U.S. courts have scrutinized the goals of a party . . . in considering the section 1506 public policy exception, the Court has seen no precedent applying that exception to the misbehavior of a party alone. The Court has been faced with bad faith filings in U.S. chapter 11 cases as well, and while it has repeatedly taken action to deal with the abusers, it has not elevated its concerns as to the debtor misconduct to the level of public policy. It does not seem right to find a violation of U.S. public policy when U.S. debtors sometimes engage in the same or similar bad faith, under U.S. law.[18]

After noting that the public policy exception is intended to be invoked only under exceptional circumstances concerning matters of fundamental importance to the U.S., the bankruptcy court concluded that, although it was "offended" by the debtors' conduct, it believed that Section 1506 had been "inappropriately invoked to deal with it."[19] Having found the public policy exception to be inapplicable, the bankruptcy court considered whether recognition was appropriate under the other requirements of Section 1517. The bankruptcy court ultimately concluded that the BVI proceeding did not qualify as either a foreign main or non-main proceeding and, therefore, denied recognition.

3. *Additional Case Law*

When determining whether to recognize a foreign proceeding, courts have also considered and declined to invoke the public policy exception in the following circumstances:

- where secured creditors in an Australian insolvency proceeding were permitted to realize the full value of their debts and tender the excess to the company rather than having to turn over the assets and seek distribution from the bankruptcy estate;[20]

- where parties objecting to recognition of a Brazilian bankruptcy proceeding alleged that (i) the Brazilian bankruptcy court entered a substantive consolidation order *ex parte* without procedural and substantive fairness to certain senior noteholders or due process of law, (ii) the Brazilian plan, which had yet to be submitted, would likely eliminate creditors' ability to avoid certain inter-debtor transfers, and (iii) because "there likely will be no redress for the [alleged fraudulent transfers] and no benefit to holders of claims against guarantors in Brazil, any distribution to [the senior noteholders] under a plan confirmed in . . . Brazil[] . . . will necessarily deviate materially from distributions that would occur under a United States plan";[21]

- where a party-in-interest alleged that a U.S. bankruptcy court violated U.S. public policy favoring openness and transparency in court

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[16] *In re Creative Fin., Ltd.* (In Liquidation), 543 B.R. 498, 502 (Bankr. S.D.N.Y. 2016) (emphasis added).

[17] *Id.* at 502, 515 (noting that the debtors' "bad faith must be imputed to the Liquidator, even if he was not trying to assist the individuals who had retained him").

[18] *Id.* at 515-16 (citing *In re Millard*, 501 B.R. 644, 651 (Bankr. S.D.N.Y. 2013)).

[19] *Id.* at 516.

[20] *In re ABC Learning Ctrs. Ltd*., 728 F.3d 301, 310-11 (3d Cir. 2013). The bankruptcy court in that case also found that "[w]hile not raised by [the objecting party] . . . inadequate notice might be grounds for refusal to grant recognition, pursuant to § 1506." 445 B.R. 318, 336 (Bankr. D. Del. 2010).

[21] *In re OAS S.A.*, 533 B.R. 83, 103–06 (Bankr. S.D.N.Y. 2015) ("Objections based on the speculation that the Brazilian Court will approve a plan or plans that permit substantive consolidation, unfair distributions, or the elimination of creditor fraudulent transfer claims are premature. They depend on the contents and effect of one or more plans that the Brazilian Court has not yet approved and may never approve. Moreover, as is evident from the record, [objecting parties] have received due process in Brazil.").

proceedings by limiting questioning about an arbitration during the hearing on recognition;[22]

- where a Brazilian bankruptcy court (i) permitted substantive consolidation notwithstanding certain creditors' arguments that a U.S. court would not have granted substantive consolidation under similar circumstances and (ii) approved the debtor's plan and distribution scheme despite inconsistencies between Brazilian and American cram-down provisions and priority rules, and notwithstanding the disparate treatment of similarly situated creditors; [23]

- where parties objecting to recognition of an Irish proceeding alleged that (i) the foreign representatives lacked independence because they were required to follow the instructions of the Irish Minister of Finance,[24] (ii) the issuance of a deed of charge could not be challenged as a fraudulent preference under Irish law, (iii) Irish law prevented the assertion of a claim for violation of transfer restrictions in the objecting parties' loan documents,[25] and (iv) the Irish proceeding discriminated against or disadvantaged U.S. citizens, deprived U.S. creditors of due process, was procedurally unfair on its face, violated the laws and rights of U.S. citizens, impaired the constitutional rights of creditors, and did not grant the same fundamental rights that creditors would receive in a U.S. bankruptcy court;[26]

