

FEDERATION OF REGULATORY COUNSEL, INC.

CHAPTER 15 - BANKRUPTCY CODE APPLICATION TO INSURERS

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Bankruptcies are governed by federal law. The United States Constitution, article 1, Section 8, provides that "Congress shall have the power ... to establish uniform laws on the subject of bankruptcies throughout the United States...." Congress exercised this power in 1978 by enacting Title 11 of the United States Code (the "Bankruptcy Code").¹ The Bankruptcy Code has been amended several times since 1978. Most recently, it was amended pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). In addition to amending numerous provisions of the Bankruptcy Code, BAPCPA added a new Chapter 15. Chapter 15 permits a United States bankruptcy court to recognize and cooperate with a foreign proceeding in which the assets and affairs of the debtor are "subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation."²

Insurance company insolvency proceedings are governed by state law. The Bankruptcy Code denied bankruptcy liquidation relief to insurance companies by providing that neither a domestic insurer nor "a foreign insurance company,³ engaged in such business in the United States" are eligible for relief under Chapter 7.⁴ Similarly, Congress denied insurers the ability to reorganize or liquidate as a going concern under Chapter 11 since (with few exceptions) only an entity that may be a Chapter 7 debtor is eligible for Chapter 11 relief.⁵

The amendments under BAPCPA continued the decades-old bar against insurance company bankruptcies, with one exception - a foreign insurance company may be the subject of a proceeding under the newly-created Chapter 15.⁶ As noted by one court:

The status of a debtor in this [Chapter 15] case *as a foreign insurance company that is ineligible to be a debtor under the Bankruptcy Code by virtue of 11 U.S.C. § 109(b)(3) does not affect the availability of Chapter 15 relief.* Foreign insurance companies are eligible for Chapter 15 relief because § 1501(c)(1) provides that Chapter 15 does not apply to "a proceeding concerning an entity, other than a foreign insurance company, identified by exclusion in section 109(b)."⁷

Although foreign insurers may be the subject of Chapter 15 proceedings, the relief that can be granted in the Chapter 15 context is in some instances more limited than would otherwise be available in a "traditional" United States bankruptcy case. For example, the foreign representative cannot sue in the Chapter 15 case to set aside or avoid pre-bankruptcy transfers. Instead, a suit of that kind can only be brought if the foreign representative files or participates in a companion, plenary case under one of the other substantive chapters of the Bankruptcy Code (such as Chapter 7 or Chapter 11).⁸ Since Congress did not amend the Bankruptcy Code to allow foreign insurers to be subject to any chapter other than Chapter 15, the foreign representative of a foreign insurer will not have standing to file or participate in a "traditional" bankruptcy proceeding, thereby precluding the ability to set aside or avoid pre-bankruptcy transfers.

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This limitation is illustrated by *In re Condor Insurance Limited (In Official Liquidation)*, Case No. 07-51045, filed in the United States Bankruptcy Court for the Southern District of Mississippi ("Bankruptcy Court"). In *Condor Insurance Limited*, the Eastern Caribbean Supreme Court in the High Court of Justice, St. Christopher and Nevis, Nevis Circuit ("Nevis Court"), ordered the winding up of Condor Insurance Limited, an entity primarily involved in the business of reinsurance. The joint liquidators appointed by the Nevis Court for Condor Insurance Limited filed a Chapter 15 proceeding in the Bankruptcy Court. After the Honorable Edward R. Gaines, United States Bankruptcy Judge, entered an order recognizing the Nevis foreign proceeding, the liquidators filed an adversary proceeding in the Chapter 15 case against Condor Guaranty, Inc. and others seeking to recover property valued at \$313 million as of 2005. The liquidators asserted that Nevis law entitled them to avoid or set aside transfers of the property or to obtain equivalent damages. Condor Guaranty, Inc. filed a motion to dismiss the adversary proceeding, alleging (among other things) that the Bankruptcy Court lacked subject matter jurisdiction since the adversary proceeding had not been filed in a related, plenary bankruptcy case under Chapter 7 or Chapter 11. The liquidators acknowledged during briefing that Chapter 15 prohibited them from using avoidance remedies under the Bankruptcy Code except in a related, plenary bankruptcy case. They further acknowledged that 11 U.S.C. § 109 prevented them from filing a related Chapter 7 or Chapter 11 case for Condor Insurance Limited because of its status as a foreign insurer. Nevertheless, they contended that nothing in Chapter 15 prohibited the use of foreign avoidance law in the Chapter 15 case.

Following briefing and oral argument, Judge Gaines took the motion to dismiss under advisement. On July 17, 2008, he rendered his Opinion⁹ and entered an Order dismissing the liquidators' complaint. In his Opinion, Judge Gaines acknowledged that foreign representatives have standing to avoid pre-petition transfers, but *only* in a separate Chapter 7 or Chapter 11 bankruptcy case that is related to the Chapter 15 proceeding. The Bankruptcy Court agreed with Condor Guaranty, Inc.'s argument that foreign representatives have no standing to avoid pre-petition transfers of property in a Chapter 15 context (citing 11 U.S.C. § 1521(a)(7) and 11 U.S.C. § 1523(a)). Because a related, non-Chapter 15 proceeding was not pending, the Bankruptcy Court found that subject matter jurisdiction was lacking. The Bankruptcy Court also agreed with Condor Guaranty, Inc. that the liquidators had not presented any authority in a Chapter 15 context to support the use of foreign avoidance law when United States avoidance law is not available.¹⁰

The worldwide economic downturn likely will generate many Chapter 15 proceedings. With BAPCPA, Congress opened the door of bankruptcy to foreign insurers, but only in a Chapter 15 context. As illustrated by *Condor Insurance Limited*, the relief available in such cases is limited. It remains to be seen how extensively Chapter 15 will be utilized for foreign insurers who are subject to foreign reorganization or liquidation proceedings.

Endnotes

1. The Bankruptcy Code replaced the Bankruptcy Act that had been in effect since 1898.
2. 11 U.S.C. § 101(23).
3. What the Bankruptcy Code calls a "foreign" insurance company is known in insurance regulatory law as an "alien" insurance company. Because this article quotes from the Bankruptcy Code, the bankruptcy nomenclature is used herein.

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4. 11 U.S.C. § 109(b)(2)-(3).
5. 11 U.S.C. § 109(d).
6. 11 U.S.C. § 1501(c)(1) provides "This chapter does not apply to (1) a proceeding concerning an entity, ***other than a foreign insurance company***, identified by exclusion in section 109(b)" (emphasis added).
7. *In re Tri-Continental Exchange, Ltd.*, 349 B.R. 627, 632 (Bankr. E.D. Cal. 2006) (emphasis added). *See also* House Report, Section 1501 ("Section 1501 contains an exception to the section 109(b) exclusions so that foreign proceedings of foreign insurance companies are eligible for recognition and relief under Chapter 15").
8. 11 U.S.C. §§ 1521(a)(7) and 1523(a).
9. The Opinion may be found at 2008 WL 2858943.
10. The liquidators have appealed the Bankruptcy Court's decision.