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JPA No. 111: Smooth Landing for Foreign SPVs in U.S. Courts

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Chapter 11 of the U.S. Bankruptcy Code[1] is viewed as a leading cross-border restructuring statute, offering the eligible company tools not available in other jurisdictions. As a corollary, representatives of foreign debtors frequently seek recognition under chapter 15 of the Bankruptcy Code[2] to access "additional relief" in aid of a foreign proceeding, such as to conduct discovery in the U.S.

As these cross-border cases increase in volume, so do the challenges to the U.S. bankruptcy court's jurisdiction over foreign parties and transactions and to the putative debtor's eligibility for relief. Consistently, though, the court's analysis starts and ends with a simple determination of whether the foreign company has "property" within the U.S. as § 109 of the Bankruptcy Code requires. The holding of *In re JPA No. 111 Co.*[3] demonstrates how the threshold to § 109 eligibility can be met, even by a debtor with no meaningful ties to the U.S., when the debtor and the presiding court follow the guidance the Bankruptcy Code provides to those seeking relief.

JPA No. 111 and JPA No. 49

In those jointly administered cases, the debtors were two special-purpose vehicles (SPVs). JPA No. 111 Co., Ltd. and JPA No. 49 Co., Ltd. (collectively, the "debtors") were formed as wholly owned subsidiaries of a Japanese company, JP Lease Products & Services Co. Ltd. (JPL). The only business conducted by each debtor was the ownership of a single Airbus A350-941 aircraft. In turn, each aircraft was leased by the debtors under a "head lease" to an intermediate entity[4] and subleased to Vietnam Airlines JSC (VNA) for operation on long-haul flights to and from the Socialist Republic of Vietnam.

Each debtor financed the acquisition of its aircraft through (1) senior and junior debt facilities for committed loans of approximately $115 million funded by a lender syndicate (the "lenders"), and (2) equity financing under arrangements known as "Tokumei kumiai."[5] Each debtor granted liens on its aircraft to the lenders' agent pursuant to an aircraft mortgage, and assigned its rights under the sublease and head lease to the lenders (the "lease assets"), pursuant to security assignment agreements (the "security agreements"). The aircraft mortgages were governed by New York law, and the security agreements were governed by English law.[6] Rent paid by VNA was pledged to the lenders as security and applied to service the debt owing from each debtor.

The parties' business relationship was disrupted in 2020 when air travel significantly declined due to the challenges brought on by the COVID-19 pandemic. VNA negotiated the terms for deferral of its lease obligations, with the lenders' consent, resuming payment of deferred rent on Jan. 1, 2021. While VNA and the debtors were negotiating terms for the long-term restatement of VNA's lease obligations, on Dec. 1, 2021, the lenders' security agent exercised its document-provided rights to terminate the VNA leases and subleases on account of then-existing defaults. Simultaneously, FitzWalter Capital Partners (Financing Trading) Ltd., incorporated in England and Wales, acquired substantial amounts of the debtors' debt and stepped in as security agent. Next, FitzWalter initiated an expedited enforcement sale process for the lease assets but not the aircraft under English law.

Chapter 11 Filing

Upon learning of FitzWalter's efforts to sell the lease assets, the debtors commenced chapter 11 cases in the U.S. Bankruptcy Court for the Southern District of New York on Dec. 17, 2021. Notably, the aircraft were not located in or flying to the U.S. At the time the petitions were filed, the debtors' bankruptcy counsel was in possession of a $250,000 security retainer for each debtor, funded by JPL, and held in New York bank accounts (the "retainers").

