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ALERT MEMORANDUM

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Barnet Clarified: NY-Law Governed Debt is Sufficient "Property" for Chapter 15 Eligibility

On October 28, 2015, Judge Martin Glenn of the United States Bankruptcy Court for the Southern District of New York (the "Court") issued a Memorandum Opinion (the "Decision") in the chapter 15 proceeding of Singaporean company Berau Capital Resources Pte. Ltd. ("Berau"), providing an expansive reading of the manner in which foreign debtors may obtain a jurisdictional hook for commencing chapter 15 proceedings under the Bankruptcy Code. In re Berau Capital Res. Pte. Ltd., No. 15-11804(MG), 2015 WL 6507871 (Bankr. S.D.N.Y. Oct. 28, 2015). The Decision, which supplemented a prior Court ruling on chapter 15 eligibility, held that USD-denominated bonds issued under New York law constitute intangible "property in the United States" that may satisfy the criteria for chapter 15 eligibility enumerated in §109(a) of the Bankruptcy Code.[1]

Background & Procedural History

Berau, the foreign debtor, is a special purpose vehicle controlled by PT Berau Coal Energy Tbk ("BCE Group"), a public company incorporated in Indonesia.[2] BCE Group's core business is the mining and export of thermal coal.

Berau was formed in 2010 with the principal purpose of raising funds on behalf of BCE Group. To this end, Berau issued $450 million of 12.50% senior secured notes due on July 8, 2015 (the "Notes"), guaranteed by BCE as well as nine other affiliated entities in various jurisdictions.[3] The Notes were issued pursuant to an indenture governed by New York law, with New York specified as the choice of forum and an authorized agent was appointed in New York for service of process.[4]

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1 See Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet), 737 F.3d 238, 247 (2d Cir. 2013) ("Barnet") (holding that §109(a) of the Bankruptcy Code applies to chapter 15 cases, thus requiring a foreign debtor to "reside[] or ha[ve] a domicile, a place of business, or property in the United States." See 11 U.S.C. § 109(a)).

2 Formally, Berau is a wholly-owned subsidiary of PT Berau Coal ("Berau Coal"). Berau Coal is, in turn, 90% owned by BCE Group. Although BCE controls 18 entities in multiple jurisdictions, Berau Coal is its "key operating asset." Verified Petition of Kin Chan, A Foreign Representative of Debtor in a Foreign Proceeding ¶ 5, In re Berau Capital Res. Pte. Ltd., No. 15-11804(MG) (Bankr. S.D.N.Y. July 10, 2015), ECF No. 2. BCE Group itself was 84.7% owned by Asia Resource Minerals plc ("ARMs"), a public company incorporated in the United Kingdom. See id. at 5.

3 Berau issued $350 million of senior secured notes on July 8, 2010, as well as an additional $100 million of Notes on August 24, 2010, pursuant to a supplemental indenture.

4 In re Berau, 2015 WL 6507871, at 3.

Due to a combination of falling coal prices and "sub-optimal . . .manage[ment],"[5] BCE Group's financial health deteriorated, leaving it unable to make the principal payments on the Notes due July 8, 2015. Thus, on July 4, 2015, BCE Group and Berau initiated insolvency proceedings in the High Court of the Republic of Singapore,[6] which granted a six-month prohibition on "the commencement or continuation of any action by any creditors against [Berau]"[7] – effectively an analog to the automatic stay under the Bankruptcy Code.

On July 10, 2015, Berau filed a Petition for Recognition of the Foreign Main Proceeding in Singapore, pursuant to chapter 15, seeking relief from its creditors under 11 U.S.C. §§ 1515 and 1517.

Notably, none of Berau's creditors opposed the Bankruptcy Court's recognition of the Singaporean proceeding. Nevertheless, the Court has the ability to independently assess whether an adequate jurisdictional basis exists for the commencement of a proceeding. To that end, after granting provisional relief on August 6, 2015, Judge Glenn issued an order granting recognition on October 16, followed by a memorandum opinion regarding the recognition decision on October 28, 2015.

The Decision

In its decision, the Court clarified the requirements for chapter 15 eligibility in the Southern District of New York. The Court held that a debtor's "intangible property" – for Berau, contractual rights through bond indentures issued under New York law – was sufficient for eligibility as a debtor under 11 U.S.C. §109(a). In re Berau, 2015 WL 6507871, at *2.

Recognition of Foreign Proceeding

With respect to chapter 15, a foreign proceeding must be "recognized" – a "gateway requirement"[8] – in order to have access to US courts. This process occurs through a foreign representative, acting on behalf of the debtor, rather than through the foreign debtor itself. Once the foreign proceeding is recognized, the chapter 15

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5 See Verified Petition of Kin Chan ¶ 7.