- where a foreign representative had not obtained permission from a U.S. court before exercising shareholder rights to vote to remove and replace directors and officers of the U.S. corporations owned by the debtor;[27]

- where an Indian insolvency proceeding lacked "a formal statutory mechanism for creditor participation";[28]

- where the foreign representative took inconsistent positions in a chapter 15 case and a Mexican

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[22] *In re Millennium Glob. Emerging Credit Master Fund Ltd*., 474 B.R. 88, 95 (S.D.N.Y. 2012) ("[E]ven if the public policy favoring openness in the courtroom were a fundamental policy of the United States, the public policy exception would not apply here because, whatever the policy favoring openness in the courtroom may mean, it does not mean that a trial court judge is obligated to allow into evidence testimony that he believes irrelevant to the dispute being argued.") (quoting *Video Software Dealers Ass'n v. Orion Pictures Corp*. (*In re Orion Pictures Corp*.), 21 F.3d 24, 27 (2d Cir. 1994)).

[23] *In re Rede Energia S.A*., 515 B.R. 69, 100-01 (Bankr. S.D.N.Y. 2014).

[24] *In re Irish Bank Resolution Corp*. (In Special Liquidation), 2014 Bankr. LEXIS 1990, at *64-65 (Bankr. D. Del. Apr. 30, 2014) ("The Objectors did not introduce any direct evidence that the Minister has exercised . . . authority in a manner that would conflict with United States laws. In fact, one of the Objectors' own experts . . . confirmed that all of the ministerial instructions issued to date are in fact consistent with the maximization of value for creditors[.]").

[25] *Id.* at *66 ("[T]he Objectors presented no evidence that the IBRC Act prevented or permitted such claims. Even assuming that the IBRC Act did bar such a claim, the Objectors failed to identify how such a claim prohibition would conflict with U.S. law.").

[26] *Id.* at *58-60. In declining to invoke the public policy exception, the bankruptcy court concluded that:

> The Objectors can point to no evidence to show that the Irish Proceedings are not affording substantive and procedural due process protections. Furthermore, none of the issues raised by the Objectors involve constitutional or statutory rights available in the United States. . . . Rather, the IBRC Act has simply "established a different way to achieve similar goals" of United States statutes. Granting recognition of the Irish Proceeding would not only comport with the intent of section 1506 of the Bankruptcy Code, but, more importantly, would also support the strong public policy of the United States in favor of a universalism approach to complex multinational bankruptcy proceedings.

Id. at *69–70 (quoting and citing *In re ABC Learning Ctrs. Ltd*., 728 F.3d 301, 311 (3d Cir. 2013)).

[27] *In re Iida*, 377 B.R. 243, 259 (B.A.P. 9th Cir. 2007) (holding that the debtor failed to "articulate[] a fundamental policy of the United States that is offended by recognizing the Japanese bankruptcy proceeding").

[28] *In re Ashapura Minechem Ltd*., 480 B.R. 129, 141 (S.D.N.Y. 2012) (holding that the foreign proceeding was collective in nature and noting that "[n]othing in the case law suggests that if the proceeding is collective in nature its recognition can be deemed to be against public policy — nor do the facts warrant such a finding").

insolvency proceeding regarding the amount of a creditor's claim;[29]

- where foreign representatives sought to obtain an unbonded stay;[30]
- where a court in Bermuda (i) allowed an involuntary bankruptcy case to be commenced by one creditor seeking to collect a single debt and (ii) gave the debtor the opportunity to avoid the appointment of liquidators by paying the petitioning creditor's claim in full;[31]
- where the liquidator in a BVI proceeding had a conflict of interest and, in a U.S. bankruptcy case, a trustee in a similar position would likely have been disqualified from acting on behalf of the estate;[32]
- where objecting parties argued that U.S. creditors may receive less in the foreign proceeding than in a U.S. court;[33]
- where the trustee in an English insolvency proceeding allegedly provided inadequate disclosure as to the origins of an order upon which a *lis pendens* was based and failed to obtain recognition of a foreign proceeding prior to filing the *lis pendens* in state court;[34] and
- where a party-in-interest alleged that the debtors in a Cayman bankruptcy proceeding were solvent and had no need to wind up.[35]

B. Other Actions Post-Recognition of a Foreign Proceeding

When considering whether to take specific actions in a chapter 15 proceeding, courts have generally declined

[29] *In re Cozumel Caribe, S.A. de C.V.*, 508 B.R. 330, 335–36 (Bankr. S.D.N.Y. 2014) ("The Court is concerned by the inconsistent positions taken by the Foreign Representative . . . on the key issue of the amount of CTIM's claim. But CTIM has not shown that the Court's grounds for granting recognition have ceased to exist or that continued recognition would be manifestly contrary to U.S. public policy. . . . CTIM is not entitled to relief in this Court because it feels slighted by decisions or actions in Mexican court proceedings — proceedings that remain open and ongoing, with multiple parties pursuing ancillary or appellate relief. Dissatisfaction with rulings of the lower Mexican courts is the proper subject for Mexican appellate proceedings, but does not implicate the Recognition Order.").