As their only "first-day motion," the debtors filed a Motion for Entry of an Order (1) Enforcing the Protections of §§ 105(a), 362, 365, 525 and 541 of the Bankruptcy Code, Restating Automatic Stay

1 Codified at 11 U.S.C. § 101, *et seq.*
2 *See* 11 U.S.C. § 1501-1532. "Chapter 15 contemplates cooperation between American and foreign bankruptcy courts, as well as facilitating protection for the Debtor in this case before the Court." *In re Modern Land (China) Co. Ltd.*, 641 B.R. 768, 787 (Bankr. S.D.N.Y. 2022).
3 No. 21-12075 (DSJ), 2022 WL 298428 (Bankr. S.D.N.Y. Feb. 1, 2022).
4 Intermediate lessors in aircraft financing lease structures are pass-through entities that are put in place for withholding tax considerations.
5 Under this structure, the investors are expected to be later repaid from the proceeds of a sale of the aircraft after payment in full of the secured loan obligations.
6 According to FitzWalter, the aircraft mortgages gave the security agent and mortgagee enforcement remedies upon a default, including a foreclosure sale governed by the New York Uniform Commercial Code. The security agreements give the security agent enforcement rights, including the right to "dispose of" such property "at the times, in the manner and on the terms it thinks fit." *In re JPA No. 111*, 2022 WL 298428, at *3 (citation omitted).

and *Ipso Facto* Provisions; and (2) granting related relief (the "stay motion"), seeking entry of a court order enforcing the automatic stay and *ipso facto* provisions of the Bankruptcy Code to prevent FitzWalter from exercising its rights to foreclose on the debtors' assets outside the U.S. The stay motion was granted over FitzWalter's objection pursuant to a court order dated Dec. 20, 2021, which served to prohibit any action to obtain possession of or exercise control over property of the debtors' estates, wherever located.

Shortly thereafter, the debtors negotiated and executed a term sheet with stalking-horse bidders that contemplated an auction process to sell the debtors' aircraft and their interest in the lease assets pursuant to § 363 of the Bankruptcy Code, in order to satisfy claims against the debtors. However, FitzWalter did not support the debtors' sale efforts, since it desired to sell the lease assets under English law, and on Jan. 2, 2022, the company filed a Motion to Dismiss or Abstain from Hearing These Chapter 11 Cases (the "motion to dismiss").

Challenges Against the Chapter 11 Cases

FitzWalter's primary argument in favor of dismissal was that the debtors did not qualify as "debtors" under § 109, requiring each putative debtor to demonstrate that it "resides or has a domicile, place of business, or property in the United States, or a municipality" to be eligible to reorganize under the Bankruptcy Code. FitzWalter urged the bankruptcy court to dismiss the cases because they did not conduct business in the U.S., and urged that the retainers did not establish eligibility under § 109. FitzWalter also sought dismissal for "cause" under the holding of *In re C-TC 9th Ave. P'ship*,[7] alleging that the cases involved a two-party dispute between the debtors and their secured creditors, filed to forestall FitzWalter's contractually available foreclosure remedies. FitzWalter pointed to the funding of the retainers to manufacture jurisdiction, which was also indicia of bad faith warranting dismissal. Alternatively, FitzWalter argued that the bankruptcy court should abstain from exercising jurisdiction over the cases under § 305(a)(1) of the Bankruptcy Code.

The debtors opposed the motion to dismiss on the basis that each debtor held the § 109 required "property" within the U.S. as of the filing date in the form of the retainers. Even though JPL funded the retainers, the debtors argued that for purposes of § 109, each held a property interest in the unfunded portion of the retainers within the broad scope of § 541. The debtors also pointed to the contract rights held under the aircraft mortgages, governed by New York law as "property" located in New York. The debtors were joined in their opposition by JPL and two of the debtors' lenders. In its reply, FitzWalter continued to stress that the debtors could not rely on the retainers as a basis for jurisdiction in the U.S. bankruptcy court, since the retainers were paid by the debtors' parent company, and FitzWalter advanced additional arguments in favor of dismissal under the factors outlined in the *C-TC* holding.