6 On June 10, 2015, Asia Coal Energy Ventures Limited ("ACE") made a general offer for the outstanding shares of UK-listed ARMs, with the goal of gaining control of BCE Group; by July 7, 2015, ACE became BCE Group's majority shareholder. At the same time, ACE attempted to restructure BCE Group's outstanding debt through a partial principal payment and a maturity extension to July 31, 2019, on the unpaid portion. See Moody's Investors Service, Berau defaults on its senior secured notes due 8 July 2015 (July 9, 2015).

7 See Verified Petition of Kin Chan ¶ 18.

8 Daniel M. Glosband & Jay Lawrence Westbrook, Chapter 15 Recognition in the United States: Is a Debtor "Presence" Required?, 24 Int'l Insolvency Rev. 28, 37 (2015).

proceeding serves as an ancillary proceeding to further the foreign insolvency proceeding as it relates to US-based assets and claims.

A threshold question when a chapter 15 case is commenced is whether the foreign debtor must satisfy the same jurisdictional requirements as debtors under chapter 11 – namely that the debtor "resides or has a domicile, a place of business, or property in the United States." 11 U.S.C. § 109(a). While the few courts to have considered this question have reached different conclusions and several commentators have argued this property requirement should not be imposed on chapter 15 cases, the United States Court of Appeals for the Second Circuit previously held in Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet), that section 109 applies to foreign debtors seeing relief under chapter 15. In re Barnet, 737 F.3d at 241. Judge Glenn noted the various criticisms of the Barnet decision, but acknowledged that it remains the governing law for courts in the Second Circuit.

What is "property in the United States"?

Prior decisions in the Second Circuit confirmed that even small amounts of property – including bank accounts or attorney retainers held in New York – could suffice for chapter 15 jurisdictional purposes.[9] The Berau decision opens up a new basis for filing chapter 15 cases, namely contractual rights stemming from New York law governed debt issued by foreign companies.

The Court, while noting that Berau's attorney retainer in New York provided eligibility, found that "it is apparent that another substantial (and frequently recurring) basis for chapter 15 eligibility exists here"[10] – Berau's Notes, denominated in US dollars and issued under New York law. Foreign entities commonly issue indentures under New York law, and the Court concluded that "[i]t would be ironic" if creditors could sue in New York to enforce their debts while the foreign representative was denied the protections provided by a chapter 15 proceeding filed in the Southern District of New York.[11] The Court concluded that "no such conundrum exists" because "the indenture is property of Berau in the United States," as a debtor's contractual rights are its "intangible property."[12]

State law governs substantive rights in bankruptcy proceedings, and thus, the Court turned its analysis towards New York law – which has "long…recognized" that intangible property rights "may have more than one situs." In re Berau, 2015 WL

9 In re Octaviar Admin. Pty. Ltd., 511 B.R. 361, 369-74 (Bankr. S.D.N.Y. 2014).

10 In re Berau, 2015 WL 6507871, at 2.

11 Id. at 3.

12 Id.

6507871, at *3. In Berau's case, the indenture explicitly requires discharge in New York, where the Trustee, Bank of New York Mellon, is located.

Furthermore, as the Court pointed out, three statutory provisions buttress the enforceability of New York governing law provisions with respect to the Notes:

1. N.Y. Gen. Oblig. Law § 5-1401 (Choice of Law): Parties to a contract for no less than $250,000 "may agree that the law of this state shall govern their rights and duties" with respect to the agreement.

2. N.Y. Gen. Oblig. Law § 5-1402 (Choice of Forum): A person may maintain an action arising pursuant to section 5-1401 against a foreign corporation with respect to a transaction in excess of $1 million.

3. N.Y. C.P.L.R. § 327(b): A court may not stay or dismiss an action to which sections 5-1401 and 5-1402 apply due to *forum non conveniens.*

Finding that Berau's indenture "easily satisfies these requirements," the Court concluded that the New York choice of law and forum selection clauses are sufficient to constitute "property in the United States" under section 109(a), making Berau an eligible debtor, and as a consequence, its foreign proceeding recognizable in the United States per chapter 15. Id.

Significance of the Decision

The Berau decision confirms an expansive reading of the nature of property that may satisfy the property requirements for eligibility for chapter 15 relief in courts in the Southern District of New York. Based on the Court's reasoning, foreign debtors with debts issued under New York law will have greater latitude to avail themselves of U.S. courts' protections under chapter 15 – which may prove to be particularly valuable where foreign companies do not have other sources of property in the United States, yet are subject to lawsuits related to their New York law-governed debt issuances that are interfering with their foreign restructuring efforts.

The Court left for another day whether other contract rights, such as patent, trademark or other intellectual property contracts, also may suffice as property that would serve as a chapter 15 jurisdictional hook. However, the decision is encouraging to foreign companies that U.S. courts are open-minded to the use of chapter 15 proceedings in furtherance of foreign insolvency proceedings, even where a company only has limited property or property rights in the United States.

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