[30] *In re* Millard, 501 B.R. 644, 651 (Bankr. S.D.N.Y. 2013) ("The ability to take an appeal without posting of a supersedeas or similar bond is not at all contrary to U.S. public policy, much less is it 'manifestly' so. Section 362 effectively provides for such for garden variety U.S. debtors.").

[31] *In re Gerova Fin. Grp., Ltd.*, 482 B.R. 86, 90, 94-96 (Bankr. S.D.N.Y. 2012) ("An involuntary bankruptcy petition filed in the United States must be supported by three or more creditors when, as here, there are more than 12 creditors in total. The three-creditor requirement . . . reflects a U.S. policy that a debtor not be forced into insolvency proceedings readily and that bankruptcy not ordinarily be used as a debt collection device available to a single creditor. Although these are important policies that Congress has continued to endorse, a contrary policy, permitting an involuntary case to be commenced by one creditor seeking to collect a single debt, would not violate a matter of 'fundamental importance' or not be in accord with 'the course of civilized jurisprudence.'") (internal citations omitted).

[32] *In re British Am. Isle of Venice, Ltd.*, 441 B.R. 713 (Bankr. S.D. Fla. 2010) ("The independence of estate representatives and professionals is indeed an important policy codified in the Bankruptcy Code. It is likely that a trustee in a United States bankruptcy case, presenting facts similar to those here, would be disqualified from acting on behalf of the estate. However, [t]he mere fact of conflict between foreign law and U.S. law, absent other considerations, is insufficient to support the invocation of the public policy exception. . . . The conflict of interest in this case does not rise to the level of severity required to trigger section 1506.") (internal quotations and citations omitted).

[33] *In re Ernst & Young, Inc.*, 383 B.R. 773, 781 (Bankr. D. Colo. 2008).

[34] *In re Loy*, 380 B.R. 154, 169 (Bankr. E.D. Va. 2007) (rejecting the debtor's argument that the trustee's conduct relating to the filing of a *lis pendens* "rises to the level that would cause [the court] to take action that is manifestly contrary to the public policy of the United States") (internal quotations omitted).

[35] *In re SPhinX, Ltd.*, 351 B.R. 103, 117 n.18 (Bankr. S.D.N.Y. 2006) ("[N]either the RCM Trustee nor any other party-in-interest contends that liquidation is inimical to the Debtors. Thus it does not appear that the commencement of Cayman Islands winding up proceedings for these admittedly liquidating entities . . . would be 'manifestly contrary to the public policy of the United States.'") (quoting 11 U.S.C. § 1506).

to invoke the public policy exception to avoid taking such actions.[36]

1. *Claims Resolution Procedure Did Not Provide for the Right to a Jury Trial*

In *In re Ephedra Products Liability Litigation*, the District Court for the Southern District of New York considered whether a claims resolution procedure, which had been approved by a Canadian court, was manifestly contrary to U.S. public policy because it deprived certain litigants of a trial by jury.[37]

Prior to the debtors' commencement of an insolvency proceeding under Canada's Companies' Creditors Arrangement Act, a number of civil actions had been filed against the debtors in U.S. state and federal courts. After the district court recognized the Canadian proceeding as a foreign main proceeding, the cases filed against the debtors in state court were transferred to the district court and consolidated with the previously transferred federal cases.

In the Canadian proceeding, the court had approved a claims resolution procedure that was designed to expeditiously assess and value all claims, including those of the plaintiffs in the U.S. actions. The claims resolution procedure provided for mandatory mediation and, if the mediation resulted in a plan approved by specified majorities of creditors, for the estimation and liquidation of the remaining claims by a claims officer.

