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Client Alert Commentary

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SDNY Ruling Restricts Involuntary Bankruptcy Filings Against Chapter 15 Debtors

Cross-border debtors gain another tool to use against dissident creditors seeking to disrupt foreign restructuring proceedings.

Introduction

In *In re Ocean Rig UDW Inc., et al.*, Case No. 17-10736, a creditor challenged the authority of the Bankruptcy Court for the Southern District of New York (the Bankruptcy Court) to prohibit creditors from filing involuntary bankruptcy petitions against the chapter 15 debtors prior to the Bankruptcy Court's entry of a recognition order. The creditor argued that an involuntary bankruptcy case was necessary to preserve value for creditors in the form of alleged causes of action against insiders, which causes of action would be released in the debtors' foreign restructuring proceedings.

The Bankruptcy Court rejected the objecting creditor's arguments and concluded that such an injunction is available on an interim basis under section 1519(a) of title 11 of the United States Code (the Bankruptcy Code).[1] [2]

The *Ocean Rig* decision adds another tool to a cross-border debtor's toolkit. If a debtor believes that dissident creditors may seek to commence an involuntary bankruptcy case in the United States to disrupt the debtor's foreign restructuring proceeding, the debtor can strike preemptively by filing a chapter 15 case and concurrently requesting an order enjoining actions against the debtor and its property in the United States, including involuntary chapter 11 petitions.

Background

Ocean Rig UDW Inc., a Cayman Islands exempted company headquartered in Athens, Greece (Ocean Rig), and certain of its subsidiaries (collectively, the Debtors)[3] are part of a group that operates as an international offshore oil-drilling contractor, owner, and rig operator.

On March 24, 2017, as part of the implementation of a restructuring through a Cayman Scheme of Arrangement, the Debtors filed winding-up petitions with the Grand Court of the Cayman Islands (the Cayman Court). Three days later, the Cayman Court appointed two individuals as joint provisional liquidators and authorized foreign representatives (the Foreign Representatives).

Temporary Restraining Order and Provisional Relief

Upon appointment, the Foreign Representatives immediately took action, filing chapter 15 petitions and an emergency motion (the Emergency Motion) with the Bankruptcy Court. The chapter 15 petitions sought recognition of the Debtors' provisional liquidation and restructuring proceedings in the Cayman Islands (the Cayman Proceedings).[4] The Emergency Motion sought (i) a temporary restraining order (the TRO) staying the holders of the Notes (as defined below) and certain other creditors from taking any action with respect to the Debtors and their property within the territorial jurisdiction of the United States to the full extent of section 362 of the Bankruptcy Code, which the Bankruptcy Court granted on the petition date, and (ii) an order granting provisional relief (the Provisional Relief Order), which would continue the relief sought in the TRO pending recognition of the Cayman Proceedings.

Highland's Objection

Following entry of the TRO, Highland Capital Management LP (Highland), which holds the majority in aggregate principal amount of the outstanding 7.25% Senior Notes due 2019 issued by Ocean Rig (the Notes), filed a limited objection to the Emergency Motion (the Objection) and, later, a memorandum of law in support of the Objection (the Memorandum of Law).[5]

Highland argued that the Bankruptcy Court lacked the authority to prohibit Highland from commencing involuntary bankruptcy proceedings against the Debtors.[6] Highland reasoned that only the imposition of the automatic stay under section 362(a) can restrict a creditor's right to file an involuntary petition under section 303 and that "[t]he filing of a chapter 15 petition for recognition does *not* trigger the imposition of the 362(a) stay."[7] Highland also noted that Congress specifically preserved creditors' right to commence an involuntary bankruptcy case under section 303 even post-recognition by providing that the stay imposed under section 1520(a) "does not affect the right of a foreign representative or *an entity* to file a petition commencing a case under this title."[8] [9]

Highland further asserted that it could commence involuntary bankruptcy cases based on public policy grounds and the equities of the Debtors' chapter 15 cases. Highland alleged that Ocean Rig's controlling director and CEO had "knowingly and intentionally siphoned" millions of dollars from the Debtors and that, in the absence of the commencement of a chapter 7 or chapter 11 case, no entity or person had the authority to file avoidance actions to recover these funds.[10] [11] Moreover, because the restructuring support agreement contemplated that the Notes would be discharged, Highland argued that if an involuntary case was not commenced prior to the sanctioning of the proposed schemes of arrangement, noteholders would lose their standing to sue for fraudulent conveyance in a subsequent bankruptcy case in the United States.[12]

