

Two Bites at the Apple: Second Circuit Requires Lower Courts to Review Sales of U.S. Assets in Chapter 15 Case Even if Sale Was Approved by Foreign Court

On September 26, 2014, in *In re Fairfield Sentry Limited*,¹ the U.S. Court of Appeals for the Second Circuit (the “**Second Circuit**”) held that a bankruptcy court presiding over a Chapter 15 case must review a sale of U.S. assets under Section 363 of the Bankruptcy Code even if the sale was previously approved by the foreign court overseeing the debtor’s main proceeding. The Second Circuit reversed the decisions of the U.S. bankruptcy court and U.S. district court, holding that the plain meaning of the applicable Chapter 15 provisions prevailed over considerations such as comity and deference to the foreign court.

This decision puts the bankruptcy courts in the Second Circuit on the same footing as those in Delaware, which in *In re Elpida Memory, Inc.* had previously ruled that the Bankruptcy Code requires Section 363 review of sales of U.S. assets in a Chapter 15 case (To access our previous client note discussing the *Elpida* decision issued by the Delaware bankruptcy court, please click [here](#)). As a result, the Second Circuit’s decision should eliminate forum shopping with respect to this particular issue by foreign representatives deciding between the New York and Delaware bankruptcy courts.

Background

Fairfield Sentry Limited (“**Sentry**”), a company organized under the laws of the British Virgin Islands (“**BVI**”), was one of the largest feeder funds that invested with Bernard L. Madoff Investment Securities, LLC (“**BLMIS**”). The failure of BLMIS triggered the collapse of its large feeder funds, including Sentry, which was placed into liquidation in the BVI. The BVI liquidator (“**BVI Liquidator**”) obtained recognition of the BVI liquidation as a foreign main proceeding under Chapter 15 of the Bankruptcy Code.

The BVI Liquidator filed claims in BLMIS’s SIPA estate and ultimately entered into a settlement with the BLMIS estate pursuant to which Sentry received allowed customer claims in the aggregate amount of \$230 million (the “**SIPA Claim**”). Sentry then agreed to sell the SIPA Claim to Farnum Place, LLC (“**Purchaser**”) for 32.125% of the Claim’s allowed amount pursuant to a trade

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¹ *In re Fairfield Sentry Limited*, 2014 U.S. App. LEXIS 18427 (2d Cir. Sept. 26, 2014).

confirmation (the “**Trade Confirmation**”). Three days after the Trade Confirmation was signed, however, BLMIS’s SIPA trustee announced that he had settled other claims that increased the BLMIS estate by \$5 billion. As a result, the value of the SIPA Claim that the BVI Liquidator had agreed to sell to the Purchaser increased significantly in value.

Feeling what the Bankruptcy Court described as “seller’s remorse,” the BVI Liquidator attempted to avoid consummating the sale. After the BVI Court approved the sale of the SIPA Claim under the terms of the original Trade Confirmation notwithstanding the BVI Liquidator’s efforts, the BVI Liquidator again sought to preclude the sale by asking the Bankruptcy Court to review the sale under Section 363(b). Under Section 1520(a)(2) of the Bankruptcy Code, Section 363 applies to the sale of assets in a Chapter 15 proceeding to the same extent as it would in a Chapter 11 proceeding if the sale is a “transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States.”²

The Bankruptcy Court denied the BVI Liquidator’s efforts to terminate the Trade Confirmation, ruling that Section 363 approval was not required because the “[s]ale does not involve the transfer of an interest in property within the United States.” The Bankruptcy Court concluded that the situs of the SIPA claim was with the debtor in the BVI and that “comity dictates that this [c]ourt defer to the BVI judgment.”

The BVI Liquidator appealed the Bankruptcy Court’s order to the U.S. District Court for the Southern District of New York which affirmed the Bankruptcy Court’s decision. The BVI Liquidator then appealed to the Second Circuit.

The Second Circuit’s Decision

The Second Circuit considered (1) whether the SIPA Claim constituted property within the US and (2) if so, whether comity considerations override the application of Section 363.

The SIPA Claim constituted property within the US

The Second Circuit did not agree with the lower courts’ analysis that the SIPA Claim was not property located within the US. The Second Circuit found that the “property” at issue was the SIPA Claim itself. By selling the SIPA Claim, the BVI trustee transferred intangible property: Sentry’s “rights, title and interest in and to [Sentry’s] claims against BLMIS.”

The Second Circuit noted that, pursuant to Section 1502(8), intangible property is located “within the territorial jurisdiction of the United States” if applicable non-bankruptcy law deems it to be located there, “including any property subject to attachment or garnishment that may properly be seized or garnished by an action in a Federal or State court in the United States.” In this case, the essence of the

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² 11 U.S.C. § 1520(a)(2).

SIPA Claim was the right to require the BLMIS trustee to distribute to Sentry its pro rata share of the recovered assets in the BLMIS customer estate. The location of that property thus rested where the party required to perform (the BLMIS trustee) was located, which was New York. Because the Second Circuit found the property to be located in New York, it vacated the Bankruptcy Court's order denying review of the sale under Section 363.

Comity does not override the application of Section 363 to Chapter 15 asset sales

The Second Circuit also ruled that the Bankruptcy Court should not have deferred to the BVI Court's approval of the sale of the SIPA Claim. The Second Circuit held that while comity considerations are important and specifically codified in Chapter 15, the express language of Section 1520(a)(2) plainly states that bankruptcy court approval is required when a Chapter 15 debtor seeks to transfer an interest in property within the territorial jurisdiction of the U.S. Therefore, the Second Circuit found that the Bankruptcy Court erred in failing to conduct a Section 363 review on the basis of comity.

Impact

The Second Circuit's decision is somewhat ironic because it countenances the BVI Liquidator's efforts to use Section 363 of the Bankruptcy Code not as a means to approve a sale, but as a method to terminate a previously approved sale that turned out to be a bad deal for the Sentry estate. Notwithstanding these unusual factual circumstances, the Second Circuit's decision in *Sentry* will permit creditors to have two bites at the apple to the extent they wish to object to an asset sale. They can do so, first, in the foreign main proceeding in the foreign court, and, if approval is granted there, then subsequently in the US bankruptcy court.

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