

## UTILIZING CROSS-BORDER INSOLVENCY LAWS TO ATTACK FRAUD: AN ANALYSIS OF HOW IT COULD WORK IN THE BRITISH VIRGIN ISLANDS, THE UNITED STATES, AND GERMANY

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## I. INTRODUCTION

THE internationalization of commerce has had a profound impact on insolvency law and the law of fraud. It has become common practice for creditors to advance value to debtors who own assets all around the globe. The law has had to adapt to this growing phenomenon in order to accommodate cross-border litigation. States have been compelled to enact legislation based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (Model Law) in order to combat complex international fraud and its sequela—global money laundering and complex asset concealment schemes. The UNCITRAL Model Law is designed to assist states in implementing modern, harmonized, and fair insolvency regimes that effectively address cross-border insolvency. The Model Law offers solutions that help in several significant ways, including: foreign assistance for insolvency proceedings taking place in the enacting state, access to the courts of the enacting state for foreign representatives, recognition of foreign proceedings, cross-border cooperation, and coordination of concurrent proceedings.<sup>1</sup> Currently, only a limited number of countries have adopted legislation based on the Model Law. While the British Virgin Islands (BVI) and the United States adopted it in 2005, the Germany decided to implement rules for international insolvencies rather based on the Council Regulation (EU) for Insolvencies.

This paper contains a comparative analysis of the cross-border effects of insolvency proceedings involving the BVI, the United States, and Germany based on a hypothetical fact-pattern.

## A. HYPOTHETICAL FACT-PATTERN

Fraudsters Limited (Fraudsters) is a company formed in accordance with the laws of the BVI in the British West Indies. Fraudsters has issued many different forms of promises and undertakings to thousands of investors in Norway, Ireland, the United Kingdom, Israel, Dubai, and elsewhere. The total value of the outstanding liabilities of Fraudsters to these investors is not yet known. But it is clear that the amount involved exceeds U.S. \$250 million.

Fraudsters employed fifty young men, who worked in a boiler room in Boca Raton, Florida, to solicit funds from investors located in countries outside of the United States.

Some of the investors in Norway discovered that Fraudsters is domiciled in the BVI and have contacted a local BVI law firm for advice. The firm has recommended that the investors involved petition the Supreme Court of the Eastern Caribbean in the BVI for an order appointing a

1. U.N. Comm'n on Int'l Trade Law [UNCITRAL], UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment, U.N. Sales No. E.99.V.3 (1997), available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html) (last visited Apr. 1, 2007).

liquidator to wind up the company's affairs. The liquidator's mandate and purpose will be to:

- identify, locate, and assist creditors and victims to file sworn proofs of claim in the BVI insolvency proceedings;
- identify and locate documents that will reveal where the creditor-victims might be and where the corrupt enterprise conducted its operations—usually in a number of different locales where various strands of the fraudulent enterprise find expression. (The senior shadow directors of Fraudsters may be in Britain, while a publishing house, mass mailer, and data processor in Quebec, Canada may have been used to (i) send written solicitations to prospective victims; (ii) receive and process the mass marketing data used by the enterprise to identify target investors; and (iii) channel information to Boca Raton, Florida for use by the boiler room boys when soliciting funds from investors over the telephone. Furthermore, the investors may have been directed to send their funds to a bank account in Prague, Czech Republic. From that point, no one knows where the funds went or how they were misapplied;
- begin the process of identifying who the primary fraudsters might be in order to commence the process of a reverse trace from the point of where the fraudsters lie into the labyrinth of money laundering vehicles used to conceal the relationship between the activity of Fraudsters, the company, and the primary wrongdoers; and
- locate evidence of the path of progress of value from the point of Fraudsters' receipt of the same from investors.

The newly appointed BVI liquidator has leads to some assets that might be quickly secured and used to fund the global investigation into this complex matter. Fraudsters has two assets of interest in the United States: (i) a bank account in New York and (ii) Fraudsters United Inc., a wholly-owned subsidiary located in Dallas, Texas, and organized as a Texas company. Fraudsters United Inc. owns bank accounts in Florida and Canada and assets in Germany consisting of a bank account in its name at a small local bank near Frankfurt and a wholly-owned subsidiary—incorporated as Fraudsters Europe GmbH—which itself owns a bank account in Lithuania and a palace near Paris, France used for the fraudsters' regular meetings.

## II. THE BVI EXPERIENCE

The majority of this section sets out how the liquidation process operates under the law of the BVI. At the end of this section, we discuss some practical tools that are used to advance fraud investigations during the liquidation of corruptly-managed BVI companies.

A. THE BRITISH VIRGIN ISLANDS CORPORATE INSOLVENCY REGIME  
– AN OVERVIEW

The BVI is a British Overseas Territory. The BVI is largely responsible for its own internal self-government. It is one of the world's largest off-shore providers of companies (with more than 740,000 companies in good standing);<sup>2</sup> and its company insolvency regime is one of the most up-to-date and comprehensive in the common law system.

BVI law generally consists of English common law, equity, and certain British Parliament at Westminster statutes, together with local legislation enacted by the BVI Legislative Council. In circumstances where there is no applicable BVI legislation and no relevant applicable U.K. legislation, the courts of the BVI apply English common law and equity (although decisions of major British Commonwealth courts such as Australia and Canada are also considered and used). The principal trial court is the Supreme Court of the Eastern Caribbean at the BVI. The intermediate court of appeal is the itinerant Appellate Division of the same court (based in St. Lucia). The ultimate appellate court is the Judicial Committee of the Privy Council in London, England.

On April 17, 2003, the BVI Legislative Council enacted the Insolvency Act 2003 (the Act). Before the Act, the BVI insolvency regime relied upon a combination of sections of the Companies Act (modelled after the English Companies Act of the late nineteenth century), case law, and parts of the English Insolvency Rules 1986.<sup>3</sup> The new Act is modelled largely on the English Insolvency Act 1986 and is the most comprehensive piece of legislation enacted in the BVI since the International Business Companies Act of 1984. The Act includes detailed sections governing, inter alia, creditors' arrangements, administration, and receivership, including administrative receivership and liquidation.<sup>4</sup> The Act

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2. This information was obtained from a telephone call at the BVI Companies Registry.
  3. Ingrid Pierce, *Insolvency and International Assistance – The Impact of the British Virgin Islands Insolvency Act 2003*, 1 KLUWER L. INT'L 39 n.1 (2004):  
*See In the Matter of Tele-Art Inc.* (an unreported 1998 decision of the BVI High Court of Justice). The Court considered the legislation and concluded that in the absence of specific winding-up rules under the BVI Companies Act, it would rely upon section 11 of the West Indies Associated States Supreme Court (BVI) Ordinance, Cap. 80. It provides that in the absence of special provisions or procedural rules regarding the exercise of the civil jurisdiction of the High Court, such jurisdiction must be "exercised as nearly as may be in conformity with the law and practice administered for the time being in the High Court of Justice in England." The Court was therefore content to apply the provisions of the English Insolvency Rules 1986. *See also Marshall v. Antigua Aggregates Ltd. & Others* (an unreported 2000 decision of the Court of Appeal of Antigua and Barbuda—highly persuasive in the BVI—in which it was accepted that since there were no local rules guiding the presentation of a winding-up petition, the Court should look to the English Insolvency Rules 1986 for guidance).
  4. See generally Insolvency Act, No. 5 (2003) (Virgin Is.), available at <http://www.bvifsc.vg/LegislationLibrary/tabid/211/DMXModule/626/Default.aspx?EntryId=67> (last visited Apr. 1, 2007). Note that this article will not address the provisions



also introduces the concept of shadow directors, the licensing of insolvency practitioners, and rules governing the disqualification of directors. The BVI court system is also well developed in the context of corporate recovery and insolvency cases.

#### B. COMMENCEMENT OF LIQUIDATION

A BVI liquidator must be a licensed insolvency practitioner and may be appointed by (1) a resolution of the members of the company passed by a super majority of seventy-five percent of all members present or represented by proxy at a meeting of members (or such higher majority as the articles of the company may provide) or (2) by the BVI High Court upon application by the company itself, a creditor, a shareholder, a supervisor of a creditors' arrangement, the BVI Financial Services Commission, or the Attorney General of the BVI.<sup>5</sup>

A liquidator may be appointed by the court on any one of the following grounds: (a) that the company is insolvent, (b) that it is "just and equitable" that a liquidator be appointed, or (c) that liquidation of the company is in the public interest.<sup>6</sup> The court can also appoint a liquidator over a foreign company if the company has or appears to have had assets in the BVI, is carrying on or has carried on business in the BVI, or there is a reasonable prospect that the appointment will benefit the creditors of the company. Once an application for the appointment of a liquidator has been made to the court, interim relief in the form of the appointment of a provisional liquidator is available. A provisional liquidator may be appointed if it is in the public interest, if the company consents, or if the court is satisfied that the appointment is necessary for the purpose of maintaining the value of the assets owned or managed by the company pending the disposition of a winding-up petition. Provisional appointments are rarely granted in the BVI as they are usually sought *ex parte* and can be devastating to an ongoing enterprise. But if the target company is a passive holding company, the management of its affairs can be shown to involve some form of dishonesty or corruption, and a high risk of asset flight can be inferred from the objective facts, the court will consider appointing a provisional liquidator.

The Act expressly describes the status, powers, and duties of the liquidator, the procedure for the removal and resignation of the liquidator, and includes detailed provisions for the conduct of liquidations. Upon appointment, the liquidator gains custody and control of the assets of the company and must advertise his appointment both in the BVI and in the company's principal place of business. Moreover, the liquidator is required to call a meeting of the creditors within fourteen days of his ap-

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regarding set-off (this section of the Act effectively mirrors rule 4.90 of the English Insolvency Rules), netting, administrative receiverships, or the creditors' arrangements procedure.

5. Insolvency Act, No. 5, part VI, § 162(2).

6. § 162(1).

pointment.<sup>7</sup> At that meeting, a liquidator appointed by the members (or the shareholders) can be removed and replaced by a liquidator nominated by the creditors. But the liquidator need not call a meeting of the creditors if the company is solvent and notice is given to the creditors stating that no meeting will be held unless the creditors elect to have such a meeting. Upon commencement of a liquidation, no proceedings may be commenced against the company or steps taken to enforce any right over the company's assets without the court's permission. This does not affect the rights of a secured creditor to enforce his security interest.

### C. VOIDABLE TRANSACTIONS

As with most insolvency regimes, the Act provides that certain transactions carried out before the onset of liquidation or administration are voidable by the court. The main transactions that are likely to be voidable are those involving unfair preferences and those transacted at an undervalued amount. An unfair preference is a transaction that has the effect of putting a creditor in a better position than that in which he would have been in a liquidation. A transaction is undervalued when the consideration provided by the company is significantly more than the value of the asset it receives. In both cases, the transaction is likely to be set aside if it (a) was entered into at a time when the company was insolvent or (b) caused the company to become insolvent. The court can also set aside certain floating charges and extortionate credit transactions. In any case, a transaction can only be set aside if it took place during a specified period prior to the onset of liquidation or administration. This period is set out in the Act and varies according to the different types of voidable transactions. The Act has avoided emphasis on the more challenging "intention to prefer" test used under English insolvency law, preferring a simple test based on the effect of a transaction. Thus, the focus is upon the objectively discernable effect rather than the subjective focused intent of the transaction.

The court has considerable discretion as to the type of order it may make if the transaction is voidable. Available remedies include orders for restoring the company to where it would have been if it had not entered into the transaction, for the variation of the terms of an extortionate credit transaction, for the re-transfer of assets to the company, or for the release or discharge of any security given by the company.

### D. MALPRACTICE AND DISQUALIFICATION ORDERS

Under the Act, liquidators are afforded wide powers to recover and restore the company's assets in cases of actions involving misfeasance, fraudulent trading, and insolvent trading. The court can issue an order against a delinquent officer of a company. The guilty party may be ordered to restore the assets to the company or pay compensation.

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7. § 178.

Where a company's business has been carried on with an intention to defraud creditors, the court may order that any person who was knowingly a party to the fraud make a contribution to the assets of the company. The insolvent trading provisions only relate to directors and former directors of the company. The court may order such a person to make a contribution to the company's assets when he knew, or ought to have known, that there was no reasonable prospect that the company would avoid insolvency, but failed to take every reasonable step to avoid or minimize the loss to creditors. In addition to the above powers, the court may make disqualification orders barring delinquent individuals from acting as a director, insolvency practitioner, receiver, or from being active in the management of a company for a specified period. An application for such an order may be made up to six years after the company becomes insolvent.<sup>8</sup>

#### E. LICENSING SYSTEM FOR INSOLVENCY PRACTITIONERS

The Act provides for a new system of licensing insolvency practitioners. Only an insolvency practitioner who is a resident of the BVI may be licensed. This has caused a number of existing accounting firms to either expand their insolvency practices or establish new ones in the BVI.

Only an insolvency practitioner may act as an administrator, administrative receiver, liquidator, provisional liquidator, interim supervisor under a proposal for an arrangement, or supervisor of an arrangement. While an individual who resides outside of the BVI cannot be licensed as an insolvency practitioner, the Act states that foreign practitioners can be appointed jointly with a licensed insolvency practitioner who does reside in the BVI. In that case, the body appointing the non-resident, whether it be the court or the other person, must satisfy itself that the appointee has sufficient qualifications and experience to competently take part in the insolvency proceedings.

#### F. INTERNATIONAL INSOLVENCY AND THE ASSISTANCE PROVISIONS

Given the sheer volume of corporations domiciled in the BVI (740,000 at last count), it is not surprising that practically every insolvency initiated there has an international dimension. Sections dealing with cross-border insolvency and international assistance are incorporated into parts XVIII and XIX of the Act. In the case of multi-jurisdictional insolvency proceedings, sections of the Act enable cooperation between the BVI<sup>9</sup> and other jurisdictions based on the UNCITRAL Model Cross-Border Insolvency Law. For example, there are detailed provisions setting out the basis for recognition of foreign proceedings and appointments. The Act also clarifies the law in relation to the issue of whether sufficient legal

8. Part X, § 261(2).

9. *See generally* Insolvency Act, No. 5. This part of the Act has yet to be brought into force.

basis exists to enable the BVI court to make requests to the English court under section 426 of the English Insolvency Act or to act on foreign requests (except those made under the Evidence Proceedings in Foreign Jurisdictions Act).