Following the Canadian court's approval of the claims resolution procedure, the monitor moved for an order recognizing and enforcing the procedure in the chapter 15 proceeding. After the Canadian court approved certain amendments to the procedure that were "designed to assure greater clarity and procedural fairness[,]" the district court granted the monitor's motion to recognize and enforce the amended claims resolution procedure.[38]

In considering whether to enforce the amended claims resolution procedure, the district court noted that federal courts have (i) enforced against U.S. citizens foreign judgments rendered by foreign courts for whom the idea of a jury trial is foreign and (ii) regularly dismissed U.S. cases in favor of foreign forums despite objections that the foreign forum provided no trial by jury.[39] Thus, the district court concluded that while "the constitutional right to a jury trial is an important component of our legal system[,] . . . the notion that a fair and impartial verdict cannot be rendered in the absence of a jury trial defies the experience of most of the civilized world."[40]

Because the claims resolution procedure, as amended, "plainly afford[ed] claimants a fair and impartial proceeding," the district court rejected the objecting parties' Section 1506 arguments and enforced the claims resolution procedure established by the Canadian court.[41]

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[36] The relative scarcity of case law applying Section 1506 may result from the fact that courts have often resorted to other determinative provisions of chapter 15 prior to analyzing the public policy implications of recognition or a requested action. *See In re Toft*, 453 B.R. 186, 195-96 (Bankr. S.D.N.Y. 2011) ("For example, a court can grant discretionary relief in a chapter 15 case 'only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected.' Similarly, . . . U.S. assets may be entrusted to a foreign representative for administration in the foreign case only if the court is satisfied that 'the interests of creditors in the United States are sufficiently protected.' In many cases, these provisions would appear adequate to resolve a dispute arising from a conflict between U.S. and foreign law, and the public policy exception would not have to be invoked.") (quoting 11 U.S.C. §§ 1521, 1522).

[37] *In re Ephedra Prods. Liab. Litig*., 349 B.R. 333 (S.D.N.Y. 2006). The objecting parties also objected on due process grounds. *Id.* at 335. The district court concluded that while certain sections of an earlier Canadian court order "could have been read as permitting the Claims Officer to refuse to receive evidence and to liquidate claims without granting interested parties an opportunity to be heard[,]" amendments were proposed and adopted in a subsequent order that eliminated any due process concerns. *Id.*

[38] *Id.* at 334.

[39] *Id.* at 336-37 (citing *Lockman Foundation v. Evangelical Alliance Mission*, 930 F.2d 764, 768 (9th Cir. 1991) (finding, in affirming forum *non conveniens* dismissal, that fact that Japan would not conduct jury trial to resolve dispute "does not render Japanese courts an inadequate forum"); *In re Union Carbide Corp. Gas Plant Disaster at Bhopal*, 809 F.2d 195, 199, 202 (2d Cir. 1987) (affirming district court's forum *non conveniens* dismissal based on finding that Indian courts were an adequate forum despite, inter alia, absence of juries)).

[40] *Id.* at 337 ("The historic function of the jury to stand as a bulwark against government abuse plainly has limited application in the civil arena, and it is difficult to detect what unfairness a plaintiff suffers from having a civil case decided by a judge rather than a jury.") (internal citations omitted).

[41] *Id.* ("[T]he [objecting claimants'] primary claim of 'prejudice' from the absence of a right to jury trial [was] simply that it [would] give them less of a bargaining position in negotiating a

2. *Far-reaching Veil Piercing*

In *In re Petroforte Brasileiro de Petroleo Ltda.*, the Bankruptcy Court for the Southern District of Florida denied a motion to dismiss a chapter 15 case on public policy grounds notwithstanding the movants' arguments that the Brazilian court orders extending the debtor's bankruptcy case to the movants were "manifestly unjust and contrary to U.S. law because [the movants] could not have been brought in as debtors under U.S. law."[42]

In Brazil, a trustee can pierce the corporate veil of an entity that did business with the bankrupt entity and bring that entity's assets into the bankruptcy estate if it can establish "that the business of the third party with the debtor occurred with the intent to defraud the creditors of the debtor, and that the third party actually belongs to the same economic group as the bankrupt company."[43] In *Petroforte*, the movants' assets had been brought into the debtor's estate as part of a fraudulent lease-back transaction.

The movants argued that recognition of the Brazilian court orders that brought the movants and their assets into the *Petroforte* case would be "manifestly contrary to the public policy of the United States" because (i) under U.S. bankruptcy law, non-debtors can be brought into bankruptcy or an existing bankruptcy case only by the filing of an involuntary bankruptcy petition pursuant to section 303 and/or through substantive consolidation and (ii) the Brazilian bankruptcy court orders extending the bankruptcy case to include their assets were entered *ex parte* and, therefore, had been issued "in a manner completely devoid of the due process protections inherent in the Bankruptcy Code."[44]