7 113 F.3d 1304 (2d Cir. 1997). The factors relied on by the Second Circuit included the following: (1) the debtor has only one asset; (2) the debtor has few unsecured creditors; (3) the debtor's one asset is the subject of a foreclosure action; (4) the debtor's financial condition is, in essence, a two-party dispute between the debtor and secured creditors that can be resolved in the pending state foreclosure action; (5) the timing of the debtor's filing evidences an intent to delay or frustrate the legitimate efforts of the debtor's secured creditors to enforce their rights; (6) the debtor has little or no cash flow; (7) the debtor cannot meet current expenses; and (8) the debtor has no employees.

Court's Memorandum Decision

The court conducted an evidentiary hearing regarding the motion to dismiss on Jan. 26, 2022, and considered the extensive record before it, including the briefing of legal issues, as well as evidence submitted during the hearing. Ultimately, after evaluating the parties' arguments, the court issued a Memorandum of Decision and Order Resolving the Motion to Dismiss on Feb. 1, 2022 (the "decision") denying the motion to dismiss. In doing so, the court found the debtors eligible as chapter 11 debtors under § 109 on account of the reversionary interests in the retainers held by them. Relying on the text of § 109, the court dismissed FitzWalter's arguments that the debtors had too few ties to the U.S. to be eligible for relief because § 109 "unqualifiedly uses the word 'property' without any *minimum value requirement*" and "courts agree that 'there is *no statutory requirement as to the property's minimum value*.'"[8]

Relying on the *In re Glob. Ocean Carriers Ltd.*[9] holding, the court held that the retainers qualified as § 109 "property," even though the debtors' parent was the funding source, since the debtors had an ownership interest in any unused funds at the end of the representation.[10] The court declined to consider whether contractual choice-of-law and forum-selection provisions can give rise to property rights that are also estate property for purposes of § 109.[11]

Bad-Faith Criterion

In its decision, the court also carefully addressed FitzWalter's argument that dismissal was appropriate for cases filed in "bad faith" under the reasoning of the *C-TC* holding. In considering each factor, and the factual support presented by the parties, the court was convinced that "the totality of the record ... gives an overwhelming impression of a good-faith effort to use bankruptcy remedies to achieve a superior outcome for all parties in interest — with the possible exception of FitzWalter, which stands to be fully paid ... if the bankruptcy sale goes forward, but which may lose profit it could otherwise achieve" through a foreclosure.[12] Central to this decision was the court's determination that the debtors had the ability to sell the aircraft, as well as a right of redemption regarding the lease assets through a § 363 sale process, at a price high enough to "satisfy all claims ... and even generate a recovery for equityholders."[13] This expedited sale process aimed at fully compensating all parties-in-interest was held to be an appropriate — not "objectively futile" — use of bankruptcy processes.[14]

While some of the *C-TC* holding factors were indeed present, the court concluded that overall, the debtors did not file their petitions in bad faith. The court also held that

8 *In re JPA No. 111*, 2022 WL 298428, at *5 (emphasis added) (quoting *In re Paper I Partners LP*, 283 B.R. 661, 674 (Bankr. S.D.N.Y. 2002)).
9 251 B.R. 31, 39 (Bankr. D. Del. 2000).
10 *In re JPA No. 111*, 2022 WL 298428, at *6.
11 In *In re Berau Cap. Res. PTE Ltd.*, 540 B.R. 80 (Bankr. S.D.N.Y. 2015), Hon. **Martin Glenn** held that the "presence of the New York choice of law and forum selection clauses in the *Berau* indenture satisfies the section 109(a) 'property in the United States' eligibility requirement." *Id.* at 84.
12 *In re JPA No. 111*, 2022 WL 298428, at *12.
13 *Id.* at *11.
14 *Id.*

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FitzWalter had not met its burden of demonstrating the "extraordinary remedy" of abstention available under § 305, particularly since there was "no advanced non-federal insolvency proceeding, but merely a nascent English foreclosure process .... underway for roughly one week."[15] Thus, the court was unable to conclude that creditors and the debtors would be better served by a dismissal.[16]

FitzWalter filed a notice of appeal of the decision to the U.S. District Court for the Southern District of New York on Feb. 15, 2022. Eventually, through extensive negotiations, the debtors and lenders reached agreement on global settlement terms in the resolution of the lenders' objections to the sale, resulting in dismissal of the appeal. The sale closed on June 14 and 15, 2022, with all secured claims paid in full at closing. Using the bankruptcy process, the debtors next confirmed a plan that provided for full payment of all unsecured claims and a return to JPL as equityholder.

