CHAPTER 15 WATCH

Turning Back the "COMI" Clock: Key Trade-Offs in Proposed Revisions to Chapter 15

By **AARON GAVIN**

On August 20, 2018, the National Bankruptcy Conference—"a voluntary organization composed of persons interested in the improvement of the bankruptcy code and its administration"—sent a letter ("**NBC Letter**") to the Subcommittee on Regulatory Reform and the Committee on the Judiciary proposing several amendments to chapter 15 of the U.S. Bankruptcy Code.[1] Most significant of these proposed amendments is a recommendation to revise sections 1502 and 1517 of the Code to specify the relevant timing for court determinations of a foreign debtor's center of main interests ("**COMI**").

Under a chapter 15 proceeding, courts often look to a number of non-exhaustive factors in making a COMI determination, including the location of the debtor's headquarters, controlling managers, primary assets and major creditors as well as the jurisdiction whose law would apply to most of its disputes.[2] Successful COMI determinations arrive with notable benefits for debtors, including recognition of a foreign insolvency proceeding as the "main" proceeding and the effectuation of an automatic stay throughout the United States.

Although numerous courts have previously held that COMI should be determined at the time of filing a chapter 15 petition,[3] the NBC Letter follows the guidance of the United Nations Commission on International Trade Law ("**UNCITRAL**"), who drafted the model law on cross-border restructurings upon which chapter 15 is based, proposing that COMI should be determined at the time that a foreign proceeding is commenced.

This proposed change is somewhat controversial.[4] The NBC Letter has defended its proposed change by focusing on how shifting the timing of COMI determinations could create more uniform and predictable insolvency laws across all national jurisdictions. However, if adopted, some individuals have expressed concern that the practice of "COMI shifting"—that is, the decision by a debtor to shift its center of main interests to another jurisdiction before filing a chapter 15 petition in order to take advantage of that jurisdiction's restructuring laws—would become more difficult to achieve, especially because debtors often require immediate

assistance and may have insufficient time to shift COMI before filing for such relief.

In order to be properly prepared, creditors and debtors should carefully consider the full-range of benefits and drawbacks that will arise from concerns like these, as well as others, if this proposal is adopted by Congress.

Certainty and Uncertainty in Cross-Border Restructurings

The NBC Letter follows UNCITRAL in noting that one of the main rationales for anchoring COMI determinations to the commencement date of a foreign proceeding is to provide certainty and predictability for cross-border insolvency laws. This allows creditors and debtors to better anticipate how such laws will be applied and enforced across various national jurisdictions.[5]

The NBC Letter highlights two scenarios where anchoring the timing of COMI determinations to the chapter 15 petition date, instead of the commencement date of a foreign proceeding, could prove problematic:

— if the business activity of the debtor ceases after the commencement date (in which case it is unclear how the loss of this factor will affect a court's COMI determination);[6] and

— if the debtor no longer has a COMI at the time of the chapter 15 petition because a "reorganizing entity" has taken its place (in which case it is unclear whether courts will seek to determine the COMI of the debtor or reorganizing entity).[7]

Even if a change to the timing rules could help debtors and creditors achieve greater certainty over how courts will act in these scenarios, it is important to note that the current timing rules, which tie COMI determinations to the chapter 15 petition date, afford a different kind of certainty for debtors and creditors in anticipating how a court might generally rule. As the Second Circuit has noted, any kind of COMI analysis that requires a court to look back at the debtor's past interests or operational history, whether in general or at a specific point in time, could only "make it more difficult to pinpoint [a] single COMI" and might cause "a meandering and never-ending inquiry into the debtor's past interests,"[8] which in turn would make it more difficult for creditors and debtors to figure out what evidence the court will rely on to determine COMI. By focusing on the chapter 15 petition date (which occurs close in time to when the court makes its COMI determination), however, debtors and creditors might have a better idea about the contours of the relevant evidence, and thus the likely result, ultimately leading the various parties to avoid costly litigation over this issue.

In any case, creditors and debtors should recognize that no matter which timing rule is adopted, some uncertainty is likely to remain. In particular, anchoring COMI determinations to the commencement date will not necessarily allow creditors and debtors to anticipate how U.S. courts will determine:

— the COMI of multinational corporations or debtors with a wide international reach who have a strong economic presence in multiple jurisdictions; or

— the COMI of debtors who have multiple foreign proceedings each competing for recognition as the foreign main proceeding.

The fact remains that creditors and debtors cannot always anticipate how courts will decide such issues, which only underscores that disputes over COMI determinations are likely to remain.