The Foreign Representatives' Position

In their supplemental brief in support of the Emergency Motion (the Supplemental Brief), the Foreign Representatives noted that section 1519 of the Bankruptcy Code grants the Bankruptcy Court broad authority to provide relief during the period between the filing of a chapter 15 petition and the entry of a recognition order (the Gap Period).[13] The Foreign Representatives also pointed out that there is no "constraint on the Court's ability to enter a stay pursuant to section 362(a), or to otherwise craft a stay providing for all relief specified in section 362(a) (including a prohibition on creditor-initiated involuntary filings under section 303)."[14]

The Foreign Representatives rejected a reading of section 1520(c) that implied the existence of an unqualified right to file an involuntary petition during the Gap Period.[15] Instead, the Foreign Representatives maintained that section 1520(c) provides a carve-out from the relief that automatically takes effect upon recognition pursuant to section 1520(a).[16]

The Foreign Representatives also argued that Highland's objections were "at odds with the fundamental principles underlying Chapter 15" and undermined the importance of comity and deference by US courts to foreign insolvency proceedings.[17] The Foreign Representatives asserted that Highland's proposed interpretation, which "would allow creditors to invoke the plenary power of a United States bankruptcy court, and the associated worldwide automatic stay, before the chapter 15 court has even rendered a decision on whether the Debtors' main interests are governed primarily by domestic or foreign laws[,] . . . cannot be what Congress had in mind when it adopted chapter 15 to foster the orderly administration of cross-border restructurings."[18]

Bankruptcy Court Decision

At a hearing held on April 20, 2017, Judge Martin Glenn expressed concern that Highland was attempting "to stop the Cayman proceeding dead in its tracks by saying we filed a Chapter 11 involuntary case, the automatic stay applies worldwide, and too bad, Cayman judge, you're stuck."[19] Judge Glenn ultimately concluded that the Bankruptcy Court had the authority to grant provisional relief prohibiting creditors from commencing or continuing actions against the Debtors or their property within the territorial jurisdiction of the United States. In reaching his decision, Judge Glenn focused on three cases cited in the Supplemental Brief that supported the Foreign Representative's assertion that the discretionary relief that may be granted by the court upon the filing of a petition for recognition under section 1519(a) is not limited to the remedies set forth in subsections (a)(1) through (a)(3).[20] [21]

On August 24, 2017, the Bankruptcy Court entered an order (the Recognition Order) that, among other things (i) recognized the Cayman Proceedings as foreign main proceedings, (ii) applied the stay under section 362 of the Bankruptcy Code throughout the duration of the Debtors' chapter 15 cases, and (iii) extended the relief granted pursuant to the Provisional Relief Order.[22] Following entry of the Recognition Order, Highland consented to the dismissal of its appeal of the Provisional Relief Order, which had been pending before the United States District Court for the Southern District of New York.[23]

Conclusion

In a case of first impression, the Bankruptcy Court concluded that it had the authority to enjoin a creditor from commencing involuntary bankruptcy cases against chapter 15 debtors prior to the entry of a recognition order. Post-*Ocean Rig*, foreign debtors contending with dissident creditors seeking to disrupt their foreign restructuring proceedings by perhaps filing involuntary bankruptcy cases in the United States may increasingly elect to file petitions for recognition and, simultaneously, petition the court for an order restricting such creditors' ability to commence involuntary chapter 7 or chapter 11 cases. The success of such tactics will depend on the particular circumstances of each case.

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Endnotes

1 Unless otherwise specified, all section references refer to the Bankruptcy Code.

2 *See* 11 U.S.C. § 1519(a) ("From the time of filing a petition for recognition until the court rules on the petition, the court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant relief of a provisional nature, including – (1) staying execution against the debtor's assets; (2) entrusting the administration or realization of all or part of the debtor's assets located in the United States to the foreign representative or another person authorized by the court, including an examiner, 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; and (3) any relief referred to in paragraph (3), (4), or (7) of section 1521(a).").

3 The other Debtors include Drill Rigs Holdings Inc., Drillships Financing Holding Inc., and Drillships Ocean Ventures Inc.

4 The Debtors bankruptcy cases are being jointly administered under case number 17-10736.

5 After holding a contested hearing, on April 3, 2017, the Bankruptcy Court entered the Provisional Relief Order [Docket No. 41]. The Bankruptcy Court's findings in the Provisional Relief Order were "without prejudice to the Court's continuing consideration

and adjudication of the relief requested in the [Objection] concerning whether Highland Capital Management LP and/or other creditors may file an involuntary petition for relief against one or all of the Debtors under chapter 7 or 11 of the Bankruptcy Code." *See* Provisional Relief Order, ¶ 3. As a result, both Highland and the Foreign Representatives submitted additional briefing on this issue.

