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Stranger in Paradise? The Role of a Foreign Bankruptcy Trustee in Chapter 15

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A common but erroneous assumption among cross-border insolvency professionals and distressed-asset investors is that the U.S.-based assets of a foreign debtor are subject to judicial oversight in the United



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States. This may be a prudent starting point, at least in theory. In practice, however, this hypothesis can wreak havoc when tested against the rigors of an actual deal. The recently enacted chapter 15, 11 U.S.C. §§1501-1532, and the relative scarcity of judicial guidance from published court decisions have not clarified this commonly misunderstood area of bankruptcy law.

To bring some clarity to this area, the Bankruptcy Appellate Panel for the Ninth Circuit Court of Appeals (BAP), in the first published appellate decision containing an extensive discussion on chapter 15, held that the foreign trustee of a Japanese debtor could exercise his authority over the foreign debtor's

¹ The authors represented the appellees (*i.e.*, the Japanese bankruptcy trustee and the management of the Hawaii-based hotel companies) in this matter. Statements contained or opinions expressed in this article are the authors' only and should not in any way be attributed to any of the courts' legal or factual findings or the litigants' positions with respect to the proceedings mentioned in this article.

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Hawaiian assets without authorization from a U.S. court.² The BAP's *Iida* decision is significant for participants in distressed cross-border deals—from principal investors to professionals

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advising creditors, purchasers of distressed assets or other interested parties. At least for the developed economies with established bankruptcy regimes, the judicial philosophy underlying the *Iida* opinion should be welcome news. Any other result could have a negative impact on international capital flow and liquidity, and reduce predictability and asset pricing uniformity

² *Iida v. Kitahara (In re Iida)*, 377 B.R. 243 (BAP 9th Cir. 2007), appealed from the U.S. Bankruptcy Court for the District of Hawaii (Hon. Robert J. Paris). The BAP's *Iida* decision was further appealed to the Ninth Circuit Court of Appeals. The authors acknowledge an earlier bankruptcy court decision on chapter 15 appealed to the District Court for the Southern District of New York and decided on July 5, 2007, *Stride v. Official Comm. (In re SPiX Ltd.)*, 371 B.R. 10. The focus of the *SPiX* decision, however, was narrow and centered primarily on the issue of a statutory presumption of the debtor's "center of main interests." See also *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd.*, Case No. 07-12383, 2007 WL 5479483 (Bankr. S.D.N.Y. Aug. 30, 2007), amended and superceded, 374 B.R. 122 (Bankr. S.D.N.Y. 2007). Both *SPiX* and *Bear Stearns* are mentioned in the BAP's opinion.

in the international markets—precisely those facets of international commerce that chapter 15 is tailored to protect and facilitate.

In August 2004, Katsumi Iida, a Japanese businessman who pioneered computerized trading of commodity futures in Japan and, as late as 2003, controlled Tokyo General, one of the largest Japanese commodity trading firms, was declared bankrupt under article 126 of the Bankruptcy Law of Japan. Iida's failure largely resulted from his attempts to diversify away from his core expertise in commodity futures. His ill-timed investments were spread across businesses ranging from a hamburger stand to a theme park in China to luxury



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hotels in Hawaii. Tokyo General's collapse was also precipitated by its continued lack of regulatory compliance.

When uncovered by the regulators, Tokyo General's trading practices were rife with improper discretionary trades, violations of customer fund-segregation rules, and false financial statements. Tokyo

General was shut down, and Katsumi Iida ended up—albeit briefly—in jail.

At the onset of Iida's bankruptcy, control over his estate, including the



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Kahala Mandarin luxury hotel in Honolulu and Kona Village Resort in Kona, passed to a bankruptcy trustee in Tokyo. This “revesting” of ownership was triggered entirely by the provisions of the Japanese bankruptcy laws. The trustee, in essence, became the sole legal owner of the assets comprising the Iida estate worldwide. Importantly, the Hawaiian hotels, with management also in Hawaii, were not part of the bankruptcy proceedings in Japan, and Iida himself did not commence any bankruptcy proceedings in the United States that would place his U.S. assets under the jurisdiction of a U.S. bankruptcy court. Additionally, Iida’s estate had no creditors in the United States; all were located in Japan.