#### G. PART XVIII

The stated purpose of Part XVIII is:  
to provide effective mechanisms for dealing with cases of cross border insolvency so as to promote the objectives of

- (a) cooperation between (i) the Court and insolvency administrators of the Virgin Islands; and (ii) the courts and other competent authorities of foreign countries involved in cases of cross border insolvency;
- (b) greater legal certainty for trade and investment;
- (c) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- (d) protection and maximisation of the value of the debtor's assets; and
- (e) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.<sup>10</sup>

Part XVIII applies where:

- (a) assistance is sought in the BVI by a foreign Court or a foreign representative in connection with a foreign proceeding;<sup>11</sup>
- (b) assistance is sought in a foreign country in connection with a [BVI corporate] insolvency proceeding;
- (c) a foreign proceeding and a [BVI] insolvency proceeding in respect of the same [corporate] debtor are taking place concurrently; or
- (d) creditors or other interested persons in a designated foreign country have an interest in requesting the commencement of, or participating in, a [BVI corporate] insolvency proceeding.<sup>12</sup>

The Act therefore contemplates that requests for assistance may be sought by foreign courts, administrators, receivers, liquidators, or other representatives, as well as creditors or other parties with an interest in a

10. Part XVIII, § 436(1).

11. A "foreign court" means a judicial or other authority competent to control or supervise a foreign proceeding. A "foreign representative" means a person or body, including one appointed on an interim basis, authorized in a foreign proceeding to administer the re-organization or the liquidation of the debtor's property or affairs or to act as a representative of the foreign proceeding. A "foreign proceeding" means a collective judicial or administrative proceeding in a designated foreign country (a country or territory designated by the Governor by notice published in the Gazette), including an interim proceeding pursuant to a law relating to insolvency in which proceeding the property and affairs of the debtor are subject to control or supervision for the purpose of re-organization, liquidation, or bankruptcy. § 437(1).

12. § 436(2).

set of BVI insolvency proceedings. In order to achieve cooperation with foreign courts or foreign representatives, section 458 provides that the court must cooperate to the "maximum extent possible" and may communicate directly with, or request information or assistance directly from, the foreign courts or foreign representatives.<sup>13</sup> Section 460 provides that such cooperation may be implemented by "any appropriate means," including:

- (a) appointment of a person or body to act at the direction of the Court;
- (b) communication of information by any means considered appropriate by the Court;
- (c) coordination of the administration and supervision of the debtor's property and affairs;
- (d) approval or implementation by courts of agreements concerning the coordination of proceedings; [and]
- (e) coordination of concurrent proceedings regarding the same debtor.<sup>14</sup>

#### H. THE PROCEDURAL STEPS<sup>15</sup>

In order for a foreign representative to obtain the assistance of a BVI court, he must make an application for the recognition of the foreign proceeding for which he has been appointed. A certified copy of the decision commencing the foreign proceeding and appointing the foreign representative or a certificate from the foreign court affirming the existence of the foreign proceeding and appointing the foreign representative must accompany the application. In the absence of such evidence, the court may be satisfied by "other evidence."<sup>16</sup> Once the foreign proceeding has been recognized by the BVI court, the foreign representative may apply directly to the court for any other relief available under part XVIII. Subject to that, the court or an insolvency office-holder may provide additional assistance to a foreign representative where permitted by part XVIII or any other act or rule of law in the BVI.

Once a foreign main proceeding has been recognized, no individual proceedings may be commenced for any relief regarding a debtor's property, and all extant proceedings or executions against a debtor's property in the BVI are stayed. Moreover, any right to transfer, encumber, or otherwise dispose of any property of the debtor within the BVI is suspended upon recognition of a foreign main proceeding. But the Act also provides that after recognition of a foreign main proceeding, a BVI insolvency proceeding may only be commenced if the debtor has assets in the BVI and must be restricted to assets of the debtor in the BVI. When a foreign

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13. Part XVII, § 458.

14. § 460.

15. § 448. The court is likely to follow the new UNCITRAL Model Law approach to encouraging cooperation with other courts from other lands.

16. § 448(2)(c).



proceeding and a BVI insolvency proceeding are taking place concurrently, the courts must cooperate and coordinate so that any relief granted to a foreign representative to protect assets of the debtor or the interests of creditors is consistent with the BVI insolvency proceeding. Thus, for example, any orders made pursuant to section 453 will be modified or terminated if found to be inconsistent with the BVI insolvency proceeding. If a stay has automatically been imposed by virtue of recognition of the foreign proceeding, that stay may subsequently be lifted if the court considers it to be inconsistent with the BVI insolvency proceeding. Further, if the foreign proceeding is pending when the BVI insolvency proceeding takes place, then no stay or suspension will come into effect.

A foreign representative may also apply to the court under section 249 for relief with respect to voidable transactions once the foreign proceeding has been recognized. But the court must not make an order granting relief with respect to voidable transactions unless it is satisfied that the foreign representative has roles and functions that are equivalent or broadly similar to the roles and functions of a liquidator or trustee-in-bankruptcy. Foreign creditors are afforded the same rights as creditors in the BVI with respect to commencing and participating in a BVI insolvency proceeding. Thus, a foreign creditor of a BVI company can apply to the court for the appointment of a liquidator on the same grounds as creditors in the BVI, namely that the company is insolvent or that it is just and equitable that a liquidator should be appointed.<sup>17</sup>

## I. PART XIX

Under part XIX, a foreign representative may apply to a BVI court under section 467(3) for an order in aid of a foreign proceeding for which he is authorised. The court has extensive powers to grant relief to a foreign representative. For example, the court may restrain the commencement or continuation of any proceedings, execution, or other legal process against the debtor or his property. The court may also make any order or grant any relief it considers appropriate, such as ordering a person to deliver any property of the debtor or the proceeds of such property to the foreign representative. It is important to note that for the purpose of this section, property must be subject to or involved in the relevant foreign proceeding, but there is no requirement that the property itself must be within the BVI. In making an order under section 467(3), the court may apply the law of the BVI or the law applicable in the foreign proceeding. In determining an application under section 467, the court shall be guided by:

what will best ensure the economic and expeditious administration of the foreign proceeding to the extent consistent with

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17. Part VI, § 162(1)(a)-(b).

- (a) the just treatment of all persons claiming in the foreign proceeding;
- (b) the protection of persons in the Virgin Islands who have claims against the debtor against prejudice and inconvenience in the processing of claims in the foreign proceeding;
- (c) the prevention of preferential or fraudulent dispositions of property subject to the foreign proceeding, or the proceeds of such property;
- (d) the need for distributions to claimants in the foreign proceedings to be substantially in accordance with the order of distributions in a Virgin Islands insolvency; and
- (e) comity.<sup>18</sup>

But the court will not make an order under section 467 when doing so would be contrary to BVI public policy. As a general proposition, this will rarely present itself as a serious barrier to relief.

Wide forms of relief are available to foreign representatives when such relief is necessary to protect the assets of the debtor or the interests of the creditors. For example, upon recognition of a foreign proceeding, a foreign representative may be entrusted with the administration or realization of the debtor's assets in the BVI. Section 454 provides as follows:

- (1) Upon recognition of a foreign proceeding, whether main or ancillary, where necessary to protect the assets of the debtor or the interests of the creditors, the Court may, at the request of the foreign representative, grant any appropriate relief, including
  - (a) staying the commencement or continuation of individual actions or individual proceedings concerning the debtor's property, rights, obligations or liabilities, to the extent they have not been stayed under section 453(1)(a);
  - (b) staying execution against the debtor's property to the extent it has not been stayed under section 453(1)(b);
  - (c) suspending the right to transfer, encumber or otherwise dispose of any property of the debtor to the extent this right has not been suspended under section 453(1)(c);
  - (d) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities;
  - (e) entrusting the administration or realisation of all or part of the debtor's assets located in Virgin Islands to the foreign representative or another person designated by the Court; [and]
  - (f) extending relief granted under section 452(1);
- (2) Upon recognition of a foreign proceeding, whether main or ancillary, the Court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's property located in the Virgin Islands to the foreign representative or another person designated by the Court, provided that

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18. Part XIX, § 468(1).

the Court is satisfied that the interests of creditors in the Virgin Islands are adequately protected.

- (3) In granting relief under this section to a representative of a foreign ancillary proceeding, the Court shall be satisfied that the relief relates to property that, under the law of the Virgin Islands, should be administered in the foreign ancillary proceeding or concerns information required in that proceeding.<sup>19</sup>

#### J. URGENT RELIEF

If an application for recognition of a foreign proceeding has been filed but not yet determined, an application may be made for urgent relief if the court is satisfied that such relief is urgently needed to protect the assets of the debtor or the interests of the creditors.<sup>20</sup> The court may grant such relief of a provisional nature as it considers appropriate, including

- (a) staying execution against the debtor's assets;
- (b) entrusting the administration or realization of all or part of the debtor's assets located in the Virgin Islands to the foreign representative or to another person designated by the Court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; [or]
- (c) any relief mentioned in Section 454(1)(c), (d) and (f).<sup>21</sup>
- (d) Unless provisional relief is extended under Section 454(1)(f), it will automatically terminate when the court determines the foreign representative's application for recognition of the foreign proceedings.<sup>22</sup>

#### K. INTERNATIONAL COOPERATION

In keeping with the principles of comity, the BVI court must promote the application of parts XVIII<sup>23</sup> and XIX in a manner that is consistent with the application of similar laws adopted by foreign jurisdictions. Section 426 of the Insolvency Act 1986 and the English case law interpreting and applying that section are thus relevant. The leading English case interpreting section 426 is *Hughes v. Hannover Ruckversicherungs-Aktiengesellschaft*,<sup>24</sup> in which the English Court of Appeal considered a request from the Supreme Court of Bermuda to the English High Court under section 426(5) to recognize the rights of joint provisional liquidators for the purpose of restraining actions or proceedings in England brought against the Bermudian debtor. The Court of Appeal held that the court in England could apply either the insolvency law of the relevant country

19. Part XVII, § 454.

20. § 452(1).

21. *Id.*

22. § 452(3).

23. Note that this part of the Act is not currently in force.

24. *Hughes v. Hannover Ruckversicherungs-Aktiengesellschaft*, 1997] B.C.C. 921 (C.A.) (appeal taken from Berm.).

concerned or its own insolvency law when faced with a request from a relevant country. Further, the Court confirmed that, notwithstanding the mandatory words in section 426(4), the English court was not bound to grant the order sought in the letter of request from the foreign court. Rather, the Court held that the reviewing court had the discretion to do so. Lord Justice of Appeal Morrit stated that in cases requiring the exercise of discretion, the fact that a request has been made is a matter to be taken into account, although it does not outweigh all other factors.

In *Re Bank of Credit and Commerce International SA*,<sup>25</sup> the liquidators of a Cayman Islands company sought the assistance of the English court in order to obtain relief under certain sections of the Insolvency Act 1986. Notwithstanding the fact that the Grand Court of the Cayman Islands had no power to grant such relief because there were no comparable provisions in the Cayman Islands Companies Act, Justice Rattee granted the relief requested, holding that section 426(4) of the Insolvency Act 1986 imposes an obligation on the English court to assist the Grand Court, although the English court nonetheless has discretion as to how such assistance should be provided.

In the BVI, the usual practice is to issue a letter of request to a foreign court requesting its assistance. For example, in *Re Trading Partners Limited*,<sup>26</sup> Justice Patten of the English High Court granted an application by the joint official liquidators of a BVI company who sought their recognition in the English court to enable them to do all things that were “necessary or convenient” in connection with the winding-up of a fraudulent BVI company, including obtaining information and records under section 236 of the Insolvency Act 1986.<sup>27</sup> Justice Patten recognized that the policy behind section 426(4) “must be to encourage the English Court to recognise the appointment of a foreign liquidator from an approved jurisdiction unless the only purpose of such recognition is to permit that liquidator to operate within the jurisdiction in a manner which this Court would regard as impermissible.”<sup>28</sup>

Under the Act, a party to a BVI insolvency proceeding who wishes to obtain the assistance of a foreign country in connection with that proceeding may rely upon the provisions of part XVII to seek wider forms of relief. Thus, just as the English court has recognized the importance of assisting the insolvency office-holders appointed by foreign courts in certain designated countries or territories, the High Court of Justice of the BVI must now cooperate “to the maximum extent possible” with foreign courts or representatives from foreign countries designated by statutory instrument.<sup>29</sup> In August of 2005, the BVI issued a list of designated coun-

25. In *Re Bank of Credit & Commerce Int'l SA*, [1993] B.C.C. 787 (Ch.).

26. In *Re Trading Partners Ltd.*, 2001 WL 1040186 (Ch.) (unreported).

27. *Id.* at ¶6 (quoting from the letter of request dated Oct. 11, 2000, from the British Virgin Islands Court to the English High Court).

28. *Id.*

29. Insolvency Act No. 5, Part XVII, § 458(1).

tries for the purposes of the cross-border insolvency provisions.<sup>30</sup> Part XIX of the Act as amended on August 22, 2005, now reads as follows:

The Financial Services Commission in exercise of the powers conferred by section 466 (1) of the Insolvency Act, 2003 designates the following countries, territories or jurisdictions as relevant foreign countries for the purposes of Part XIX of the Insolvency Act 2003:

1. Australia; 2. Canada; 3. Finland; 4. Hong Kong; 5. Japan; 6. Jersey; 7. New Zealand; 8. United Kingdom; and 9. United States of America

The designations shall take effect on the 23rd day of August, 2005.<sup>31</sup>

#### L. SUMMARY OF THE NEW ACT

The Act has clearly upgraded and simplified the insolvency regime in the BVI. The procedure for applying for recognition of foreign representatives and relief in aid of foreign proceedings is now defined. This removes much of the uncertainty that existed in this area previously, although the sections dealing with cross-border insolvencies have yet to come into force<sup>32</sup> (along with the provisions dealing with administration). The new Insolvency Rules 2005 will replace the current practice of relying on the U.K. Insolvency Rules. While it remains to be seen how the cross-border insolvency provisions will apply in practice, given the substantial commonality between the BVI and U.K. provisions and the current practice of relying upon U.K. precedent, it can be expected that the BVI Court will draw upon the experience of the U.K. courts in interpreting and applying these provisions. The new regime can also be expected to lead to a great increase in the number of insolvencies in which the BVI represents the primary domicile of insolvency (as opposed to those in which the BVI aspect operates as a satellite proceeding).

#### M. THE TOOLS FOR LOCAL INVESTIGATION IN THE BVI BY THE LIQUIDATOR

Returning to the hypothetical problem discussed above, the BVI liquidator of Fraudsters may well identify the names of a number of other BVI companies linked to it. Assume that such linked companies are in fact discovered and are administered by seven different company formation agents located in the BVI. If the controlling malefactors (suspected to be in the United Kingdom) learn of the liquidator's discovery of these links, they are likely to further dissipate whatever bank accounts or other assets held by the linked companies administered by the other BVI formation agents.

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30. Part XIX, as amended Aug.22, 2005.