The bankruptcy court held that while the movants had been brought into the *Petroforte* case under procedures different from those available under the Bankruptcy Code, such differences did not render the Brazilian orders manifestly contrary to U.S. public policy. The movants' due process argument also failed because, although the Brazilian court orders extending the bankruptcy to the movants were entered *ex-parte*, the movants were allowed to present both argument and evidence on appeal.[45]

3. *Additional Case Law*

Courts have also declined to invoke the public policy exception:

a. where trustees sought extension of comity to a Brazilian order permitting the trustees to conduct an investigation confidentially and under seal;[46] and

b. where, after a Mexican district court entered an order prohibiting any action against the U.S. property of the debtor *and* its non-debtor affiliates, the foreign representative filed a motion to stay an adversary proceeding in which the plaintiff sought a declaratory judgment that certain funds were not property of the debtor and,

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footnote continued from previous page…

settlement of their claims than they would have if a jury . . . were asked to value their claims. Deprivation of such bargaining advantage hardly rises to the level of imposing on plaintiffs some fundamental unfairness.").

[42] *In re* Petroforte Brasileiro de Petroleo Ltda., 542 B.R. 899, 906 (Bankr. S.D. Fla. 2015). The movants included the "alleged mastermind" behind the wrongdoing that was the subject of an ongoing investigation by the trustee and one of that individual's many corporate entities. *See id.* at 904-05.

[43] *Id.* at 904.

[44] *Id.* at 906.

[45] *Id.* at 907 ("After considering evidence and argument, the Brazilian appellate courts made specific findings of wrongdoing by [the movants] in relation to the [lease-back] transaction and the subsequent efforts to cover up the fraud.").

[46] *In re Transbrasil S.A. Linhas Aereas*, 2014 Bankr. LEXIS 1891, at *5-6 (Bankr. S.D. Fla. Apr. 24, 2014) ("The appellate court with jurisdiction in Brazil justified sealing the investigation because it was concerned that 'the current communications' speed allows financial operations in a matter of minutes, and, as such, [the Trustee's] actuation, here or abroad, must not be disturbed by the obvious possibility of frustrating his initiative to localize [locate] the assets'. This Court understood those concerns and extended comity to the seal ordered in Brazil. Thus, continuation of the seal as permitted under section 107(b) is consistent with the purposes of Chapter 15. The wholesale notion that allowing filings under seal as permitted under the Bankruptcy Code is 'manifestly contrary to the public policy of the United States' under 11 U.S.C. §1506 is rejected.") (internal citations omitted); *see also Marigrove, Inc. v. de Arruda Pinto*, 2015 U.S. Dist. LEXIS 66312, at *21-23 (S.D. Fla. Mar. 30, 2015) (holding that the bankruptcy court in *In re Transbrasil S.A. Linhas Aereas* "did not abuse its discretion when it extended comity to the seal ordered in Brazil").

therefore, not subject to the automatic stay.[47]

INVOKING THE PUBLIC POLICY EXCEPTION

Given the consensus in the U.S. that the public policy exception in Section 1506 should be used sparingly and applied narrowly, U.S. courts have denied recognition of a foreign proceeding or refused to grant the relief sought by a foreign representative on public policy grounds on only a few occasions.

A. Violation of the Automatic Stay

In *In re Gold & Honey*, the Bankruptcy Court for the Eastern District of New York denied recognition of an Israeli receivership proceeding finding that the foreign proceeding was pursued by a creditor in violation of both the automatic stay and orders of the bankruptcy court reinforcing the stay and that such a proceeding would therefore harm the United States' ability to carry out fundamental bankruptcy and jurisdictional policies.[48]

In or about 1993, Gold & Honey, Ltd. ("GH Ltd."), a corporation organized under the laws of the State of Israel, and Gold & Honey (1995) L.P. ("GH LP"), a New York limited partnership, moved their manufacturing facility from New York to Israel. First International Bank of Israel ("FIBI"), a foreign banking corporation, was a lender to GH Ltd. In late July 2008, FIBI seized substantially all of GH Ltd. and GH LP's assets and accounts, and commenced a receivership proceeding in Israel. The Israeli court, however, denied FIBI's emergency applications for the appointment of a receiver.

On September 23, 2008, GH Ltd. and GH LP (together, the "GH Debtors") filed petitions under chapter 11 of the Bankruptcy Code. On October 2, 2008, notwithstanding the pendency of the chapter 11 cases, FIBI continued its application for the appointment of a temporary receiver before the Israeli court taking the position that the automatic stay did not apply to FIBI's actions or its attempt to obtain control over the property of the bankruptcy estates of the GH Debtors.