[6] *See* Objection, ¶ 10.

[7] *See* Memorandum of Law, p. 2 (emphasis in original).

[8] *See id.* at p. 3 (quoting 11 U.S.C. § 1520(c) (emphasis added)); *see also id.* at p. 9 (quoting *A. Collier Monograph: Ancillary and Other Cross-Border Insolvency Cases Under Chapter 15 of the Bankruptcy Code*, ¶ 7[2]); Objection, ¶ 17.

[9] Highland also pointed to section 1529 as further evidence of Congress' intent to preserve creditors' rights to file an involuntary petition and argued that when Congress sought "to restrict an entity's right to file an involuntary petition, they did so unambiguously." Memorandum of Law, p. 3-4 (citing 11 U.S.C. § 1511; 11 U.S.C. § 1529).

[10] *Id.* at p. 4-5; *see also* Objection, ¶ 7. Highland asserted that the Foreign Representatives did not have the right to sue for fraudulent disposition in the Cayman Islands and could not sue for avoidance in Chapter 15 (because such actions are not the Debtors' property under section 1528) and creditors were not permitted to sue for avoidance in the Cayman Islands without leave of the Cayman Court. *See* Memorandum of Law, p. 5.

[11] Highland also noted several ways in which creditors are protected in bankruptcy proceedings in the United States that are absent in the Cayman Proceedings, including "requirements for the filing of a debtor's schedules and statement of financial affairs, rights of parties-in-interest to take discovery, request information and examine witnesses and affiants, the appointment of a committee to represent the interests of unsecured creditors, and the presence of a United States Trustee as an independent overseer." *Id.* at p. 6.

[12] *See id.* at p. 5. According to Highland, implementing the proposed schemes of arrangement would therefore "effectively release the claims of creditors against the Debtors' insiders, a sweeping non-consensual, third-party release negotiated by a handful of senior lenders and these same insiders . . . that violates U.S. public policy and harms, rather than protects, non-consenting creditors." *Id.* at p. 5-6.

[13] *See* Supplemental Brief, p. 3; 11 U.S.C. § 1519(a) ("From the time of filing a petition for recognition until the court rules on the petition, the court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant relief of a provisional nature[.]").

[14] *See* Supplemental Brief, p. 3.

[15] *See id.* (stating that Highland's reading of section 1520(c) "distorts the statutory text beyond recognition").

[16] *See id.*

[17] *See id.* at p. 4.

[18] *Id*. (noting that Chapter 15, the Model Law on Cross-Border Insolvency, and related case law all emphasize the importance of deference to the foreign proceeding).

[19] Hr'g Tr. 15:7-10 (Apr. 20, 2017); *see also id.* at 45:22-25 ("I have real concern that the effect of lifting the stay and having an involuntary is to try and totally bollix up the Cayman proceeding, which I'm not anxious to do.").

[20] *See id.* at 7:3-8:1; 46:15-47:1 (citing *Lavie v. Ran (In re Ran)*, 607 F.3d 1017, 1021 (5th Cir. 2010) (noting that section 1519(a)(1)-(3) represents "[a] non-exhaustive list of relief available to a foreign proceeding's representative in a Chapter 15 case"); *Vitro v. ACP Master, Ltd. (In re Vitro)*, 455 B.R. 571, 579 (Bankr. N.D. Tex. 2011) ("[T]he relief enumerated in section 1519 is not all-inclusive."); *In re Pro-Fit Holdings Ltd.*, 391 B.R. 850, 866 (Bankr. C.D. Cal. 2008) ("[T]he list in § 1519 of the sections from the other parts of the bankruptcy code that can be adopted as provisional relief under § 1519 is incomplete. Thus, a number of other provisions of the bankruptcy code may be applied provisionally under § 1519 while an application for recognition is pending.")).

[21] Consequently, Judge Glenn questioned whether the issue at hand was truly an issue of first impression. *See id.* at 7:17-18 ("I read [*In re Vitro*, *In re Ran,* and *In re Pro-Fit Holdings Ltd.*] as saying it's not a question of first impression."); *but see id.* at 43:25-44:1 ("I suppose if you define the issue narrowly enough, it's a question of first impression.").

[22] *See* Recognition Order, p. 4-5.

[23] *See In re Ocean Rig UDW Inc., et al.*, Case No. 17-03751, *Stipulation of Voluntary Dismissal Pursuant to Fed. R. Bankr. P. 8023* [Docket No. 27].