31. Part XIX (2003).

32. Notwithstanding their lack of force, these sections still provide helpful guidance in analysing how the BVI High Court exercises its inherent jurisdiction in this area. See generally Insolvency Act, No. 5.



BVI counsel to the liquidator recommends that the liquidator immediately apply for a *Norwich Pharmacal/Bankers Trust* document-disclosure order without notice and to have such order wrapped with a seal and a gag. The order will be directed against the seven local BVI company formation and administration concerns that hold records establishing the beneficial ownership and the identity of the directors involved abroad. Also, the order will be tailor-made to ensure that copies of all directions and instructions from outside of the BVI regarding these companies are produced, as well as copies of all electronic funds transfer advices or cheques used to pay any invoices issued by the local formation agents in exchange for the provision of their annual services and for the upkeep of the linked companies involved.

The *Norwich Pharmacal/Bankers Trust* jurisdiction is dependent upon a showing by the liquidator that the seven targeted BVI company formation agencies have somehow managed to innocently get themselves mixed up with, or have facilitated, the commission of certain serious forms of wrongdoing done to the estate of Fraudsters (in liquidation).

The BVI High Court can order the sealing and gagging of these formation agents for a period of not more than twenty-eight days.<sup>33</sup> The duration of the seal and gag may be extended at a hearing that takes place before the expiry of this twenty-eight day period.<sup>34</sup>

#### N. WHAT CAN THE BVI LIQUIDATOR OF FRAUDSTERS DO ABROAD, AND HOW DOES HE GO ABOUT DOING IT?

Clearly, the estate in liquidation needs further funding because the petitioning creditors were only able to advance U.S. \$200,000. The liquidator believes that it will cost somewhere between U.S. \$5 and U.S. \$10 million to complete his investigations and to have a serious chance of recovering very substantial value in this matter.

The bank account of Fraudsters located in New York is worth U.S. \$5 million, while the assets of Fraudsters United Inc., the subsidiary in Dallas, Texas (and which owns certain bank accounts in Florida and in Canada), have a combined estimated value of U.S. \$5 million as well. If these assets can be quickly and effectively frozen, then the liquidator should be in a position to raise further funds from creditors, and eventually liquidate the U.S. \$10 million of assets in North America with a view to completing the job at hand.

In order to facilitate these urgent activities, the liquidator is advised by BVI counsel to submit Requests for Judicial Assistance Abroad to bankruptcy or insolvency courts in Canada, the United States, and Germany. These letters of request should set out the background of the matter, the facts and nature of the BVI insolvency proceedings, the fact that the BVI court will reciprocate with the courts to whom the letters of request are

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33. EASTERN CARIBBEAN R. CIV. P. § 17.4 (4) (2000).

34. § 17.4 (7).

directed under similar fact circumstances, and the nature of the relief requested—namely, orders of recognition of the powers of the BVI liquidator in the countries in question.

Although letters of request are not always necessary in order to obtain recognition of a BVI liquidator's powers abroad, they certainly provide a further objective basis for the exercise of a foreign court's jurisdiction to order the recognition of the BVI liquidator's powers for local purposes. In the hypothetical problem, they would objectively set out in clear terms the BVI court's own provisional findings regarding the matter—which would be particularly useful in a fraud case.

O. DO NATIONAL RULES IN THE BVI ON MONEY LAUNDERING INFLUENCE OR RETARD THE PROCESS OF THE LIQUIDATION?

In the BVI, the Financial Services Commission regulates and enforces the local money laundering laws. All company formation and administration concerns and trust companies must be registered and licensed to do business by the Financial Services Commission. Detailed regulations have been promulgated requiring the offshore financial services community in the BVI to know their customers. Photocopies of passports and other identifying detail of beneficial owners and directors of each BVI company are now, in theory, held by the relevant formation agents. This form of documentation can prove to be very useful in the investigation of global fraud.

It is theoretically possible that there could be a collision between the modern proceeds-of-crime legislation and the insolvency laws of the BVI. If the BVI company was used to obtain value by fraud, it is possible that the state could argue that such proceeds should be forfeited to the Crown—thereby depriving its creditors of a source of recovery. As a practical matter, it is most unlikely that this hypothetical form of collision between public and private law would arise. The BVI government simply has not allocated sufficient resources to local law enforcement to make the possibility of this type of collision between legal norms and rights likely. Moreover, local law enforcement authority is more inclined to assist the victims of fraud in obtaining compensation than to fatten the local public purse.

This notwithstanding, if any such hypothetical clash in rights did occur, it is probable that the BVI High Court would look to decisions from Australia and other parts of the Commonwealth indicating that (a) the rules and legal norms governing the administration of insolvent companies have over one hundred years of sophisticated jurisprudential development in support of them; (b) the rules pertaining to the forfeiture or seizure of the proceeds of crime are virtually brand new in contrast; and (c) these new rules could not possibly have been intended to be used by the state for the purpose of disrupting the legitimate private property rights of creditors or victims of the very form of abusive conduct that the money laundering laws are intended to suppress. In other words, money

laundering as a concept in public law is intended to suppress the very harm being done to innocent victims and creditors. It can hardly be said that the legislature intended to place a spear in the hands of the police with which to stab the victim-creditor a second time.

P. A PRACTICAL PROBLEM IN SEEKING RECOGNITION OF THE POWERS OF A FOREIGN INSOLVENCY OFFICE-HOLDER IN THE CONTEXT OF A FRAUD-RECOVERY INSOLVENCY CASE

In international cross-border insolvencies, foreign courts prefer to have a direct link to or conversation with the home court (i.e., the place of domicile of the debtor). In order to invoke the jurisdiction of the foreign court, there must be some link with that jurisdiction in the context of the liquidation, or some objective to be secured by doing so that is compatible with the goals of the liquidation—in simple terms, to secure the most equitable distribution of assets amongst creditors. Assets, the location of the business, and the whereabouts of creditors of the foreign debtor in a particular foreign jurisdiction are the classic cornerstones that are sought during an ancillary insolvency proceeding. But in fraud investigations and insolvencies, the existence of a place of business or the location of assets abroad may not be known so much as suspected. Insolvency office-holders will often attach a much higher priority to obtaining access to information and documentation than to the immediate gathering of assets, particularly in circumstances where it is believed that a much bigger pot of gold can be tapped eventually.

The three most important factors in securing assets in an international insolvency are location, location, and location. But in fraud cases, the location will often be unknown without access to information. Documents and information are very important in a tracing case—for obvious reasons, if a foreign country's insolvency court requires proof of an asset within the country in question before it will recognize the office holder, then information regarding the location of assets is clearly a valuable asset in and of itself. Accordingly, if information or documentation that would advance the trace is reposed in a foreign country, then the foreign court involved should have the power to assist.

Article 27 of the UNCITRAL Model Law, the substance of which has been incorporated into the BVI Cross Border Insolvency provisions, emphasizes the importance of cooperation. It specifically notes that cooperation may be implemented by any appropriate means,<sup>35</sup> including appointment of a person or body to act at the direction of the court; communication of information by any means considered appropriate by the court; and coordination of the administration and supervision of the

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35. UNCITRAL, MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT art. 27, U.N. Sales No. E.99.V.3 (1997), available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html) (last visited Apr. 1, 2007).

debtor's assets and affairs.<sup>36</sup>

Cross-border cooperation is a core element of the Model Law. Its objective is to enable courts and insolvency administrators from two or more countries to efficiently achieve optimal results. Cooperation is often the only realistic way to prevent dissipation of assets or even to locate assets. The ability of courts, with appropriate involvement of the parties, to communicate directly and to request information and assistance from foreign courts or foreign representatives avoids the use of time-consuming procedures traditionally implemented. This ability is critical when the courts must act with urgency. These necessities justify the power of foreign court to provide access to information without requiring definite proof of presence of assets, place of business, or creditors as a precondition to such assistance. The Act represents a major leap forward for legal and accounting professionals involved in complex fraud investigations. The incorporation of the Model Law will provide a convenient platform from which to launch international investigations within the context of the insolvency model, regardless of the fact that the relevant provisions have not yet been brought into operation.

### III. THE U.S. EXPERIENCE

#### A. OVERVIEW OF CHAPTER 15 OF THE UNITED STATES CODE

##### 1. *Advantages of Chapter 15*

Even though the BVI Liquidator has non-bankruptcy and non-chapter 15 bankruptcy options, it is likely that he would seek relief under chapter 15 in relation to the proceedings against Fraudsters. This is because relief under chapter 15 would give him more control over the liquidation of Fraudsters' U.S. assets, more tools to protect those assets, and more options to coordinate and synthesize any liquidation with his overall goals and the requirements of his appointing court.

##### 2. *Control*

If a chapter 15 petition is recognized, and unless the court orders otherwise, "the foreign representative may operate the debtor's business and may exercise the rights and powers of a trustee under and to the extent provided by sections 363 and 552."<sup>37</sup> Section 363 of the Bankruptcy Code generally provides that only the trustee, in this case the foreign representative, may lease or sell the debtor's property, and may make transfers outside the ordinary course of the debtor's business, with the approval of the bankruptcy court.<sup>38</sup> This ensures that only the foreign representative will be able to lawfully transfer assets outside the ordinary course of business, and if any such assets are transferred by someone other than the

36. *Id.*

37. Bankruptcy Code, 11 U.S.C.A. § 1520(a)(3) (West 2005).

38. 11 U.S.C. §§ 363(b),(f) (2000).

foreign representative, the transfer is subject to avoidance.<sup>39</sup> Additionally, upon recognition of the foreign proceeding, the bankruptcy court may “entrust the distribution of all or part of the debtor’s assets located in the United States to the foreign representative or another person . . . provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected.”<sup>40</sup> Section 552 of the Bankruptcy Code generally provides that pre-bankruptcy liens do not attach to property acquired by the debtor after the petition for recognition is recognized, meaning that the debtor will be able to generate unencumbered assets, albeit subject to significant restrictions.<sup>41</sup>

Therefore, one of the main benefits of a chapter 15 filing, especially if managers of assets in the United States refuse to abide by the foreign representative’s instructions, is that the foreign representative will be able to take control of the debtor and any liquidation or reorganization proceedings.

### 3. Ability to File Bankruptcy Under Other Chapters

If the chapter 15 petition is recognized, the foreign representative will have the authority to file a bankruptcy case under other chapters of the Bankruptcy Code (although he may have this authority without chapter 15 as well).<sup>42</sup> If the foreign proceeding is recognized as a “foreign main proceeding,” the foreign representative will have the authority to file a voluntary bankruptcy petition on behalf of entities owned by the debtor in the United States.<sup>43</sup> But if the foreign proceeding is recognized as a “foreign nonmain proceeding,” the foreign representative will be limited to filing an involuntary bankruptcy petition against any such entity.<sup>44</sup>

### 4. The Automatic Stay

Upon the recognition of a chapter 15 petition by a bankruptcy court, the automatic stay becomes effective automatically.<sup>45</sup> The automatic stay is extremely broad and, although subject to certain limitations, it enjoins and prohibits creditors and governmental agencies from initiating or continuing a judicial proceeding against the debtor and its assets, and from seizing, foreclosing on, or setting off against the debtor’s assets.<sup>46</sup> Thus, “[t]he purpose of the automatic stay . . . is to protect the debtor and his creditors by allowing the debtor to organize his affairs, and by ensuring that the bankruptcy procedure may operate to provide an orderly resolu-

39. See discussion *infra* at Section II C, p.9.

40. 11 U.S.C.A. § 1521(b) (West 2005).

41. 11 U.S.C.A. § 552(b) (West 2005).

42. See 11 U.S.C.A. § 1511(a) (West 2005).

43. See § 1511(a)(2).

44. See § 1511(a)(1).

45. The foreign representative can request that the bankruptcy court impose the stay or other injunctive relief prior to recognition, on an interim basis, as discussed below.

46. See 11 U.S.C.A. § 362(a) (West 2005 & Supp. 2006).



tion of all claims.”<sup>47</sup> Chapter 15 also grants the bankruptcy court the power to stay even those actions that are not otherwise stayed by the automatic stay, if the bankruptcy court thinks it appropriate and necessary.<sup>48</sup> Since the automatic stay becomes effective automatically, the affirmative motion of a creditor and the affirmative granting of relief by the bankruptcy court must occur before the protections of the automatic stay with respect to any given property or action will be modified or terminated.<sup>49</sup> As such, bankruptcy courts treat the automatic stay, and any violations thereof, most seriously. Parties that violate the stay become subject to sanctions for contempt of court and to payment of actual and potentially punitive damages.<sup>50</sup>

### 5. *Avoidance Actions*

The Bankruptcy Code contains several so-called avoidance actions—actions designed to set aside fraudulent transfers (pre-bankruptcy transfers for less than reasonable equivalent value), preferential transfers (the favoring of one creditor over another), and unauthorized post-bankruptcy transfers.<sup>51</sup> Upon the avoidance of the transfer, either the property transferred or its value must be returned to the bankruptcy estate.<sup>52</sup> Avoidance actions are statutorily created and arise automatically upon the commencement of any bankruptcy case under non-chapter 15 chapters of the Bankruptcy Code. Only the trustee or the debtor entity has the standing to initiate avoidance actions unless the bankruptcy court grants leave to another party to commence an avoidance action.<sup>53</sup>

Chapter 15 automatically grants the foreign representative that special standing: “[u]pon recognition of a foreign proceeding, the foreign representative has standing in a case concerning the debtor pending under another chapter of this title to initiate actions under sections 522, 544, 545, 547, 548, 550, 553 and 724(a).”<sup>54</sup> This is a powerful tool because the foreign representative will not be subject to the will of a potentially hostile trustee or obstreperous debtor management (management which, for example, may have no intention of initiating avoidance actions to avoid transfers that they may have authorized to themselves or insiders).

### 6. *Rights of Foreign Creditors*

Another advantage of chapter 15 is that it expressly provides that foreign creditors have the same rights regarding the commencement of, and

47. *Pursifull v. Eakin*, 814 F.2d 1501, 1504 (10th Cir. 1987).

48. *See* 11 U.S.C.A. § 1521(a)(1)-(2) (West 2005). While the bankruptcy court has this greater power, it may not enjoin a police or regulatory act of a governmental unit, including that of a criminal nature. § 1521(d).

49. 11 U.S.C.A. § 362(d) (West 2005 & Supp. 2006).

50. 11 U.S.C.A. § 362(k) (West 2005 & Supp. 2006).

51. 11 U.S.C.A. §§ 547-549 (West 2005).

52. *See* 11 U.S.C. §§ 550-551 (2000).

53. *See, e.g., Girard v. Michener (In re Michener)*, 217 B.R. 263, 270 (Bankr. D. Minn. 1998).

