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Putting the INSOL Fellowship to the Test



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INSOL Fellows may hope, but few expect that their newly-honed international skills will be put to the test immediately after successfully completing the arduous but rewarding course.

So receiving a call late at night in February 2009 from a Fellowship classmate in Hong Kong, just weeks after graduating as a Fellow was an almost immediate dose of international reality. The enquiry concerned whether my firm might be interested in representing liquidators of a now defunct furniture manufacturer. The company, Decoro Ltd (“Decoro”) and its subsidiaries, manufactured sofas and other furniture in two huge factories in Shenzhen, China. The furniture was then drop-shipped around the world to department stores, furniture outlets and other buyers. Decoro’s American subsidiary, Decoro USA, Ltd., acted as a commissioned agent for the parent company in the United States.

Decoro and its subsidiaries had reported revenue of 1.4 billion Hong Kong Dollars in 2007. The company’s financial picture changed drastically in the later half of 2008 due to a variety of internal factors in addition to a slowing economy, leading to a cessation of trading early in 2009. Its factories in Shenzhen were seized by the local government. Principals of the company were alleged to have relocated to Italy. In February 2009, liquidation proceedings were commenced against the company in Hong Kong, its registered place of business. The proceedings remain pending in the High Court of the Hong Kong Special Administrative Region Court of First Instance.

Decoro petitioned the High Court for appointment of its suggested liquidator. The High Court chose not to appoint the liquidator requested by the company. Rather, based upon opposition from bank Intesa Sanpaolo, the Court appointed independent co-liquidators associated with the CCIF Corporate Advisory Services firm in Hong Kong. The liquidators quickly discovered that the company might have assets in the United States. All of the manufacturing assets and real estate located in Shenzhen

fell under government control. The Chinese government had advance a considerable sum of money to pay laborers left stranded when the company’s management seemed to have disappeared from China. Management left virtually all of the books and records of Decoro in China. Following the seizure of the factories in China, it was exceedingly difficult for the liquidators to recover assets and records.

Prior to its demise, Decoro USA transferred millions of dollars to Decoro on a regular basis under an alleged distribution agreement. This money primarily funded the parent company’s operations. The American subsidiary owned assets such as real estate, equipment and receivables. The problem was that since disappearance of the company’s management and owners to Europe, nobody with any stake in the company was “minding the store” in the United States.

In fact, the employees of Decoro USA learned about the parent’s liquidation proceeding only shortly before the company’s shut down. They had been trying to sell off the inventory of furniture in order to pay company bills, since the parent company was no longer funding operations under the so-called distribution agreement between parent and subsidiary. These belated efforts failed, leaving Decoro USA with millions of dollars of unsecured debt as well as a tax claim by the Internal Revenue Service of over US\$13m. The IRS subsequently asserted a tax claim of over US\$100m against Decoro itself, in an effort to pierce the corporate veil and demonstrate that the Chinese parent was the real entity selling furniture in the US without paying taxes.

In March 2009, the liquidators filed a proceeding for Decoro under Chapter 15 of the United States Bankruptcy Code. A primary initial task for the liquidators was obtaining provisional relief from the Bankruptcy Court in the Middle District of North Carolina. This was necessary to prevent assets of the companies from being dissipated pending the Bankruptcy Court’s recognition of the Hong Kong liquidation proceeding as the foreign main proceeding under 11 U.S.C. § 1517.

Simultaneously, the liquidators filed an application with the Court for provisional relief under 11 U.S.C. § 1519 (a). Specifically, the liquidators sought protection against creditors seeking to take actions against the assets of Decoro. The liquidators also requested relief permitting the liquidators to administer the assets of Decoro in the United States for purposes of protecting those assets (11 U.S.C. § 1519 (a)(1)(2)). The liquidators sought such relief not only as to the assets of Decoro, but also as to the assets of the subsidiary, Decoro USA.