On motion by the GH Debtors, the bankruptcy court determined, over FIBI's objection, that the automatic stay applied to the GH Debtors' property wherever located and by whomever held (the "Stay Order"). The bankruptcy court did not reach the issue of whether the automatic stay specifically applied to the Israeli receivership proceeding, but the court did advise FIBI that if it proceeded before the Israeli court in that proceeding, it did so at its peril.

Nonetheless, FIBI continued to prosecute the Israeli receivership proceeding. The Israeli court declined to give effect to the automatic stay or the Stay Order. Instead, in November 2008, the Israeli court appointed receivers for the GH Debtors in the Israeli receivership proceeding. In January 2009, the receivers filed a petition seeking recognition of the Israeli receivership proceeding as a foreign main proceeding under Section 1515.

The bankruptcy court determined that the appointment of the receivers in Israel was a violation of the automatic stay, which automatically enjoined the continuation of any litigation against the GH Debtors and continuing lien enforcement against the GH Debtors to enforce a prepetition claim against them. The bankruptcy court also noted that FIBI proceeded in the Israeli receivership proceeding "in spite of and in the face of" the Stay Order.[49] FIBI knew and was specifically told that the stay applied to all property of the GH Debtors wherever located and by whomever held, and, therefore, "[i]t would fly in the face of the Bankruptcy Code" to recognize the petition and "authorize the post-petition appointed Receivers to proceed in the United States when they were appointed as the result of a knowing and willful violation of the stay by FIBI." Addressing the public policy exception, the bankruptcy court held that:

> Recognition of the Israeli Receivership Proceeding as a foreign proceeding would be manifestly contrary to the public policy of the United States because such recognition would reward and legitimize FIBI's violation of both the automatic stay and this Court's Orders regarding the stay. . . . [A]llowing the offensive use of a stay violation here would severely impinge the value and import of the automatic stay. Recognizing a foreign seizure

[47] *In re Cozumel Caribe, S.A., de C.V.*, 482 B.R. 96, 112-13 (Bankr. S.D.N.Y. 2012) ("[T]he stay relief sought by the Foreign Representative is not manifestly contrary to public policy. . . . Precautionary Measures extending protection to non-debtor affiliates may be important and appropriate in providing a debtor with a respite from creditors and a chance to reorganize.").

[48] *In re Gold & Honey, Ltd.*, 410 B.R. 357 (Bankr. E.D.N.Y. 2009).

[49] *Id*. at 368.

> of a debtor's assets postpetition would severely hinder United States bankruptcy courts' abilities to carry out two of the most fundamental policies and purposes of the automatic stay — namely, preventing one creditor from obtaining an advantage over other creditors, and providing for the efficient and orderly distribution of a debtor's assets to all creditors in accordance with their relative priorities.
>
> Moreover, condoning FIBI's conduct here would limit a federal court's jurisdiction over all of the debtors' property "wherever located and by whomever held," as any future creditor could follow FIBI's lead and violate the stay in order to procure assets that were outside the United States, yet still under the United States court's jurisdiction.[50]

Because of the serious ramifications that would ensue "in derogation of fundamental United States policies," the bankruptcy court refused to recognize the Israeli receivership proceeding as a foreign proceeding.[51]

B. Violation of Privacy Rights and U.S. Criminal Laws

In *In re Toft*, the Bankruptcy Court for the Southern District of New York denied a request by the foreign representative in a German insolvency proceeding to gain access to e-mail accounts of the debtor, Dr. Jürgen Toft, on the servers of two internet service providers (the "ISPs") in the U.S. finding that such relief would contravene public policy and would likely violate federal law.[52]

Dr. Martin Prager served as the insolvency administrator in a German proceeding concerning Dr. Toft, an orthopedic surgeon. Prager initiated a chapter 15 proceeding for the purpose of gaining access to Toft's U.S. e-mail accounts. Toft otherwise had no assets in the U.S., was not a party to any lawsuits pending in the U.S., and did not reside in the U.S. Because Toft's "intransigence, obstructionism, and evasive tactics ha[d] allegedly thwarted the German insolvency proceeding," the German court entered an order authorizing Prager to intercept Toft's postal and electronic mail.[53] In addition, the English High Court of Justice issued an *ex parte* order, which granted recognition and enforcement of the German order. Prager requested that the bankruptcy court grant comity to the German and English court orders by compelling the ISPs to disclose to Prager, without notice to Toft, "all of [Toft]'s e-mails currently stored on their servers and to deliver to Prager copies of all e-mails received by [Toft] in the future."[54]