54. Bankruptcy Code, 11 U.S.C.A. § 1523(a) (West 2005).

participation in, a chapter 15 proceeding as domestic creditors.<sup>55</sup> Moreover, “the claim of a foreign creditor . . . shall not be given a lower priority than that of general unsecured claims without priority solely because the holder of such claim is a foreign creditor.”<sup>56</sup> Foreign creditors are also to be provided notice of the chapter 15 filing, together with sufficient time to file claims, and are entitled to notice of actions taken in the chapter 15 case and to contest those actions.<sup>57</sup> Therefore, any fears that foreign creditors might be prejudiced in normal judicial proceedings in the United States, whether justified or not, are obviated through chapter 15—foreign creditors (except foreign taxing authorities) share equal rights with domestic creditors.

### 7. *Ability to Intervene in Current Bankruptcies*

In addition to obtaining access to courts in the United States in general, chapter 15 specifically grants the foreign representative, upon the recognition of the chapter 15 petition, the right “to participate as a party in interest in a case regarding the debtor under this title.”<sup>58</sup> This is of potential significant importance because it will mean that the foreign representative will be allowed to be heard and to object to actions being taken against the debtor whose assets it is administering in a foreign country in a U.S. bankruptcy proceeding against that debtor. It may also grant the foreign representative greater rights with respect to any bankruptcy case involving the foreign debtor’s U.S. assets, such as a subsidiary.<sup>59</sup>

## B. THE CARROT (ASSISTANCE TO THE FOREIGN REPRESENTATIVE AND THE FOREIGN COURT)

### 1. *Access to Courts in the United States*

Chapter 15 opens the door to all courts in the United States and not just to courts of the United States (i.e., federal courts only). Once the chapter 15 petition is recognized, the foreign representative has the capacity to sue and to be sued in any court in the United States and to apply to any such court for assistance and relief.<sup>60</sup> Significantly, courts in the United States are required to “grant comity or cooperation to the foreign representative,” although this provision may well prove to be unconstitutional.<sup>61</sup> If a particular state or local court refuses to provide such comity or cooperation, an argument can be made that the federal government, absent a treaty (which chapter 15 is not), lacks the authority to command courts of sovereign states of the United States. The foreign representa-

55. 11 U.S.C.A. § 1513(a) (West 2005).

56. 11 U.S.C.A. § 1513(b)(1) (West 2005).

57. 11 U.S.C.A. § 1514(a)-(d) (West 2005).

58. 11 U.S.C.A. § 1512 (West 2005).

59. In this case, had Fraudsters United already filed a bankruptcy case, or had one been filed against it, the foreign representative should have the authority to protect his interests in such a case.

60. 11 U.S.C. § 1509(b)(1)-(2) (West 2005).

61. 11 U.S.C.A. § 1509(b)(3) (West 2005).

tive is also granted specific authority to intervene (become a party to) any legal proceeding in state or federal court in which the debtor is a party.<sup>62</sup>

A foreign representative is subject to all U.S. non-bankruptcy law regardless of whether a chapter 15 petition is recognized.<sup>63</sup> Nevertheless, if a foreign representative files a chapter 15 petition, it “does not subject the foreign representative to the jurisdiction of any court in the United States for any other purpose.”<sup>64</sup> This protects the foreign representative from personal or derivative claims and does not alter the normal jurisdictional provisions, both subject matter and personal, and venue provisions applicable to suing the foreign representative on other matters.

### 2. *Cooperation and Coordination with Foreign Representative and Foreign Court*

The bankruptcy court is authorized to provide assistance to the foreign representative in addition to, and other than, the specific relief that is identified in chapter 15 and in the Bankruptcy Code.<sup>65</sup> In other words, through the exercise of comity, the bankruptcy court is specifically authorized to take actions that it deems appropriate to ensure the just treatment of creditors, protect domestic creditors from prejudice in a foreign proceeding, prevent fraudulent or preferential transfers of property, distribute property under the equitable scheme of the Bankruptcy Code, and even grant a discharge.<sup>66</sup> Not only will the foreign representative obtain the assistance of courts in the United States, but also the bankruptcy court is directed to communicate and cooperate with the foreign court to the maximum extent possible.<sup>67</sup> The bankruptcy court is entitled to request information or assistance from the foreign court.<sup>68</sup> Similarly, in addition to the bankruptcy court, any bankruptcy trustee or examiner appointed concerning the debtor is directed to cooperate with the foreign representative and foreign court, and is entitled to communicate directly with them.<sup>69</sup>

### 3. *Presumptions in Favor of the Foreign Representative*

The foreign representative is granted several presumptions to assist him in fulfilling his duties. If the certificate from a foreign court submitted with a petition for recognition indicates that the foreign proceeding is a “foreign proceeding” for purposes of chapter 15 (meaning that the elements of the term are satisfied), and that person is the “foreign representative,” the bankruptcy court is entitled to presume the same.<sup>70</sup> The

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62. 11 U.S.C.A. § 1524 (West 2005).

63. 11 U.S.C.A. § 1509(e) (West 2005).

64. 11 U.S.C.A. § 1510 (West 2005).

65. 11 U.S.C.A. § 1507(a) (West 2005).

66. 11 U.S.C.A. § 1507(b) (West 2005).

67. 11 U.S.C.A. § 1525(a) (West 2005).

68. 11 U.S.C.A. § 1525(b) (West 2005).

69. 11 U.S.C.A. § 1526(a)-(b) (West 2005).

70. See 11 U.S.C.A. § 1516(a) (West 2005).

bankruptcy court is also entitled to presume that documents submitted with the petition for recognition are authentic and genuine, regardless of whether they are formally proved up.<sup>71</sup> For purposes of a “foreign main proceeding,” the debtor’s registered office, or, if the debtor is an individual, his habitual residence, is presumed to be the “center of the debtor’s main interests.”<sup>72</sup> If the foreign representative commences an involuntary bankruptcy proceeding, there is a presumption, upon the recognition of the foreign proceeding, that the debtor is generally not paying its debts as they become due, which is one of the elements that must be met by anyone filing an involuntary bankruptcy case.<sup>73</sup>

#### 4. *The Stick (Beware of Politics and Public Policy)*

Although chapter 15 provides many advantages, it is not without its pitfalls—potentially significant pitfalls depending on the country of origin, the debtor, the judge, and American public opinion and policy. The United States, as with all democracies, has certain influential lobbyists and special interest groups, some of who wield significant influence if their constituency is negatively impacted or threatened. A foreign insolvency representative, expecting to file a routine case, may well find himself suddenly confronted with issues or with archaic laws that he would never suspect (although it is highly unlikely that the BVI liquidator would face these issues, since the British Virgin Islands and the United States share friendly relations). Nevertheless, just as the BVI liquidator must be a master of insolvency laws, it would not hurt for him to have some understanding about American politics and public opinion.

#### 5. *Treaty Obligations Trump Chapter 15*

Under U.S. law, treaties are given equal weight to the Constitution and trump all statutes, whether federal or state. It is not surprising, therefore, that chapter 15 provides that to the extent it conflicts “with an obligation of the United States arising out of any treaty or other form of agreement to which it is a party with one or more other countries, the requirements of the treaty or agreement prevail.”<sup>74</sup> For example, suppose that the United States does not recognize the government of a country (as it did not recognize communist China in the 1960s), and enters into a treaty with what it considers to be the lawful government of that country (in this example, Taiwan) to the effect that the agents of the unrecognized state will not have access to U.S. courts. Entities subject to the jurisdiction of the unrecognized government may be precluded from seeking relief under chapter 15.

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71. See 11 U.S.C.A. § 1516(b) (West 2005).

72. See 11 U.S.C.A. § 1516(c) (West 2005).

73. See 11 U.S.C.A. § 1531 (West 2005).

74. 11 U.S.C.A. § 1503 (West 2005).

### 6. *Public Policy Trumps Chapter 15*

Additionally, chapter 15 provides: “[n]othing in this chapter . . . prevents the court from refusing to take an action governed by this chapter . . . if the action would be manifestly contrary to the public policy of the United States.”<sup>75</sup> This is Congress’ safety-valve, which is designed to ensure that courts of the United States do not do the bidding of foreign governments or take actions perceived to be hostile to the interests of the United States, and may take many forms. For example, would a Cuban liquidator be granted relief under chapter 15? Would an Iranian liquidator be able to propose a plan or liquidation that would transfer advanced technology to an Iranian company? Would a representative of Libya be granted relief under chapter 15, if citizens of the United States had significant unpaid claims against that country? These are but a few examples of situations which may raise issues of public policy, or at least the public policy of the bankruptcy judge who may have his own views on the matter and is granted the discretion under chapter 15 to make such decisions.

### 7. *Denial of Recognition with Prejudice*

Finally, the bankruptcy court has the power to refuse to recognize a chapter 15 case and prevent other courts from accommodating the foreign representative. Specifically, if the bankruptcy court refuses to grant relief under chapter 15, “the court may issue any appropriate order necessary to prevent the foreign representative from obtaining comity or cooperation from courts in the United States.”<sup>76</sup> While the foreign representative may otherwise be able to obtain a favorable order from a non-bankruptcy court under principles of comity, such as from a local court that orders the garnishment of a bank account, if the foreign representative tries to obtain relief under chapter 15 and fails, he could find all of the other courts in the United States closed to him.

## C. THE MECHANICS OF CHAPTER 15

### 1. *Foreign Proceedings and Foreign Representatives*

A case under chapter 15 is commenced by the filing of a petition with a United States bankruptcy court for “recognition of a foreign proceeding” under chapter 15.<sup>77</sup> The petition for recognition is filed by the “foreign representative” who, by filing the petition, “applies to the court for recognition of a foreign proceeding in which the foreign representative has been appointed.”<sup>78</sup> The term “foreign representative” is defined as “a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor’s assets or affairs or to act as a representa-

75. 11 U.S.C.A. § 1506 (West 2005).

76. 11 U.S.C.A. § 1509(d) (West 2005).

77. 11 U.S.C.A. § 1504 (West 2005).

78. 11 U.S.C.A. § 1515(a) (West 2005).



tive of such foreign proceeding”<sup>79</sup> The foreign representative can, therefore, be an individual or a company, such as a professional organization of accountants or other insolvency specialist, but the foreign representative must be appointed by the foreign court in the particular foreign proceeding that he is seeking the recognition of.<sup>80</sup>

The phrase “foreign proceeding” is a defined term, meaning “a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.”<sup>81</sup>

Clearly, not every foreign insolvency proceeding qualifies as a “foreign proceeding.”<sup>82</sup> First, there must be court supervision of the process. Alternatively, a foreign tribunal may supervise insofar as it is an “authority competent to control or supervise a foreign proceeding,” which definition has yet to be fully addressed, although some level of governmental officialdom appears to be required.<sup>83</sup> Second, that supervision must be for the purpose of a financial reorganization or liquidation of the entity that is the subject of the proceeding. A foreign proceeding to recover a single asset, without the overall purpose of reorganization or liquidation, for example, does not qualify. Third, the foreign proceeding must be a collective proceeding, meaning that it is designed to address the claims of creditors as a whole, as opposed to only one or a few creditors. Fourth, the foreign proceeding must be a proceeding in a court in a foreign country, which is straightforward. Fifth, the foreign proceeding must be a proceeding under a law relating to insolvency or reorganization<sup>84</sup>.

## 2. *Entities that May Not Seek Relief Under Chapter 15*

Even if the definitions of “foreign proceeding” and “foreign representative” are met, and assuming that no treaty exists or public policy exception applies, not every foreign entity is eligible for relief under chapter 15. This is an important distinction because it is anticipated that a significant number of foreign insolvency proceedings will fit within the applicable exclusions and will, therefore, not be eligible for chapter 15. This is because the Bankruptcy Code prohibits certain domestic entities from seeking or obtaining relief, and it would be paradoxical for foreign entities of

79. 11 U.S.C. § 101(24) (2000).

80. 11 U.S.C.A. § 1515(a) (West 2005).

81. 11 U.S.C. § 101(23) (2000).

82. The Bankruptcy Code contained a definition of “foreign proceeding” prior to the enactment of chapter 15. That definition, however, has been extensively changed, and practitioners are advised not to rely on court interpretations of the prior definition.

83. 11 U.S.C.A. § 1502(3) (West 2005).

84. A proceeding under a law whose purpose is merely to recover assets to satisfy a judgment does not qualify. The use of the words “relating to” however could allow sufficient and potentially far-reaching flexibility.

the same excluded type to be able to seek or obtain such relief.<sup>85</sup>

Specifically, chapter 15 relief cannot be granted to an entity that is otherwise excluded by the Bankruptcy Code from seeking relief.<sup>86</sup> The only exception is that, while a foreign insurance company engaged in business in the United States may not seek relief under other chapters of the Bankruptcy Code, it is apparently permitted to seek relief under chapter 15 (although it remains unclear as to whether it is still excluded if it engages in business in the United States).<sup>87</sup> Similarly, chapter 15 also contains limitations and exclusions on *in rem* remedies. Specifically, chapter 15 relief is not available regarding “any deposit, escrow, trust fund, or other security required or permitted under any applicable State insurance law or regulation for the benefit of claim holders in the United States.”<sup>88</sup> This provision relates to state laws that require insurance companies to establish reserve and security accounts, and evidences Congress’ intent that those reserves be available to U.S. creditors since the domestic creditors have effectively paid for those protections.

### 3. Foreign Main Proceeding Versus Foreign Nonmain Proceeding

Chapter 15 distinguishes between two types of foreign proceedings that may be recognized: (i) a “foreign main proceeding;” and (ii) a “foreign nonmain proceeding.”<sup>89</sup> This is an important distinction that will affect the rights and options of the foreign representative under chapter 15.

A “foreign main proceeding” is a “foreign proceeding pending in the country where the debtor has the center of its main interests.”<sup>90</sup> Significantly, the phrase “main interests” does not necessarily mean the country where the debtor has its main assets, and may be interpreted as, for example, the country where the debtor’s principal corporate decisions and management reside or are made.<sup>91</sup> In other words, “interests” may mean property interests, as that term is frequently used in American law, but it may also be interpreted in the broader linguistic sense such as business interests. But in the absence of contrary evidence, “the debtor’s regis-

85. For historical, constitutional, and other reasons outside the scope of this article, insurance and banking companies are generally prohibited from seeking relief under the Bankruptcy Code. In the United States, these types of companies are chartered and controlled by individual states, and must establish certain services and insurance or reinsurance, with each state providing detailed provisions for their court-supervised insolvencies and receiverships.