While the *Iida* proceedings were unfolding in Japan, the Kahala Mandarin hotel and Kona Village Resort were sold. After the Japanese bankruptcy trustee was appointed in 2004, he sought—and received—at various times the Japanese bankruptcy court’s explicit approval to exercise control over Iida’s assets located in the United States. As a prerequisite to the trustee’s ability to administer Iida’s assets in the United States, the Japanese bankruptcy trustee caused Iida, his son and his close business associates to be removed as directors and officers of the hotel holding corporations, in compliance with Hawaii law and the corporate bylaws. Under the bylaws, the removal was proper so long as the majority of the shareholders then entitled to vote approved it. Under Hawaii corporate law, the corporations were authorized to accept the vote or consent of a “trustee in bankruptcy” in his capacity as the trustee for the sole shareholder.

When the Japanese bankruptcy trustee eventually sought to repatriate the sale proceeds for distribution to Iida’s creditors in Japan, Iida resisted. Nearly two years after the Japanese bankruptcy trustee assumed his role as the sole legal administrator of the *Iida* estate, Iida sued the trustee in a Hawaii state court. The key issue raised by Iida’s lawsuit was whether the Japanese bankruptcy trustee had properly exercised his control over the U.S. companies without seeking approval or intervention from a court in the United States. Iida also sought to be reinstated as the hotel holding companies’ *de jure* director and officer.

Faced with this challenge to his authority to administer the Hawaiian assets of the *Iida* estate, in June 2006 the

Japanese bankruptcy trustee filed a chapter 15 petition in the U.S. Bankruptcy Court for the District of Hawaii seeking recognition of Iida’s Japanese bankruptcy as a foreign main proceeding in the United States. The chapter 15 proceeding was filed for the sole purpose of enabling the Japanese bankruptcy trustee to remove Iida’s state court action to the Hawaii bankruptcy court. This was the first chapter 15 petition in the District of Hawaii, and was one of the earlier petitions for recognition filed in the United States. Iida contested the chapter 15 filing in part on the grounds that it violated U.S. public policies. The bankruptcy court rejected his argument and granted the chapter 15 petition for recognition.

As planned, the trustee then removed the state court action to the Hawaii bankruptcy court and thereafter moved for dismissal of Iida’s complaint. In support of dismissal, the trustee argued that Iida was attempting to circumvent his authority as the Japanese bankruptcy trustee to liquidate the *Iida* estate’s assets under the clear-cut mandate of Japanese bankruptcy laws and the orders of the Japanese court administering the *Iida* bankruptcy. Moreover, the trustee argued that his prerogative to exercise control over the Hawaiian companies as their sole shareholder was not limited by state or federal law. In response, Iida once again complained that there was no judicial recognition in the United States of the Japanese bankruptcy trustee’s actions taken with respect to the Hawaiian companies. The bankruptcy court agreed with the trustee and granted his motion for dismissal, treating the motion as one for summary judgment. Iida then took his case to the BAP.

The question on appeal, as framed by the BAP, was whether the Japanese bankruptcy trustee had to “obtain permission from a court in the United States before exercising shareholder rights to vote to remove and replace directors and officers” of the Hawaii corporations. *Iida*, 377 B.R. at 252-53. The BAP unanimously answered that question in the negative. In reaching that decision, the BAP analyzed the historical evolution of American legislation on domestic recognition of foreign bankruptcies, including §304 of the Bankruptcy Code, 11 U.S.C. §304, the statutory predecessor to chapter 15, as well as the history and purpose of chapter 15.

Iida made three arguments on appeal. First, the Japanese bankruptcy laws stop at the borders of Japan and have no extraterritorial application in the United States. Second, chapter 15 and §304 are mandatory and *required* the Japanese bankruptcy trustee file a petition for recognition of the Japanese bankruptcy proceeding in a U.S. court before he could exercise control over the governance of the Hawaiian corporations. Third, the definition of a “trustee in bankruptcy” under Hawaii corporate law did not extend to a *foreign* bankruptcy trustee and therefore, there was no authority under Hawaii law that permitted the Japanese bankruptcy trustee to vote Iida’s shares to effect the removal and replacement of officers and directors of the Hawaiian corporations. The last argument was easily dispensed with by the BAP because there was simply no case law or legislative history that would support a statutory construction necessarily limiting the phrase “trustee in bankruptcy” to a domestic, and not a foreign, trustee.