COMI Shifting and Forum-Shopping

The NBC Letter further notes that anchoring a COMI determination to the commencement date promotes UNCITRAL's goal of ensuring that foreign proceedings are recognized "in a country where the debtor ha[s] a tangible economic presence."[9] By tying recognition to economic

presence, the NBC Letter highlights how this timing rule might decrease the ability of a debtor to shift its COMI and shop for a forum or jurisdiction that is more favorable to its restructuring before filing a chapter 15 petition.

Reducing the likelihood of COMI shifting could be beneficial. It could create a greater sense of security among creditors in knowing that debtors cannot shift their COMI to achieve greater benefits in another jurisdiction and then seek implementation of those benefits in U.S. courts. In turn, this could increase confidence in lending and ease capital flows with direct benefits to both creditors and debtors.

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However, a number of individuals have expressed concern about the possible end of COMI shifting,[10] which could have negative effects not only for debtors but for foreign restructurings more broadly. Forum-shopping can be a net-positive for both debtors and creditors when a debtor shifts its COMI to a jurisdiction that allows for a reorganization plan that maximizes value and better serves the interests of all parties involved. In addition, because the current rules already check some of the unsavory aspects of COMI shifting by allowing courts to reject a debtor's attempt to shift its COMI if it is proven that the debtor "manipulated its COMI in bad faith," the current rules also provide a check against some of the unsavory aspects that may result from COMI shifting.[11]

Even if the proposed change is adopted, it is still somewhat unclear whether COMI shifting would end completely. Some debtors may attempt to shift their COMI well before filing any kind of restructuring proceeding, which means that the proposed change may be inconsequential for them. For example, in the recently decided *In re Ocean Rig* (2017),[12] foreign debtors shifted their COMI to the Cayman Islands to support their reorganization. Because their main business was in the Marshall Islands, which had no reorganization laws and only provided for the equivalent of chapter 7 liquidation, the debtors sought relief under Cayman reorganization laws. However, the debtors accomplished this shift not only before filing the chapter 15 petition, but also before filing for reorganization in the Cayman Islands altogether. Therefore, this kind of COMI shift would remain possible even after any change to the timing rules and as long as debtors plan ahead.

Uniformity vs. Flexibility

In noting that the U.S. timing rules are "not consistent with how UNCITRAL itself deems timing to function under the Model Law," the NBC Letter finally stresses that "the Model Law was promulgated in the first instance to promote uniformity of application around the world, a principle to which Congress subscribed in enacting section 1508."[13] Arguably, uniform law across all national jurisdictions is a good in itself, and could also aid in creating greater legal predictability, as well as increase confidence in cross-border lending, as described above.

However, with greater uniformity will also arrive a trade-off against the current system, which is quite flexible. While COMI determinations are currently measured against the chapter 15 petition date, judges are also able to disqualify any manipulative COMI shifts that occur in "bad faith." Together, this two-faceted test provides U.S. judges with a larger degree of discretion than a one-size-fits-all rule that requires COMI to be determined at the commencement date of a foreign proceeding. Indeed, it is not clear that the new timing rules would even account for "bad faith" COMI shifts that occur prior to the commencement of a foreign restructuring because this rule is a judge-made standard and the NBC Letter has made no recommendations about this key issue.

It will remain the responsibility of Congress to weigh any such trade-offs before deciding whether to revise the timing aspects of COMI determinations. In the meantime, creditors and debtors should be prepared and ready to understand the implications of this potential revision if it comes to fruition. ■

1. NBC Letter at 1. (Caps omitted). The NBC Letter is available at https://drive.google.com/file/d/1DIfvi1wP9vQHFugAk1rcsPChmhw6VDX1/view.
2. See *In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d Cir. 2013).
3. A number of courts have followed the lead of the Second Circuit in *In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d Cir. 2013), which is referred to below.
4. See Kyle J. Oritz, Sarah Denis and Rafael X. Zahralddin-Aravena, "NBC Proposes Revisions to Chapter 15 of the Bankruptcy Code," ABI Journal (October 8, 2018).
5. NBC Letter at 13.
6. Id.
7. Id.
8. *In re Fairfield Sentry Ltd.*, 714 F.3d 127, 134 (2d Cir. 2013) (Internal quotations and citations omitted).
9. NBC Letter at 15.
10. *Supra*, Note 4.
11. *In re Fairfield Sentry Ltd.*, 714 F.3d 127, 137 (2d Cir. 2013).
12. *In re Ocean Rig UDW Inc.*, 570 B.R. 687 (Bankr.S.D.N.Y.2017)
13. NBC Letter at 15.

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