86. 11 U.S.C.A. § 1501(c) (West 2005). These include railroads, domestic insurance companies, domestic banks of various types, and foreign banks with a branch in the United States, a stockbroker (with limitations), a commodity broker (with limitations), and entities and persons subject to the Securities Investor Protection Act of 1970 (generally, brokers and dealers outside the United States who engage in brokerage business inside the United States). See 11 U.S.C.A. § 109(b) (West 2005); cf. 11 U.S.C.A. § 1501(c)(1) (West 2005) with 11 U.S.C.A. § 109(b)(3)(A) (West 2005).

87. Cf. § 1501(c)(1) with § 109(b)(3)(A).

88. 11 U.S.C.A. § 1501(d) (West 2005).

89. 11 U.S.C.A. § 1502(4)-(5) (West 2005).

90. § 1502(4).

91. *Id.*

tered office, or habitual residence in the case of an individual, is presumed to be the center of the debtor's main interests.<sup>92</sup>

A "foreign nonmain proceeding," on the other hand, is the opposite of a foreign main proceeding.<sup>93</sup> A foreign nonmain proceeding is a "foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment."<sup>94</sup> Basically, this term means a foreign proceeding pending in any country against the debtor, other than the country where a foreign main proceeding is pending. But there must nevertheless be a foreign proceeding pending, which raises the requirements and the considerations applicable to the determination of whether a foreign proceeding is pending, as discussed above.

#### 4. *The Procedure*

A case under chapter 15 is commenced by the filing of a petition with a United States bankruptcy court for "recognition of a foreign proceeding" under chapter 15, also referred to as a petition for recognition.<sup>95</sup> Upon the filing of a valid petition for recognition, accompanied by the proper fee and the proper documents, the bankruptcy court is commanded to decide the petition for recognition at the earliest practical time.<sup>96</sup> But as with most court actions under the Bankruptcy Code, the court may grant the petition for recognition only "after notice and a hearing."<sup>97</sup> If the foreign proceeding is main, then any party-in-interest may contest the granting of the petition for recognition.<sup>98</sup> If the foreign proceeding is nonmain, providing legal notice is much more difficult. First, the foreign representative has to obtain a summons from the clerk of the court.<sup>99</sup> That summons, and the petition for recognition, must be served on the debtor and on any party against whom provisional relief under chapter 15 is sought (as discussed below), in the manner prescribed for the service of summons in general.<sup>100</sup> If the debtor is a U.S. entity, service of the summons is fairly straightforward, but if the debtor is not a U.S. entity, service of the summons can become quite complicated and expensive, may involve governmental entities and treaties, and may take a significant amount of time (adding to the potential that provisional relief under chapter 15 may be needed until the summons is legally served). If service under the normal legal methods cannot be accomplished, the court has leeway to order other methods of service, including, if applicable, through publications.<sup>101</sup>

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92. 11 U.S.C.A. § 1516(c) (West 2005).

93. § 1502(5).

94. *Id.*

95. § 1504. See exhibit 1 in appendix A for an example of a chapter 15 petition. Exhibit 2 is an order granting the petition.

96. See 11 U.S.C.A. § 1517(c) (West 2005).

97. 11 U.S.C.A. § 1517(a) (West 2005).

98. See FED. R. BANKR. P. 1011(a).

99. See FED. R. BANKR. P. 1010.

100. See *id.*

101. See *id.*

In addition to the procedural rules, chapter 15 preserves the rights of foreign creditors. Among other things, “[f]oreign creditors have the same rights regarding the commencement of, and participation in, a case under this title as domestic creditors.”<sup>102</sup> To ensure that foreign creditors are protected, therefore, chapter 15 requires that any notice that must be served on domestic creditors (including notice of the hearing on the petition for recognition) must also be served on foreign creditors.<sup>103</sup> The bankruptcy court has the power to provide for notice to foreign creditors, including through notice publication in foreign newspapers, although individual notice is the statutorily preferred method.<sup>104</sup> Additionally, the notice provided to foreign creditors must inform them of the deadline for filing claims, as well as the mechanism applicable to the same.<sup>105</sup>

### 5. *Interim Relief Prior to Recognition*

Most of the relief under chapter 15 is available only after the bankruptcy court recognizes the foreign proceeding. But the period between the filing of the chapter 15 petition and its recognition may enable creditors to seize assets or obtain liens against them, while fraud continues and new creditors arise, or while management or others transfer assets for their own benefit or to preferred creditors. By the time that the bankruptcy court recognizes the chapter 15 petition, it may be too late and the whole basis of the filing may be rendered moot.

Chapter 15 recognizes this danger and offers the foreign representative a valuable tool to counter it. Immediately upon the filing of the chapter 15 petition, the bankruptcy court is authorized to grant provisional relief “where relief is urgently needed to protect the assets of the debtor or the interests of the creditors.”<sup>106</sup> Only the foreign representative may request such provisional relief, and only if he satisfies the urgency and protection requirements.<sup>107</sup> Moreover, chapter 15 expressly provides that the elements and standards applicable to the granting of injunctive relief apply to provisional chapter 15 relief. This means that the foreign representative will have to make an evidentiary presentation, meet the difficult burdens that govern injunctions, and otherwise comply with fairly rigorous requirements that determine whether an injunction is appropriate and the extent to which it is appropriate.<sup>108</sup>

102. 11 U.S.C.A. § 1513(a) (West 2005).

103. See § 1514(a)-(b).

104. See *id.*

105. See § 1514(c).

106. 11 U.S.C.A. § 1519(a) (West 2005). This relief includes: “[i] staying execution against the debtor’s assets; [ii] entrusting the administration or realization of all or part of the debtor’s assets located in the United States to the foreign representative”; [iii] suspending the right [of the debtor] to transfer, encumber [i.e. lien] or otherwise dispose of any assets”; [iv] “[ordering] the examination of witnesses”; [and] [v] “granting any additional relief” that is otherwise available to an ordinary bankruptcy trustee. § 1519(a)(1)-(3); 11 U.S.C.A. § 1521(a)(3)-(7) (West 2005).

107. See § 1519(a).

108. See 11 U.S.C.A. § 1519(e) (West 2005). Generally, the following four elements must each be met before a court will grant a preliminary injunction: “(1) a substan-

## 6. *Need for the Recognition of the Foreign Proceeding*

There is an immediate difference between chapter 15 and other chapters of the Bankruptcy Code because the chapter 15 petition requires its recognition by the bankruptcy court. Under all other chapters of the Bankruptcy Code, and unlike the laws of many countries, a bankruptcy court does not need to make a finding that the debtor is insolvent, that the debtor is a bankrupt, or that bankruptcy is appropriate. Similarly, the filing of a bankruptcy petition automatically provides access to the Bankruptcy Code for the debtor. It takes the affirmative action of some party to move for, and to obtain, an order from the court dismissing the bankruptcy case. With respect to chapter 15, however, the filing of the petition for recognition does not automatically grant access to the bankruptcy court or the bankruptcy laws since that petition must first, by definition, be recognized or granted by the bankruptcy court.

Parties must file an answer or objection to the petition for recognition within twenty days after service of the petition for recognition and the summons.<sup>109</sup> Also, if a summons is not served until sometime after the filing of the petition, the hearing may be further delayed because a summons must be served—if to be served in the United States—within ten days of its issuance.<sup>110</sup> With the procedural requirements satisfied (i.e., notice of the petition and service of the summons), the court may hold the hearing on the petition and consider whether to grant the petition on a substantive basis. In this respect, the substantive issues are straightforward: (i) there must be a foreign proceeding, which includes an analysis of whether that definition is met, as discussed above; (ii) the foreign representative must have filed the petition, which includes an analysis of the definition of foreign representative, as discussed above; and (iii) the petition must have been properly filed, with the necessary certifications from the foreign court or other acceptable evidence, also as discussed above.<sup>111</sup>

If the three requirements stated above, together with their sub-requirements (such as the elements of the definition of “foreign proceeding” and “foreign representative”) have been met, the bankruptcy court must recognize the petition, unless one of the public policy or treaty exceptions discussed above apply. At the time that the bankruptcy court recognizes the chapter 15 petition, the bankruptcy court must also adjudicate whether the foreign proceeding is main or nonmain, and that issue is likely to be litigated (if in controversy) at the same time that recognition is litigated.<sup>112</sup>

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tial likelihood of success on the merits; (2) a substantial threat that [the plaintiff] will suffer irreparable injury absent the injunction; (3) that the threatened injury outweighs any harm the injunction might cause the defendants; and (4) that the injunction will not impair the public interest.” *Bernat v. Guadalajara, Inc.*, 210 F.3d 439, 442 (5th Cir. 2000).

109. See FED. R. BANKR. P. 1011(b).

110. See FED. R. BANKR. P. 7004(e).

111. See § 1517(a)(1)-(3).

112. See 11 U.S.C.A. § 1517(b) (West 2005).



## D. THE BVI LIQUIDATOR'S CHAPTER 15 CASE

The BVI Liquidator would, under the facts of our hypothetical, most likely find it advisable to file a chapter 15 case so as to maximize his control over, and his options concerning, Fraudsters' New York bank account, and Fraudsters United and its assets. The following is a brief analysis of what the BVI Liquidator's chapter 15 case would look like.

1. *Where to File*

The first question that the BVI Liquidator would face, after deciding to file a chapter 15 petition, is where to file that petition. A case under chapter 15 may be commenced in the district where: "(1) . . . the debtor has its principal place of business or principal assets in the United States; (2) if the debtor does not have a principal place of business or assets in the United States, [in the district where] there is pending against the debtor an action or proceeding in a Federal or State court; or (3) [if neither paragraphs (1) or (2) apply, the district] in which venue will be consistent with the interests of justice and the convenience of the parties."<sup>113</sup>

Under this statutory scheme, the "debtor" is Fraudsters, thereby necessitating an analysis of where, in the United States, it (and not the BVI Liquidator or any other company) has its principal place of business or principal assets. Did Fraudsters transact business in the United States? If so, its principal place of business is generally the location where its major (i.e., high level) business decisions are made.<sup>114</sup> This may be of little help to the BVI Liquidator if Fraudsters made no business decisions in the United States. If Fraudsters, however, transacted business through Fraudsters United, then the actual location of Fraudsters United may be applicable. But, if Fraudsters United is just a non-operating entity that Fraudsters owns, and Fraudsters does not conduct its business through Fraudsters United, then Fraudsters United may not be Fraudsters' principal business in the United States.

But both Fraudsters United and the New York bank account are assets of Fraudsters located in the United States. It is therefore necessary to determine whether one, or both, may be considered the principal assets of Fraudsters in the United States. This will depend on the relative value of these assets: the amount of funds in the New York bank account versus the value of Fraudsters United.<sup>115</sup> If both are of comparative value, then it is likely that the BVI Liquidator can characterize whichever one he wants as the principal assets, and it is not likely that a court would overturn the BVI Liquidator's characterization, since that kind of a characterization is entitled to deference from the court and the burden is on a party opposing venue to prove that venue is not proper or that it should

113. 28 U.S.C.A. § 1410 (West 2005).

114. *In re Peachtree Lane Assocs.*, 150 F.3d 788, 795-96 (7th Cir. 1998).

115. *See generally In re Veliotis*, 79 B.R. 844 (Bankr. E.D. Mo. 1987).

be changed.<sup>116</sup>

## 2. *Preliminary Relief*

The BVI Liquidator would next have to retain capable bankruptcy counsel in the United States, experienced in complicated cross-border bankruptcy issues, and then prepare the petition for recognition as well as the supporting documents. A list of creditors would have to be prepared, and the petition for recognition, as well as the notice of hearing scheduled by the court, would have to be properly served.

At this same time, the BVI Liquidator would have to consider whether to seek interim relief from the bankruptcy court. Is the management of Fraudsters United transferring assets, paying certain creditors on a preferential basis, or engaging in ongoing fraudulent activity? Is Fraudsters United's management refusing to cooperate with the BVI Liquidator? Is a lawsuit against the New York bank account, Fraudsters United, or its bank accounts about to go to trial? Is a creditor, or a governmental unit, about to seize assets, or foreclose on them? Does the BVI Liquidator need access to discovery or to witnesses? Does the BVI Liquidator need to have BVI's assets placed under his control urgently, or does he urgently need to take control over its business? These are some of the questions that must be asked and, if any of this kind of relief is urgently required, a motion requesting that relief will have to be filed and the BVI Liquidator will have to prepare to attend a hearing on that motion in person and substantiate the motion with appropriate evidence.

## 3. *Recognition of the Chapter 15 Petition*

After a hearing before the bankruptcy court, at which the BVI Liquidator may need to be personally present, and depending on whether any objection to recognition of the chapter 15 petition is filed, the bankruptcy court would recognize Fraudsters' BVI proceedings as a "foreign proceeding" and the BVI Liquidator as the "foreign representative."<sup>117</sup> Accordingly, because the location of registration is presumed to be the center of a debtor's main interests, the bankruptcy court would recognize Fraudsters' BVI proceeding as a foreign main proceeding—which is important for the BVI Liquidator regarding his authority over Fraudsters United. But this is only a presumption, and if Fraudsters is only a shell in the BVI and instead transacted all of its business in the United States, it is possible that Fraudsters' proceeding will not be recognized as a foreign main proceeding but only as a foreign nonmain proceeding.

Upon the recognition of the BVI Liquidator's chapter 15 petition, the court will sign an order to that effect. In the United States, orders signed by judges are usually prepared by the lawyers. The order should include detailed provisions respecting the BVI Liquidator's authority: that the

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116. See, e.g., *In re Bell Tower Assocs.*, 86 B.R. 795 (Bankr. S.D.N.Y. 1988).

117. § 101(23)-(24).

debtor's assets in the United States are entrusted to his care, that all persons are enjoined from proceeding against the debtor or its assets, that the BVI Liquidator may appear in all other courts in the United States, that such other courts are to grant comity, that the orders of the BVI court appointing the BVI Liquidator and granting him authority are to have full force and effect in the United States, that the BVI Liquidator may file a bankruptcy petition on behalf of Fraudsters United, that all persons are prohibited from transferring assets of Fraudsters without court authority, that the BVI Liquidator is authorized to examine witnesses and obtain any financial records of Fraudsters in the United States, that the BVI Liquidator is authorized to operate Fraudsters' business in the United States, that parties violating the order shall be subject to sanctions and contempt, and any other matter that the BVI Liquidator finds advisable.

#### 4. *What to do with Fraudsters United?*

The BVI Liquidator may be contemplating a sale of Fraudsters United's business, or its assets, or he may be contemplating its straight liquidation. A bankruptcy filing for Fraudsters United may be the best way to implement these plans. Even if the BVI Liquidator does not have any plans, a bankruptcy filing by Fraudsters United will buy the BVI Liquidator the time that he will need to analyze options, while preventing adverse creditor actions and potentially adverse actions by the management of Fraudsters United.