More significantly, the BAP rejected Iida’s contentions based on the long-standing doctrine of international comity and the legislative purpose behind both §304 and chapter 15. With respect to chapter 15 in particular, the BAP stated that it was enacted as a “fundamentally procedural” statute and “did not constitute a change in the basic approach of U.S. law, which...has long been one of honoring principles of comity.” *Iida*, 377 B.R. at 256. Fundamentally, chapter 15, as did §304 before it, gives a foreign representative or trustee of a foreign debtor certain rights to administer, with the assistance of a U.S. bankruptcy court *if necessary*, the assets of a foreign debtor located in the United States. The foreign representative, however, need not seek the imprimatur of a federal bankruptcy tribunal in the United States before taking legally permissible actions with respect to assets in the United States. As the BAP noted: “Nothing in the statute requires prior judicial permission for acts that do not implicate matters of comity or cooperation by courts.” *Id.* at 258. Chapter 15 does not restrain a foreign trustee or representative from discharging his duties in the United States, so long as those duties do not violate the public policy of the United States and do not *require* “judicial assistance.” *Id.* The difference between the permissive and

mandatory nature of the statute is critical. The BAP's decision in *Iida* underscores that the permissive nature of old §304 has carried over to chapter 15.

Iida, of course, dealt with a Japanese bankruptcy case, which bears close resemblance to a chapter 7 liquidation in the United States. The BAP explicitly acknowledged this similarity. 377 B.R. at 247 n.2. Although the BAP's reasoning did not require it to expressly extend comity to the orders of the Japanese court, the principles of international comity played an important role in the decision.³ The BAP was also aware of prior U.S. case law finding many parallels between the Japanese and U.S. bankruptcy laws. Perhaps an undeveloped or under-developed foreign bankruptcy regime might have led the BAP to a different conclusion. Accordingly, *Iida*, because it implicates a U.S. court's interpretation of the Japanese bankruptcy laws, is of direct import for all participants in cross-border restructuring deals involving the U.S.-based or Japanese assets, and should be carefully studied by those advising foreign investors committing capital in these countries.

On a broader level, the *Iida* opinion properly construes chapter 15 as supportive of the global exchange of capital and international commerce. While the BAP did not specifically address the subject of international commerce in *Iida*, it is a reasonable assumption that underlying its decision was the principle that no impediments should exist to prevent a foreign representative from exercising any and all rights of an insolvent entity upon the corporate governance of a domestic corporation, as long as the public policies of the United States are not manifestly violated and applicable state law is complied with. Presumably, the same principle should apply in Japan or any foreign country, allowing a trustee or debtor-in-possession in a bankruptcy case pending in the United States to participate in the corporate governance of a foreign corporation, without the necessity of obtaining judicial assistance in the foreign country.

The irony, of course, is that *Iida*'s arguments—made on behalf of a once-prolific Japanese business visionary

with investment portfolios spread among different asset classes in several countries throughout the world—would, if accepted, curtail the authority of a foreign representative outside Japan and contravene the purpose not only of chapter 15, but also undercut one of the cardinal elements of the Model Law on Cross-Border Insolvency promulgated by UNCITRAL—namely, to encourage “greater legal certainty” in international trade and investment. The BAP's opinion in *Iida* underscores this principle, and the lessons learned from it are clear: A foreign bankruptcy trustee administering assets in the United States is not a stranger in paradise or, for that matter, to the framework of international comity. Chapter 15 is there for his benefit and is not an impediment to his authority over the affairs of a foreign debtor. ■

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³ The bankruptcy court, whose ruling *Iida* appealed to the BAP, expressly extended comity to the orders of the Japanese court in granting summary judgment against *Iida*.