The bankruptcy court ultimately determined that "this [was] one of the rare cases in which the relief sought by the Foreign Representative must be denied under § 1506 of the Bankruptcy Code as manifestly contrary to the public policy of the United States." The reasons for the denial were as follows: (i) a bankruptcy trustee would not be entitled to the relief sought under U.S. law and a chapter 15 proceeding cannot ordinarily be pursued without notice to the debtor; (ii) the relief requested would contravene the protection against disclosure of e-mails by internet service providers contained in the Electronic Communications Privacy Act, 18 U.S.C. §§ 2701, *et seq.*, and would likely constitute an unlawful interception of electronic communications in transit under the Wiretap Act, 18 U.S.C. § 2511, *et seq.* such that the relief sought might subject the foreign representative, his U.S. agent, and possibly the ISPs to criminal liability in the U.S.; and (iii) the "relief sought would directly compromise privacy rights subject to a comprehensive scheme of statutory protection, available to aliens, built on constitutional safeguards incorporated in the Fourth Amendment, as well as the constitutions of many States."[55]

C. Detrimental Effect on Technological Innovation

In 2011, the Bankruptcy Court for the Eastern District of Virginia applied the public policy exception to deny a request seeking to restrict the applicability of U.S. bankruptcy law to allow a foreign representative to terminate U.S. licenses to use the debtor's patents under foreign law.[56]

In January 2009, Qimonda AG, a semiconductor memory device manufacturer headquartered in Germany, filed an application in the Munich insolvency court, and Dr. Jaffé was appointed as the insolvency administrator. In June 2009, the bankruptcy court entered an order granting Jaffé's petition for recognition of the German proceeding under chapter 15 and a

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[50] *Id*. at 371-72 (citing 28 U.S.C. § 1334(e)).

[51] *Id.*

[52] *In re* Toft, 453 B.R. 186 (Bankr. S.D.N.Y. 2011).

[53] *Id*. at 188-89.

[54] *Id.*

[55] *Id*. at 198.

[56] *In re Qimonda AG*, 462 B.R. 165 (Bankr. E.D. Va. 2011).

supplemental order, which, among other things, made Section 365 applicable to the chapter 15 proceeding. Qimonda's assets included approximately 10,000 patents, approximately 4,000 of which were U.S. patents.

Jaffé ultimately determined that Qimonda should be liquidated. As part of his analysis, he identified contracts to which Qimonda was a party that fell within Section 103 of the German Insolvency Code, which governs mutual contracts with respect to which the obligations of the debtor and the counter-party have not been completely performed. Under German insolvency law, such contracts are automatically unenforceable unless the insolvency administrator elects to perform the contracts.

Jaffé determined that electing non-performance of certain of Qimonda's U.S. license agreements was appropriate. Accordingly, he sent letters of non-performance to such licensees, certain of whom took the position that they were protected by Section 365(n) with respect to Qimonda's U.S. patents. Section 365(n) permits a licensee, following the rejection of its license, to elect "to retain its rights (including a right to enforce any exclusivity provision of such contract) under such contract" in exchange for making royalty payments and waiving any rights of set off or administrative claims.[57] Jaffé filed pleadings committing to relicensing Qimonda's patent portfolio and noted that he might also sue former licensees for infringement of such licenses.

Although the question had not yet been decided by Germany's highest court, the bankruptcy court assumed that, under Section 103 of the German Insolvency Code, an insolvency administrator, by electing non-performance of a patent license agreement, may terminate a licensee's right to use the debtor's patents.

The bankruptcy court noted that the mere fact that application of a foreign law leads to a different result than U.S. law is not sufficient to invoke the public policy exception. Instead, the analysis focuses on two factors: (i) whether the foreign proceeding was procedurally unfair and (ii) whether the application of foreign law would "severely impinge the value and import" of a U.S. statutory or constitutional right, such that granting comity would "severely hinder United States bankruptcy courts' abilities to carry out . . . the most fundamental policies and purposes" of such rights.[58]

The licensee objectors did not contend that either German insolvency law or the German insolvency proceedings lacked procedural fairness or that any Constitutional right was implicated. While the statutory right that was implicated, *i.e.*, the right of a non-bankrupt licensee to continue using a patent license, was deemed by Congress to be of great public importance in creating Section 365(n), the bankruptcy court considered whether the policy that Section 365(n) seeks to promote is fundamental.[59] The bankruptcy court also questioned whether the protections afforded by Section 365(n) could be fundamental where they are discretionary in a chapter 15 proceeding and noted that the particular threat to American technology identified in the legislative history (*i.e.*, allowing licenses to be cancelled in bankruptcy would encourage those seeking to use a patent to insist on an assignment, which would decrease the financial return to the inventor and would create disincentives to fully develop intellectual property) differed from the threat articulated by the objectors.