Under the facts as assumed, it would make most sense for the BVI Liquidator to file a chapter 11 bankruptcy case on behalf of Fraudsters United. This may or may not be simple. Hopefully, the order recognizing the BVI Liquidator's chapter 15 petition will specifically grant him the authority to do this, but, even if it does not, the provisions of chapter 15 ought to enable him to file a case on behalf of Fraudsters United.<sup>118</sup> The reason why it would be preferable that the order recognizing the chapter 15 case specifically grants the BVI Liquidator this authority is that the present management of Fraudsters United, or one or more of its creditors, may contest the BVI Liquidator's ability to cause Fraudsters United to file a voluntary bankruptcy case.<sup>119</sup> Additionally, not only should the order recognizing the chapter 15 petition specifically authorize the BVI Liquidator to file a petition for Fraudsters United, but it should also specifically provide that the BVI Liquidator will have management authority over Fraudsters United during its bankruptcy case, so that the

118. See § 1511(a)(2) (authorizing foreign representative to file a voluntary bankruptcy case); see also § 1520(a)(3) (authorizing representative to operate the debtor's business).

119. Creditors, parties-in-interest, and the U.S. Trustee (the President's representative administering the bankruptcy system for a given judicial district) would all have the ability to move to dismiss a chapter 11 petition based on the lack of authority of the person purporting to file it, and authority to file sometimes leads to highly complex and expensive battles. See 11 U.S.C.A. § 1112 (West 2005).

BVI Liquidator can choose between those managers that he finds helpful to Fraudsters United's bankruptcy case, and those that oppose his intentions.

A chapter 11 bankruptcy case for Fraudsters United would not be simple. It would be costly, since Fraudsters United would have to hire bankruptcy counsel and may have to also pay for the attorneys of a committee of unsecured creditors, if one is appointed. A creditor or other party-in-interest may move for the appointment of a chapter 11 trustee to manage and run Fraudsters United, if they are uncomfortable with the BVI Liquidator assuming that role, if pre-bankruptcy management remains and is accused of serious malfeasance. The BVI Liquidator may request that a chapter 11 trustee be installed if he wants to replace management and does not have the resources or expertise to operate the business.<sup>120</sup> The BVI Liquidator may wish to request the appointment of an examiner.<sup>121</sup> The BVI Liquidator would also face many of the same complicated issues faced by debtors in chapter 11 cases, including: whether Fraudsters United will generate a positive post-bankruptcy cash flow to pay administrative expenses and the costs of the chapter 11; the potential need for post-bankruptcy financing; the need to obtain court permission to use cash, receivables, and accounts that may be subject to a valid lien (so-called cash collateral); motions filed by creditors for relief from the automatic stay so that they can pursue litigation or foreclose on their collateral; if the BVI Liquidator has located a buyer for some or all of Fraudsters United's assets, the need to have the court establish bid procedures and approve the proposed sale; the need to decide which leases and executory contracts to reject and which to assume; and a host of other substantive, procedural, and administrative burdens associated with operating a business in chapter 11.

Immediately upon the filing of a bankruptcy case by Fraudsters United, however, judicial proceedings, collection activities, and the like would stop due to the imposition of the automatic stay. Fraudsters United's Dallas bank account would be protected, and the BVI Liquidator would have the breathing spell needed to preserve Fraudsters United's value and to begin an orderly liquidation or reorganization. He would also

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120. Normally, the debtor in a chapter 11 case manages and operates its assets and business. But the bankruptcy court has the authority to order the appointment of a chapter 11 trustee, who supplants and replaces the debtor's management. *See* 11 U.S.C.A. § 1104(a) (West 2005). There are numerous reasons why a chapter 11 trustee may be appointed, but most often they take the form of "fraud, dishonesty, incompetence, or gross mismanagement of . . . the debtor by current management" whether prior to the bankruptcy filing or after. § 1104(a)(1).

121. The bankruptcy court has the authority to appoint an examiner for one or more purposes in a chapter 11 case. *See* 11 U.S.C.A. § 1104(c) (West 2005). An examiner is an officer of the court and reports to the judge, who may decide that an examiner is appropriate to investigate the debtor's management or business, or to investigate or undertake a complicated and burdensome task that the court does not have the time to address (such as reviewing thousands of pages of invoices submitted by the attorneys for the debtor for interim court approval), in which case the court may rely on the recommendations of the examiner.

have some period of time before a plan has to be filed (if it is not filed in time, any other creditor would obtain the ability to file his plan) to formulate a strategy not only for Fraudsters United, but also for the synthesis of that strategy with his broader strategies and duties regarding Fraudsters. This would be heavily dependent on the facts of any given case, as is always the case with chapter 11, such that more specific guidance cannot be given in the scope of this article, but, together with his powers under chapter 15 and the flexibility afforded by chapter 11 for Fraudsters United, it is highly likely that some solution would be found, so long as Fraudsters United's post-bankruptcy business is lawful and generated positive cash flow.

Ultimately, a chapter 11 plan would have to be formulated and proposed,<sup>122</sup> voted on by the creditors, and confirmed by the court—a potentially lengthy and difficult process, but with much give and take, which would afford the BVI Liquidator the discretion to consider various options to formulate a plan that suits Fraudsters United's creditors and also comports with his overall duties regarding Fraudsters. It is in this respect that a chapter 11 case would be preferable to a chapter 7 case because a chapter 7 case can take much longer; involves the cessation of business, and therefore the loss of going concern value; and follows a strict formula for administration and distribution. For example, a chapter 11 plan, unlike chapter 7, would give the BVI Liquidator the options of requesting a discharge of Fraudster United's debts, and the imposition of injunctions preventing creditors from pursuing third parties, such as directors, officers, affiliates, and even the BVI Liquidator himself.

#### E. FRAUDSTERS UNITED'S CANADIAN BANK ACCOUNT

Fraudsters United's Canadian bank account presents some of the same initial issues as does Fraudster's New York bank account. The BVI Liquidator, as the administrator of the Fraudsters United's bankruptcy estate, should be able to instruct the Canadian bank to transfer the funds to an American account for use by the Fraudsters United's bankruptcy estate. As with the New York account, this may become impossible if the account has been frozen or seized, if it is subject to liens, or if it is subject to forfeiture or other actions by the creditors of either Fraudsters or Fraudsters United.

If that becomes the case, the BVI Liquidator will have no choice but to initiate legal action in Canada. While the Canadian account would certainly be property of Fraudsters United's bankruptcy estate, and the U.S. bankruptcy court in that case would have jurisdiction over that account, no treaty apparently exists between the United States and Canada such that the Dallas bankruptcy court's orders could be enforced in Canada

122. Normally, only the debtor has the exclusive right to file a plan during the first 120 days after the bankruptcy case, an exclusive period that may be extended only up to eighteen months after the date of the filing of the case. See 11 U.S.C.A. § 1121(b) (West 2005).



without judicial action on the part of Canadian courts. Therefore, the BVI Liquidator will most likely have to resort to Canadian law, namely part XIII (International Insolvencies) of the Bankruptcy and Insolvency Act of Canada, which vests jurisdiction in the Canadian bankruptcy court to recognize the powers of a "foreign representative" of a foreign insolvency estate.<sup>123</sup>

With respect to the bankruptcy case of Fraudsters United (as opposed to Fraudsters), the U.S. bankruptcy court would be the home court. The Canadian act defines "debtor" as "an insolvent person who has property in Canada,"<sup>124</sup> which would be the case with Fraudsters United since it has a bank account in Canada, and it defines "foreign proceeding" as "a judicial or administrative proceeding commenced outside Canada in respect of a debtor, under a law relating to bankruptcy or insolvency and dealing with the collective interests of creditors generally."<sup>125</sup> A "foreign representative" means a person "holding office under the law of a jurisdiction outside Canada who . . . is assigned, under the laws of the jurisdiction outside Canada, functions in connection with a foreign proceeding that are similar to those performed by a trustee, liquidator, administrator or receiver appointed by the court."<sup>126</sup> Since all of these definitions are met with respect to Fraudsters United, the Canadian court can grant relief, which means that "[t]he court may, in respect of a debtor, make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under this Act with any foreign proceeding."<sup>127</sup> Thereafter, the proceedings and results are very similar to chapter 15, but are outside the scope of this article with respect to their detail.

#### IV. THE GERMAN EXPERIENCE

##### A. INTRODUCTION

As is referred to in the hypothetical fact pattern, assets of Fraudsters Limited were identified in Europe. Fraudsters Limited owns (i) a bank account in Frankfurt in its own name and (ii) is the sole shareholder of Fraudsters Europe GmbH, which is located in Frankfurt. Fraudsters Europe GmbH itself is the owner of a bank account in Lithuania and of an ancient palace in France where the meetings of the Fraudsters were held in a convenient atmosphere.

It is vital to understand that insolvency proceedings in continental Europe differ from Anglo-Saxon insolvency proceedings and follow different rules. In order to give a better understanding of continental insolvency proceedings, the following material will give advice to the BVI

123. Bankruptcy and Insolvency Act, R.S.C. ch B 3, § 267 (1985); 1992 S.C., ch. 27 (Can.), available at <http://laws.justice.gc.ca/en/showtdm/cs/B-3>.

124. *Id.*

125. *Id.*

126. *Id.*

127. Bankruptcy and Insolvency Act, R.S.C. ch B 3, § 268(3) (1985).

Liquidator of Fraudsters Ltd. on how to proceed step-by-step through the insolvency proceedings in continental Europe.

### 1. Bank Account in Frankfurt

As Fraudsters Limited is the owner of the Frankfurt bank account; this account is part of the assets of Fraudsters Limited, represented by the BVI Liquidator only.

### 2. German International Insolvency Law

Germany's Insolvency Act (IA) was amended in 2003 with special sections for international insolvencies. The legislator chose not to base the IA solely on the UNCITRAL Model Law, but instead incorporated a range of the Council Regulation (EC) No. 1346/2000 of Insolvency Proceedings (CRIP) as well. It is vital to understand that the CRIP only applies to insolvencies that were commenced within one of the member States of the European Union. The new sections of the IA therefore apply to international insolvencies that are not connected with one of the member states of the European Union.

As mentioned above,<sup>128</sup> the BVI is a British Overseas Territory. Nevertheless the CRIP was only agreed to by the member states of the European Union. This being the case, the CRIP is in effect between the United Kingdom and Germany, but an extension to the British Virgin Islands was not agreed upon. Therefore only the provisions of the IA are applicable in respect to the BVI liquidation.

The principle is that the insolvency proceedings themselves and their effects are governed by the law of the state in which the insolvency proceedings were instated (*lex fori concursus*).<sup>129</sup> If the proceedings were instated abroad, the foreign law is recognized domestically; if, however, the proceedings are opened within Germany only, German law is applicable.<sup>130</sup> Exemptions from this general provision were made for:

- contracts on immovable property;<sup>131</sup> according to section 336 IA<sup>132</sup> and the principles of the Private International Law (*lex rei sitae*) the law of the state is applicable to the situs of the land or the property;
- employment relationships;<sup>133</sup> where the German International Law in the German Introductory Law of the German Civil Code applies, which is mostly the law of the state where the employee performs the work (article 30 German Introductory Law of the German Civil Code);

128. See BVI EXPERIENCE, PART II A.

129. Insolvenzordnung [InsO] [Insolvency Code] Oct. 5, 1994, Bundesgesetzblatt, Teil I [BGBl. I] 2866, as amended, § 335.

130. See *id.*

131. Similar regulation for European insolvencies can be found. See Council Regulation 1346/2000, art. 8, 2000 O.J. (L 160) 1, 7 (EC), available at [http://europa.eu.int/eur-lex/pri/en/oj/dat/2000/l\\_160/l\\_16020000630en00010018.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2000/l_160/l_16020000630en00010018.pdf).

132. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 336.

133. *Id.* art. 10.

- set-off;<sup>134</sup> where the creditors' right to offset a claim is preserved when the creditor already obtained the possibility to set-off pursuant to the law applicable to the claim;
- rescission;<sup>135</sup> which will be governed by the law applicable to the insolvency proceedings unless the defendant demonstrates that the law applicable to the legal act does not allow rescission under any circumstances.

Section 343, clause 1 of IA is based on the presumption that where foreign insolvency proceedings are instated domestically, the effects are those in accordance with the law of the country in which the proceedings are instated. Securing measures taken in foreign insolvency instatement proceedings will likewise be recognized. Recognition includes the approval of the German state that the effects of the insolvency proceedings instated abroad will also apply to Germany. At the same time, the recognition conceded by the law includes an order to domestic Courts and authorities to observe the effects of the foreign insolvency proceedings and to assert them in the application of the law. Private persons must also act on the basis of the recognized effects in legal relations in order to avoid legal disadvantages, in particular with regard to third party liability.

Legal recognition does not imply that foreign insolvency proceedings are regarded as an equal to German insolvency proceedings (although this is the case in Switzerland under art. 17, section 2, Swiss International Private Law); it is the effects of the foreign bankruptcy proceedings in Germany which are actually being recognized here.

The most important consequence of the recognition of the instatement of foreign insolvency proceedings is that assets located in Germany are treated as part of the foreign bankruptcy estate.<sup>136</sup> The extent of the attachment is determined exclusively on the basis of the law at the place where the proceedings are instated pursuant to section 335 IA.<sup>137</sup> Only the foreign *lex fori concursus* regulates the distinction of insolvency-free assets of the debtor from the insolvency estate, application of a title acquisition after instatement of the proceedings, and distinction of the insolvency assets from third party property rights which can be asserted by separate satisfaction or right of separation.<sup>138</sup> If there is a need for additional orders to secure the assets of the insolvent pursuant to section 344 IA<sup>139</sup>, the German insolvency court is allowed to issue these additional rulings.<sup>140</sup>

The consequences of German recognition of foreign insolvency proceedings to BVI receivers are discussed below.

134. *Id.* art. 4, ¶ 2(d); *see also id.* art. 6.

135. *Id.* art. 4, para. 2(m); *see also id.* art. 13.

136. Braun/Liersch, *InsO*, 2. Auflage, § 343, Rn. 1.

137. *InsO* Oct. 5, 1994, BGBl I 2866, as amended, § 336.

138. *Id.* Rn. 11.

139. *InsO* Oct. 5, 1994, BGBl I 2866, as amended, § 344.

140. *Id.* Rn. 13.

### 3. *The Receiver's Management and Disposal Authorization*

The other side of the recognition of the attachment effect is that the receiver appointed in the foreign proceedings is exclusively authorized domestically to manage and dispose of the debtor's assets. His authorization is based on the law of the country in which the insolvency proceedings are instated, not on the articles of incorporation.