Conclusion

The *JPA* holding is not groundbreaking nor surprising, based on past interpretations of § 109(a) as offering the global restructuring industry somewhat assured access to U.S. bankruptcy courts. Whether a mere "peppercorn" or an intangible interest in a security retainer, § 109's gatekeeping function is limited to the consideration of whether a debtor has any property in the U.S., and if so, no further examination regarding whether other of the debtor's assets are located is necessary, as lacking textual support.[17] Section 109(a) states "nothing about the amount of such property nor does it direct that there be any inquiry into the circumstances surrounding the debtor's acquisition of the property."[18]

This relatively low threshold for § 109 eligibility also ensures that the proverbial jurisdictional "doors" are open to representatives of foreign bankruptcy cases seeking access to relief under chapter 15 of the Bankruptcy Code. A split has developed regarding whether § 109 must be met in order to initiate a proceeding under chapter 15 and in chapter 11.

In *In re Barnet*,[19] the Second Circuit held that the eligibility requirement of § 109 applies to chapter 15 cases. Less than one week later, the Delaware Bankruptcy Court in *In re Bemarmara Consulting a.s.*[20] held that § 109(a)'s requirements do *not* apply in chapter 15 proceedings, so the applicant was not required to reside or have a domicile, place of business or property in the U.S.[21] Recently, on appeal from an order of the U.S. Bankruptcy Court for the Middle District of Florida, the U.S. District Court for the Middle District of Florida held in *In re Al Zawawi*[22] that § 1517 provides the sole requirements for recognition in a chapter 15 case, rendering § 109 inapplicable. That holding has been appealed to the Eleventh Circuit Court of Appeals.[23] Briefing in that appeal is complete as of the date of this article, including an *amicus curiae* brief filed by the American College of Bankruptcy, with oral argument yet to be scheduled. Whatever the ultimate ruling, the *JPA* decision and other precedent provide guidance to any foreign company or representative considering whether a filing before the U.S. bankruptcy courts is subject to dismissal. Chances are that with calculated pre-filing planning and property in the U.S., that can be avoided. abi

15 *Id.* at *13.
16 *See id.*
17 *See, e.g., In re McTague*, 198 B.R. 428 (Bankr. W.D.N.Y. 1996).
18 *In re Octaviar Admin. Pty. Ltd.*, 511 B.R. 361, 373 (Bankr. S.D.N.Y. 2014); *see also In re Foreign Econ. Indus. Bank Ltd., "Vneshprombank" Ltd.*, 607 B.R. 160, 166 (Bankr. S.D.N.Y. 2019) ("Section 109(a) does not specify how much property must be present or when or for how long property has had a *situs* in New York."); *In re Forge Grp. Power Pty Ltd.*, No. 17-CV-02045-PJH, 2018 WL 827913, at *12 (N.D. Cal. Feb. 12, 2018) ("Section 109(a) does not set parameters for how much or what kind of 'property in the United States' is required." (citation omitted)). *But see In re Head*, 223 B.R. 648, 652 (Bankr. W.D.N.Y. 1998) (debtors had not met § 109(a) standard in their attempts to "manufacture eligibility" by obtaining U.S. postal addresses and opening small bank accounts in U.S. banks).
19 737 F.3d 238, 251 (2d Cir. 2013).
20 No. 13-13037 (KG) (Bankr. D. Del. Dec. 17, 2013).
21 Similarly, one court has declined to follow *In re Barnet*. *See In re Viacao Itapemirim S.A.*, No. 18-24871-BKC-RAM (Bankr. S.D. Fla. March 10, 2020).
22 637 B.R. 663, 668 (M.D. Fla. 2022).
23 Docketed as appeal no. 22-11024.