Ultimately, the Bankruptcy Court considered whether "declining to apply § 365(n) in the context of the semiconductor industry would nevertheless adversely threaten U.S. public policy favoring technological innovation" and found that:

> Although innovation would obviously not come to a grinding halt if licenses to U.S. patents could be cancelled in a foreign insolvency proceeding, the court is persuaded by . . . testimony that the resulting uncertainty would nevertheless slow the *pace* of innovation, to the detriment of the U.S. economy. Thus, the court determines that failure to apply § 365(n) under the circumstances of this case and this industry would "severely impinge" an important statutory protection accorded licensees of U.S. patents and thereby undermine a fundamental U.S. public policy promoting technological innovation. For that reason, the court holds that deferring to German law, to the extent it allows cancellation of the U.S. patent licenses, would be manifestly contrary to U.S. public policy.[60]

[57] 11 U.S.C. § 365(n)(1)(B), (2)(B), and (2)(C).

[58] *In re Qimonda AG*, 462 B.R. at 183.

[59] *Id.* at 184 ("The legislative history is clear that Congress believed that allowing patent licenses to be terminated in bankruptcy would impose[] a burden on American technological development.") (internal quotations omitted).

[60] *Id*. at 185 (emphasis in original).

On those grounds, the bankruptcy court entered an order confirming that Section 365(n) applied with respect to Qimonda's U.S. patents. Interestingly, the Fourth Circuit, on direct appeal, upheld the bankruptcy court's decision to apply Section 365(n), but on different grounds. The Fourth Circuit held that the application of Section 365(n) was necessary to ensure the licensees under Qimonda's U.S. patents were "sufficiently protected" under Section 1522, which requires a weighing of the interests of the debtor in receiving the requested relief against the competing interests of those of the licensees who would be adversely affected by such relief.[61]

D. Enforcement of Third-Party Releases

U.S. courts vary in their application of the public policy exception to the granting of third-party non-debtor releases. In *Vitro, S.A.B. de C.V. v. ACP Master, Ltd.*, the Bankruptcy Court for the Northern District of Texas concluded that:

> [T]he protection of third-party claims in a bankruptcy case is a fundamental policy of the United States. The *Concurso* Approval Order does not simply modify such claims against non-debtors, they are extinguished. As the *Concurso* plan does not recognize and protect such rights, the *Concurso* plan is manifestly contrary to such policy of the United States and cannot be enforced here.[62]

Because the debtor's plan, as approved by the Mexican court, extinguished claims against non-debtor third parties, the bankruptcy court held that the plan was manifestly contrary the U.S. policy of protecting third-party claims. Despite the bankruptcy court's ruling, the Fifth Circuit, on appeal, ultimately relied on Sections 1507 and 1521 (instead of Section 1506) to deny recognition of the *Concurso* plan.[63]

In contrast, the bankruptcy court for the Southern District of New York has twice granted comity to Canadian orders that included non-debtor third-party releases.[64] In *In re Sino-Forest Corp.*, the bankruptcy court held that in the Second Circuit, "where the third-party releases are not categorically prohibited, it cannot be argued that the issuance of such releases is manifestly contrary to public policy."[65]

CONCLUSION

It is expected that U.S. courts will continue to apply Section 1506 narrowly and will invoke the exception only where a fundamental public policy is implicated. Indeed, as chapter 15 is based on principles of comity, permitting Section 1506 to deny recognition of a foreign proceeding or to deny recognition of a foreign ruling in a broad array of circumstances would defeat the main purpose of chapter 15's focus on international cooperation and collaboration. ■

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[61] *Jaffe v. Samsung Elecs. Co*., 737 F.3d 14, 29 (4th Cir. 2013).

[62] *In re Vitro, S.A.B. de C.V*., 473 B.R. 117, 132 (Bankr. N.D. Tex. 2012). The *Concurso* Approval Order was issued pursuant to the *Ley de Concursos Mercantiles*, the commercial bankruptcy law which went into effect in Mexico in May 2000.

[63] *See Ad Hoc Grp. of Vitro Noteholders v. Vitro SAB de CV* (*In re Vitro SAB de CV*), 701 F.3d 1031, 1070 (5th Cir. 2012).

[64] *In re Sino-Forest Corp*., 501 B.R. 655 (Bankr. S.D.N.Y. 2013); *In re Metcalfe & Mansfield Alt. Invs*., 421 B.R. 685, 698 (Bankr. S.D.N.Y. 2010).

[65] *In re Sino-Forest Corp.*, 501 B.R. at 663, 665.