*Lex fori concursus* decides if the bankrupt's estate itself receives legal capacity and capacity to be party to legal proceedings and is represented by the receiver or if the receiver acts in his own name. Accordingly, *lex fori concursus* also decides if the foreign receiver has the authority to conduct litigation on behalf of the estate, if he has to file suit for the debtor's claims himself (within the country), and if he may authorize a third party (including the debtor) to conduct litigation. The foreign receiver may file for the foreclosure of the debtor's property pursuant to section 172 of the Law on Compulsory Sale of Real Property<sup>141</sup>; for this purpose he does not require a debt enforcement title.

### 4. *Exceptions from Effects of Seizure Due to Presumption of Accuracy of Registers*

Where the debtor is the owner of a right registered in the domestic State Register, Maritime Register or Shipbuilding Register, or Register of Liens on Aircraft, another right may be acquired from the receiver (even after instatement of insolvency proceedings) on the basis of the domestic regulations on bona fide acquisition, as long as no insolvency notice is registered in the Land Register of the respective other register. Section 349 I IA<sup>142</sup> states this explicitly.

Pursuant to section 346 IA<sup>143</sup>, the foreign receiver must file for an application at the domestic insolvency court. The court must, in turn, request registration by Land Register Office or Register Court and should do this on an emergency basis to avoid any bona fide acquisition. It is not clear why the foreign receiver (departing from section 32 II 2 IA<sup>144</sup> or article 22 CRIP<sup>145</sup>) does not have the right to file a direct application with the Land Register Office. The foreign type of disposal-restriction is to be registered regardless of whether an insolvency notice in the Land Register is customary in foreign law.

The purchaser of a chattel within the country who may not know that the seller may not dispose of his assets due to the instatement of (recognized) foreign insolvency proceedings will only be protected where the insolvency law of the country in which the proceedings are being instated

141. Gesetz über die Zwangsversteigerung und die Zwangsverwaltung [ZVG] [Law on Compulsory Public Sale and Receivership] Mar. 24, 1897, Recihsgesetzblatt [RGBL] 97, as amended, § 172.

142. InsO Oct. 5, 1994, BGBI I 2866, as amended, § 349.

143. InsO Oct. 5, 1994, BGBI I 2866, as amended, § 346.

144. InsO Oct. 5, 1994, BGBI I 2866, as amended, § 32, ¶ 2

145. Council Regulation 1346/2000, art. 22, 2000 O.J. (L 160) 1, 9 (EC).

has special protection in the case of bona fide acquisition of chattels. Where this is not the case, these regulations will also apply domestically in accordance with *lex fori concursus*.

Beyond this there is no bona fide protection. In the literature, it is partially recommended that the bona fide purchaser should be protected by application of sections 135 (11) and 932 of the Civil Code<sup>146</sup> until the instatement of the foreign insolvency proceedings has been published domestically. But recognition of the foreign insolvency proceedings pursuant to section 343 IA<sup>147</sup> is not dependent on domestic publication, and in domestic proceedings there is no bona fide protection in the case of ignorance of the instatement of insolvency proceedings, as there is in the case of real property acquisition. Hence, there is no reason to protect the domestic purchaser more strongly against foreign proceedings than in domestic proceedings.

According to German law, instatement of insolvency proceedings against the assets of a businessman are registered in the Commercial Register ex officio (section 32 of the Commercial Code<sup>148</sup>; section 31 IA<sup>149</sup>). For this reason, the foreign court can certainly request registration through letters rogatory. The German court must have this registration performed ex officio at the seat of the domestic subsidiary (sections 13d III<sup>150</sup>, 15 IV<sup>151</sup>, 32 of the Commercial Code<sup>152</sup>). The provision in article 22 CRIP<sup>153</sup> providing that publications in the Commercial Register and all other public registers have to be affected does not apply to insolvencies outside the European Union.<sup>154</sup>

In order to preserve the parallelism with the domestic proceedings and to relieve the register courts of the burden of inspection of the prerequisites for recognition, the application must be addressed (pursuant to article 102, section 6 I of the Introductory Law to the Insolvency Act) to the insolvency court (appointed under article 102, section 1 of the Introductory Law to the Insolvency Act); the latter will then request registration with the register. There is nothing against recognizing the same right of application for a receiver in a third party country of instatement of proceedings. But the publication effect will not commence before registration.

146. Bürgerliches Gesetzbuch [BGB] [Civil Code] Aug. 18, 1896, Reichsgesetzblatt [RGBI] 195, as amended, §§ 135, 932.

147. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 343.

148. Handelsgesetzbuch [HGB] [Commercial Code] May 10, 1897, Reichsgesetzblatt [RGBI] 219, as amended, § 32.

149. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 31.

150. HGB May 10, 1897, RGBI 219, as amended, § 13d, ¶ 3.

151. HGB May 10, 1897, RGBI 219, as amended, § 15, ¶ 4.

152. HGB May 10, 1897, RGBI 219, as amended, § 32.

153. Council Regulation 1346/2000, art. 22, 2000 O.J. (L 160) 1, 9 (EC).

154. HamburgerKommentar-Undritz, § 346, Rn. 2.



### 5. *Payment to Debtor*

In accordance with the attachment effect and transfer of estate administration to the receiver, a person owing money to the debtor may in principle no longer be released by payment to the debtor.

The extent to which bona fide protection is conceded to a bona fide debtor is essentially based on *lex fori concursus* (section 335 IA). But in general, a party is additionally protected in international private law where he acts in accordance with the laws generally applicable there. Hence, for protection of legal and business relations, the third party debtor may invoke section 82 IA<sup>155</sup> where at the time of payment he was ignorant of the instatement of the (recognized) foreign proceedings. This can be inferred from section 335 IA. If the debtor effected payment before publication of the foreign proceedings, it is assumed in every case that he was ignorant of the instatement of the insolvency proceedings.

### 6. *Litigation*

When German civil proceedings concerning the bankrupt's estate are pending at the time of the instatement of foreign insolvency proceedings, an assignment of the authority to conduct litigation to the receiver as decreed by the court must be observed. Where necessary, the position of the receiver in procedural law according to the authoritative insolvency law of the country in which the insolvency proceedings are being instated is to be adapted to German procedural law.

Before there is actually an assignment of litigation authorization, the pending lawsuit is suspended in first instance in accordance with German procedural regulations (section 240 Civil Proceedings<sup>156</sup>). This automatic suspension and the type and resumption of proceedings is also provided for by section 352 IA<sup>157</sup> according to the *lex fori* principle when foreign insolvency proceedings are instated against the debtor which essentially can have a universal effect. It is irrelevant whether suspension of the proceedings is also provided for by foreign law.<sup>158</sup>

The litigation authorization for German litigation issued by the debtor will always expire (section 117 IA<sup>159</sup>). If it turns out that the debtor has retained the power of disposal, he can resume the proceedings himself.

### 7. *Vis attractiva concursus*

In contrast to German law, many countries such as the United States and countries belonging to legal systems based on Roman law provide that the insolvency court also has the function or jurisdiction over the recognition of claims, contestation of the insolvency, separation, separate

155. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 82.

156. Zivilprozessordnung [ZPO] [Civil Procedure Statute] Sept. 12, 1950, Bundesgesetzblatt [BGBl] 533, as amended, § 240.

157. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 352.

158. InsO Oct. 5, 1994, BGBl. I 2866, as amended, § 352.

159. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 117.

satisfaction, and creditors' right to default of acceptance. Section 335 IA provides that the respective *lex fori concursus* determines whether and how instatement of the proceedings affects bringing legal action against individual creditors (i.e., recognizes a change of competence associated with a *vis attractiva concursus*, insofar as no proceedings are pending at the time of the instatement of the proceedings).

One objection to this is that the parties are taken away from their legal judge. But section 335 IA possibly refers to foreign competence regulations. If there foreign provisions are incorporated, the requirements of article 101 I 2 of the German Constitution<sup>160</sup> are met—at least with regard to disputes directly associated with insolvency such as contestation lawsuits, separate satisfaction lawsuits, and lawsuits concerning whether a claim is part of the passive estate if *vis attractiva concursus* is to be observed.

#### 8. Individual Debt Enforcement Stay

Pursuant to section 237 I KO<sup>161</sup> (the Insolvency Act before being reformed by the current IA), the instatement of insolvency proceedings abroad did not prevent a creditor from instating debt enforcement procedures against the debtor's domestic assets. This provision is no longer part of German insolvency law.

Section 354ff IA<sup>162</sup> concedes the possibility of instating territorially limited proceedings restricted to the domestic assets. Section 335 IA also provides that the effects of the instatement of insolvency proceedings and the legal action measures by individual creditors are to be based on *lex fori concursus*. Accordingly, the insolvency law of the (foreign) country in which the proceedings are instated decides whether and to what extent there is also a debt enforcement prohibition against the debtor's domestic assets. As such, a debt enforcement prohibition can generally be assumed—at least domestic individual debt enforcement measures (in accordance with sections 89 and 90 IA<sup>163</sup>) in favour of insolvency creditors are essentially impermissible, regardless of whether the proceedings were instated in an E.U. country or a third party country.

Where an individual debt enforcement measure is carried out as a consequence of the ignorance of a domestic individual debt enforcement measure, the proceedings are to be returned to the foreign receiver.

#### 9. Domestic Provisional Legal Protection

Instatement of foreign insolvency proceedings need not generally exclude domestic provisional legal protection. But the debt enforcement prohibition for insolvency creditors must be observed. For this reason, an

160. GRUNDGESETZ [GG] [Constitution] art. 101(2).

161. Konkursordnung [KO] [Bankruptcy Code] May 20, 1898, Reichsgesetzblatt [RGBI] 612, as amended, § 237.

162. InsO Oct. 5, 1994, BGBl I 2866, as amended, §§ 354-358.

163. InsO Oct. 5, 1994, BGBl I 2866, as amended, §§ 89-90.

insolvency creditor may not file for seizure of the bankruptcy estate items after instatement of the recognized insolvency proceedings (sections 918, 930 Civil Proceedings<sup>164</sup>). There is only the possibility of seizure where the foreign proceedings cannot be recognized. A disposal prohibition, by way of injunction, in favour of an in rem creditor is also possible if the creditor would otherwise risk losing his in rem right.

Accordingly, the law of the country in which the insolvency proceedings are instated decides if there is a reverse ban similar to section 88 IA<sup>165</sup> and if it is to be recognized in Germany. Section 88 IA cannot be regarded as a compulsory intervention provision that always applies where the debtor has domestic assets. But in order to protect domestic creditors, domestic separate proceedings in which section 88 IA then applies may be instated pursuant to section 344 IA<sup>166</sup>.

#### 10. *Recognition of the Receiver's Authorization*

Pursuant to section 335 IA, the receiver's authorization is based on *lex fori concursus*. Hence, the practical consequence of recognizing foreign insolvency proceedings is that the administration and disposal authorization of the foreign receiver are automatically recognized domestically.

As proof of his appointment, the receiver must present a certified copy of the appointment resolution or another court certificate (section 347 I IA<sup>167</sup>). Pursuant to section 347 I 2 IA<sup>168</sup>, a certification of the translation by a person authorized in the country where the insolvency proceedings are instated may be requested and will be requested in practice.

The receiver may exercise all asset administration rights with regard to domestic assets according to the law of the country of instatement of the proceedings, as long as no insolvency proceedings have been instated domestically pursuant to sections 345 ff IA<sup>169</sup>. As the party authorized for management and disposal of the assets, the receiver may remove them from the country and add them to the principal insolvency estate or use them otherwise. In particular, he may exercise the rights from shares of the debtor in domestic companies.

When exercising his authorization, the foreign receiver must also observe domestic substantive law. The receiver must comply with cooperation and information duties toward the Federal Labour Department, Social Security contributions, and other organizations in accordance with domestic law. He may not exercise means of force within the country on the basis of his appointment.

Where the instatement resolution serves as a debt enforcement title for restitution enforcement against the debtor, this resolution must be de-

164. ZPO Sept. 12, 1950, BGBl 533, as amended, §§ 918, 930.

165. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 88.

166. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 344.

167. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 347, ¶ 1.

168. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 347, ¶ 2.

169. InsO Oct. 5, 1994, BGBl I 2866, as amended, §§ 345-352.

clared enforceable by a bailiff before appointment of the competent enforcement body in Germany (sections 883 ff Civil Proceedings<sup>170</sup>). Such a title serves the purpose of carrying out the insolvency proceedings. If the ruling is from a non E.U.-country, the enforceability declaration must be carried out pursuant to section 353 I IA<sup>171</sup>, upon a suit for an enforcement ruling (sections 722, 723<sup>172</sup> Civil Proceedings).<sup>173</sup>

Because an individual debt enforcement measure is no longer admissible during foreign insolvency proceedings, the problem of demanding return of domestic debt enforcement proceeds arises only in the exceptional case where the foreign proceedings were not known within the country or were wrongly not observed. In such cases, the foreign receiver has a restitution claim pursuant to section 342 I IA.<sup>174</sup>

### 11. *Provisional Securing of the Bankrupt's Estate*

Securing measures taken in a third party country after the filing of an application for instatement must also be automatically recognized within the country pursuant to section 343 II IA<sup>175</sup>, insofar as the general requirements for recognition stipulated by section 343 I IA are met.

Where a provisional receiver is appointed in the foreign proceedings similar to sections 21 II Nr. 2 and. 3, 22 IA<sup>176</sup>, a general disposal prohibition imposed on the debtor is published, debt enforcement measures against the debtor are prohibited or provisionally stopped, and these effects must likewise be recognized domestically. Accordingly, an insolvency notice on the (foreign) disposal prohibition can also be registered in the Land Register. Parties acquiring proceeds from the debtor contrary to the prohibition or by debt enforcement must return the proceeds to the foreign estate. Securing measures by a third party country may only be declared enforceable pursuant to section 353 II IA<sup>177</sup> by a debt enforcement suit.

Where a domestic securing measure becomes necessary at short notice, it should be more expedient for the provisional receiver pursuant to section 344 IA<sup>178</sup> to apply domestically to have the securing measure issued pursuant to section 21 IA<sup>179</sup>.

Of course, alternatively, there is also the possibility that the foreign receiver applies for instatement of domestic secondary proceedings (section 336 II IA<sup>180</sup>) and simultaneously the issue of securing measures for the bankrupt's estate in the secondary proceedings.

170. ZPO Sept. 12, 1950, BGBl 533, as amended, § 883.

171. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 353.

172. ZPO Sept. 12, 1950, BGBl 533, as amended, §§ 722-723.

173. *See id.* § 353.

174. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 342, ¶ 1.

175. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 343, ¶ 2.

176. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 21, ¶ 2, sentences 2-3, § 22.

177. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 21, ¶ 2, sentences 2-3, § 22.

178. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 344.

179. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 21.

180. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 336.

## 12. Recognition of Other Rulings in Insolvency Law

If the instatement of the insolvency proceedings is to be recognized, so are the consequential rulings in the course of the foreign insolvency proceedings (sections 335, 343 I IA<sup>181</sup>). This applies to any deferred payment of creditor's claims, declaration of loss due to delayed registration, reduction of debt by a recapitalization or insolvency plan, and to the foreign residual debt redemption regardless of whether it starts upon distribution of the bankrupt's estate or later.

When debt enforcement measures are to be carried out on the basis of such a ruling during the foreign insolvency proceedings, a declaration of enforceability is required first. For rulings from third party countries, a debt enforcement suit is required pursuant to sections 722 and 723 of Civil Proceedings<sup>182</sup> before the procedural court (section 353 I IA<sup>183</sup>). The court having jurisdiction is the court as determined in section 722 II Civil Proceedings<sup>184</sup> (section 353 I 2 IA<sup>185</sup>).

Encroachment and the debtor's personal freedom by information and cooperation duties, forced summons before a court, and incarceration orders (e.g., pursuant to sections 97, 98 IA<sup>186</sup>) are based on *lex fori concursus*.

Where the foreign insolvency court orders a mail ban against the debtor, it may not be informally recognized, even if it has already been provided for in the insolvency resolution.

But a foreign mail ban can be recognized within the country according to autonomous German law. There is a legal gap here. According to the legal assessment of article 10 of the German Constitution<sup>187</sup> and section 353 II IA<sup>188</sup>, a respective declaration of enforceability is to be requested in accordance with sections 722 and 723 of Civil Proceedings. If the debtor accordingly has his personal residence within the country, even though main insolvency proceedings are being instated against him abroad (at his main place of business), application for territorially-limited insolvency proceedings or for the issue of securing measures pursuant to section 344 IA would be expedient in order to achieve a mail ban against the debtor more quickly.

## 13. Enforceability of Foreign Rulings

Insofar as there is to be a domestic individual debt enforcement measure on the basis of rulings in insolvency law, during the further course of the proceedings (in particular on the basis of a resolution to instate pro-

181. InsO Oct. 5, 1994, BGBl I 2866, as amended, §§ 335, 343, ¶ 1.

182. ZPO Sept. 12, 1950, BGBl 533, as amended, §§ 722-723.

183. ZPO Sept. 12, 1950, BGBl 533, as amended, §§ 722-723.

184. ZPO Sept. 12, 1950, BGBl 533, as amended, §§ 722-723.

185. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 353, ¶ 1.

186. InsO Oct. 5, 1994, BGBl I 2866, as amended, §§ 97-98.

187. GG art. 10.

188. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 353, ¶ 2.



ceedings, rulings to stop proceedings, a recognition of a foreign list of creditor's claims, etc.) a declaration of enforceability is required.

Rulings by third party states are only enforceable pursuant to section 353 I IA where they are declared enforceable on the basis of rulings in enforcement proceedings pursuant to sections 722 and 723 of Civil Proceedings. Pursuant to section 353 II IA, even securing measures may only be declared enforceable by this procedure. This provision is regrettable, as it unnecessarily hinders effective transnational cooperation with the insolvency courts abroad.

#### 14. *Participation in Foreign Proceedings and Distribution of the Estate*

##### a. Registration of Claims Abroad

When foreign insolvency proceedings are to be recognized domestically, domestic creditors must register their claims in foreign proceedings in accordance with the formalities and deadlines prescribed there, insofar as there are no secondary domestic proceedings.

Individual domestic litigation is not permitted even where an exclusive domestic place of jurisdiction was agreed on for the claim. Whether and to what extent the expiry of the insolvency proceedings or registration of claims is hindered (as pursuant to section 204 I Nr. 10 Civil Code<sup>189</sup>) is subject to the law of the country of the instatement of the proceedings under section 335 IA. The law of the country where the insolvency proceedings are instated also determines whether non-registration or delayed registration has material disadvantages (e.g., costs for special review date) until extinguishment of the debt. Such consequences do not contradict the German *ordre public* if they concern all creditors and there was the opportunity for registration.

##### b. Full Satisfaction of Priority Creditors, Priority of Claim, Distribution

Whether the claim is to be fully satisfied by priority creditors or to be satisfied by liquidation (simple, priority, secondary, excluded, etc.) depends on the respective *lex fori concursus* (cf. section 335 IA). Consistently, distribution of the bankrupt's estate is also based on the same law (section 335 IA).

#### 15. *Cooperation of the Insolvency Courts*

CRIP and autonomous German law only regulate the work of the receivers in the instated insolvency proceedings. But especially in the instatement proceedings and also afterwards, insofar as court decisions need to be taken, there is a need for coordinated action by the insolvency courts.

189. Bürgerliches Gesetzbuch [BGB] [Civil Code] Aug. 18, 1896, Reichsgesetzblatt [RGBl] 195, as amended, § 204, ¶ 1, sentence 10.

Even though article 25 UNCITRAL Model Law<sup>190</sup> explicitly provides for such a duty and it was successfully put into practice by protocols in a number of cases, the German legislator has not taken up this suggestion. But because the concept of a well-coordinated general conclusion of principal and secondary proceedings is the basis of both systems, cooperation of the courts as well is expedient. As cooperation in formal legal assistance relations would tend to be counterproductive in the instatement proceedings, direct contact should be permissible and is supported by almost all competent judges known to the author.

#### 16. *Resolution for Fraudsters Limited*

In the hypothetical example, it would thus be permissible for the receiver appointed by the competent court in BIV to order the domestic bank to dissolve the account in the name of Fraudsters Paradise Ltd. and to have the credit amount paid out to him personally upon presentation of proof of his court appointment.

In practice, however, the banks are very reserved and for reasons of third party liability are reluctant toward the account holder to recognize foreign insolvency proceedings. But the fact must not be ignored that, especially in Germany, numerous small regional banks without their own legal departments operate and not just the major banks such as Deutsche Bank AG, Commerzbank AG, and Dresdner Bank AG.

The recognition is granted by the law itself and does not require any special court ruling. In order to avoid any disturbances and dispositions of the debtor, the foreign receiver should apply at least for the public announcement of the foreign court's ruling and, if real property is part of the debtor's assets, for registration in the Land Register.

Upon hearing the application of the foreign receiver, the competent German court will examine the following aspects:

- The foreign proceedings must be qualified as insolvency proceedings tending to satisfy the debtor's creditors jointly;
- The foreign proceedings must already be instated, which is tested by the foreign law (*lex fori concursus*);
- The foreign proceedings must have international effects, which is denied when the *lex fori concursus* does not tend to influence assets abroad;
- The court opening the insolvency proceedings must be internationally competent, which is tested by German law (section 343 IA); and
- The recognition applied for must not violate essential basics of German law (*ordre public*). That is, the recognition must not violate fundamental rights laid out in the German Constitution. This is mostly discussed when the foreign court would not hear the debtor before issuing its ruling.

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190. UNCITRAL, Model Law on Cross-Border Insolvency art. 25, *supra* note 1.

To receive the recognition, the foreign receiver has to file an application. The court having jurisdiction over the place of residence or the place of business (or when no place of business is maintained, the court where the assets of the debtor are located, section 348 IA<sup>191</sup>), is the competent court for issuing the ruling. All applications must be filed in German under section 184 of the Judicature Act,<sup>192</sup> but there are no statutory requirements that they must be presented by a lawyer.

The foreign receiver must present a certified copy of the ruling opening the insolvency proceedings and appointing him as receiver, and in almost every case, the German court will ask for a translation certified by a translator being competent under the laws of the foreign state. It is strictly advisable that the foreign court's ruling and the certificate by the translator is apostilled or authenticated under the rules of the Hague Convention, abolishing the legal requirement of legalisation of foreign public documents. .

As from the time of filing of the application, the foreign receiver is obliged to inform the German court of all major changes in the foreign insolvency proceedings and all further foreign insolvency proceedings known to the foreign receiver.

To enable the court to rule within a reasonable period of time, it is beneficial not only to present the application itself with the documents, but to inform the court in an appropriate manner about the further requirements discussed above in the application itself and the status quo of the foreign proceedings.

## V. FRAUDSTERS EUROPE GMBH

As discussed above, the foreign receiver is entitled to act under the *lex fori concursus* in respect to all assets of the insolvent company. As Fraudsters Limited is the sole shareholder of Fraudsters Europe GmbH, the foreign receiver may act as appropriate with respect to this company.

### A. LIQUIDATION IN ACCORDANCE WITH GMBH (LIMITED LIABILITY COMPANY) LAW

It is not the termination of the company that is intended by insolvency proceedings, as is the case in English law for example, but liquidation in accordance with the provisions of the Limited Liability Company Law. Pursuant to section 50(1) of the Limited Liability Company Law<sup>193</sup>, a Limited Liability Company—the most common legal form in Germany—is dissolved by resolution of the shareholders or by instatement of insolvency proceedings against their assets. Outside of the insolvency pro-

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191. InsO Oct. 5, 1994, BGBl I 2866, as amended, § 348.

192. Gerichtsverfassungsgesetz [GVG] [Judicature Act] Sept. 12, 1950, Bundesgesetzblatt, Teil I [BGBl I] 533, as amended, §184.

193. Gesetz betreffend die Gesellschaften mit beschränkter Haftung [GmbHG] [Law Regarding Limited Liability Companies] Apr. 20, 1892, Reichsgesetzblatt [RGBl] 477, as amended, § 50, ¶ 1.

ceedings, liquidation is carried out on the basis of the provisions of the Limited Liability Company Law.

Liquidation proceedings are not insolvency proceedings and follow other rules. Liquidation can be resolved by the partners with at least a 75 percent majority. Following such a resolution, dissolution of the company is to be registered in the Commercial Register (section 65 Abs. 1<sup>194</sup> Limited Liability Company Law).

At the same time, the liquidators must publish the dissolution of the company three times and order the creditors to report to the company. The managing directors of the company are appointed by law as the liquidators but the shareholders may also recall the managing director and appoint and liquidator.

The liquidators must ensure that they are registered in the Commercial Register, and subsequently they must terminate the company's current business, satisfy the obligations of the dissolved company, collect its debts, and translate the company's assets into money.

Only after this (at the earliest one year after the last publication) and redemption of all of the company's debts, the assets of the company are distributed among the shareholders on the basis of the ratio of their shares in the company.

If during the liquidation proceedings it is established that the company's assets are not sufficient in order to satisfy all creditors, the liquidators must file for insolvency proceedings against the assets of the company.

If the foreign receiver realizes that the existing assets are likely to be sufficient in order to satisfy all creditors, he may resolve as the sole shareholder, or with the approval of 75 percent of votes, to liquidate the company, appoint a liquidator of his choice, collect the assets of the company (in our example by dissolving the account in Lithuania and by the sale of the palace in France), adjust the company's assets, and regard the remaining assets as part of his insolvency estate after one year.

#### B. INSOLVENCY OF FRAUDSTERS EUROPE GMBH

When there are insufficient financial resources to satisfy all creditors of the company, the managing director or directors must file for instatement of insolvency proceedings against the assets of Fraudsters Europe GmbH in order to prevent being subject to legal prosecution. As the company in the hypothetical case is a company domiciled in Frankfurt whose business was also exclusively managed from Frankfurt, insolvency proceedings may only be filed consistent with German law.

#### C. ASSETS IN LITHUANIA AND FRANCE

In the hypothetical case, the receiver must actually establish that all assets of the company are located outside of Germany in countries of the

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194. GmbHG Apr. 20, 1892, RGBI 477, as amended, § 65, ¶ 1.

European Union. CRIP will apply exclusively to transboundary insolvency proceedings within the European Union.

CRIP contains a provision that a ruling issued by another court within the European Union must automatically be recognized, as should any authorization granted to the foreign receiver in a foreign member state in accordance with the law of the country instating the insolvency proceedings.

With regard to the account balance in Lithuania, the receiver appointed in Frankfurt may collect the account balance in accordance with *lex fori concursus*. As for the palace in France, article 11 of CRIP<sup>195</sup> stipulates that the law of a member state under whose supervision the register is being kept will apply with regard to the effects of insolvency law for an immovable asset registered in a public register. In the present case, this would be French law.

## VI. INFLUENCE OF CRIMINAL PROCEEDINGS ON THE INSOLVENCY PROCEEDINGS

Frequently, the criminal prosecution authorities also act in cases of fraud on the basis of complaints. In Germany it is the prosecuting attorneys who do so. The German system of asset tracing and recovery is the responsibility of the prosecuting attorneys or criminal courts; the Anglo-Saxon system of *Norwich Pharmacal/Bankers Trust* and *Anton Piller* orders is not used in Germany during civil proceedings instated by the victim. Recently the German government announced that pursuant to an E.U. directive to enhance the protection of intellectual property, a statute similar to the *Norwich Pharmacal/Bankers Trust* order will be implemented into the respective laws. This means that the victim of a fraud must be aware of the possibility that the criminal authorities may become involved.

When the perpetrator is sentenced in criminal proceedings, the criminal court must order that the assets obtained by the perpetrator be forfeited to the state pursuant to section 73 of the Criminal Code.<sup>196</sup> This, however, will not explicitly apply when the victim is entitled to a claim against the perpetrator, the fulfilment of which would remove the required assets from the perpetrator (section 73 Abs. 1 Clause 2 Criminal Code<sup>197</sup>). In other words, the victim's damage claim has absolute precedence.

In investigation proceedings prior to sentencing, the prosecuting attorneys may seize such items or order seizure of the perpetrator's assets (sections 111b and 111d Code of Criminal Procedure<sup>198</sup>). But these mea-

195. Council Regulation 1346/2000, art. 11, 2000 O.J. (L 160) 1, 7 (EC).

196. Strafgesetzbuch [StGB] [Penal Code] May 15, 1871, Reichsgesetzblatt [RGBl] 127, as amended, § 73.

197. StGB May 15, 1871, RGBl 127, as amended, § 73, ¶ 1, sentence 2.

198. Strafprozessordnung [StPO] [Code of Criminal Procedure] Sept. 12, 1950, Bundesgesetzblatt [BGBl] 455, §§ 111b, 111d.



sures are also secondary to the injured party's claims. On the basis of his damage compensation claims against the perpetrator, the victim can always achieve overriding satisfaction by applying to the court for an assignment of the rights of the prosecuting attorneys in the priority ranking acquired by it under section 111g of Code of Criminal Procedure.<sup>199</sup>

When insolvency proceedings are instated against the assets of the perpetrator or the company being used by him, the criminal courts assume that the rights specified above may be asserted exclusively by the receiver and that therefore the injured parties have the burden of asserting their rights in the respective insolvency proceedings.

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199. StPO Sept. 12, 1950, BGBI 455, § 111g.