The Court granted the liquidators provisional relief but expressed concern over granting such relief for the US subsidiary. Decoro USA then filed belated objections to the relief and requested an expedited hearing on the matter. Decoro USA was still conducting limited operations and had retained counsel to represent it. Although Decoro USA was clearly owned by Decoro, the argument advanced was that Decoro USA was not a debtor and was therefore not subject to the protections which the court might afford a debtor under 11 U.S.C. §§ 1519 or 1521. In other words, the Chapter 15 Petition was filed for Decoro, not its US subsidiary, so why would the provisions of Chapter 15 apply to the subsidiary?

The order placing Decoro in liquidation in Hong Kong governed liquidation of the parent company as well as all of its subsidiaries. It charged the liquidators with the task of investigating and securing the assets of Decoro and its subsidiaries throughout the world. The order enabled the liquidators to bring such actions as the liquidators deemed necessary to accomplish those tasks mandated by the order, including retention of professionals to assist in these endeavors.

The liquidation order of course did not specifically define Decoro USA as a debtor. The liquidators argued that all of the entities subject to the liquidation order were debtors. However, 11 U.S.C. § 101 (13) defines a debtor as a “person or municipality concerning which a case under this title has been commenced.” The Chapter 15 was commenced by the liquidators for Decoro and not Decoro USA.

Ultimately, the matter was resolved as between the liquidators and Decoro USA. The Court never ruled on the issue of whether relief under 11 U.S.C. § 1519 (a) encompasses debtors who are related to the Chapter 15 debtor but are not the petitioning debtor. The Court did not amend its order allowing provisional relief against both the parent and its subsidiary but did ultimately condition its ruling.

In April 2009, the Bankruptcy Court granted recognition of the Hong Kong liquidation proceeding as the foreign main proceeding under 11 U.S.C. § 1517 (a). The Court further extended the provisional relief granted under section 1519 pursuant to 11 U.S.C. § 1521 (a) and (b). However, the Order of Recognition did not extend the provisional relief against Decoro USA indefinitely (11 U.S.C. § 1521 (a)(6)). The Court afforded the liquidators a certain time period to determine whether or not to bring further proceedings under the Bankruptcy Code involving Decoro USA.

The Order of Recognition was merely the first step in what has become a lengthy, cumbersome process of liquidation. Decoro’s only asset in the United States was its ownership of Decoro USA. Discovery was permitted by the Court under 11 U.S.C. §§ 1519 (a)(3) and 1521 (a)(4). This process revealed many transfers and other irregular transactions between Decoro and Decoro USA and others, including principals and related companies. Although the liquidators were granted permission to sell assets under 11 U.S.C. § 363 and avoid post-petition transfers under 11 U.S.C. § 549 (11 U.S.C. § 1520 (a)(2)), the assets at issue were owned by Decoro USA not the petitioning debtor. Further, section 1521 (a)(7) of the Bankruptcy Code specifically excludes granting of

relief to the liquidators under the avoidance provisions of the Bankruptcy Code, including 11 U.S.C. §§ 544, 547, and 548.

In May 2009, a Chapter 11 petition was filed for Decoro USA with the Bankruptcy Court in North Carolina. An adversary action was then filed by Decoro USA against one principal of the company and a related company seeking relief under various provisions of Chapter 5 of the Bankruptcy Code and state law. The debtor also commenced numerous adversary proceedings seeking recovery of assets including accounts receivable, equipment and real estate.

In September 2009, the Bankruptcy Court confirmed the Chapter 11 Plan of Liquidation of Decoro USA. Subsequently, the Plan Trustee filed objections to claims asserted against Decoro USA. One of the claims objections was lodged against the Internal Revenue Service. The IRS took the position that it could simultaneously assert claims in the Chapter 15 proceedings against Decoro and in the Chapter 11 proceedings against Decoro USA, for the same tax liability. The matter is presently in litigation before the Bankruptcy Court.

As a result of the position of the IRS, the liquidators filed a motion in the Chapter 15 requesting the Bankruptcy Court to issue a claims procedures order requiring that all claims against Decoro must be filed in Hong Kong. There is no provision under the Bankruptcy Code or Rules delineating a claims procedure in Chapter 15. The Court did enter an order requiring that all claims against Decoro must be lodged with the liquidators in the proceeding pending in Hong Kong. The IRS subsequently requested that the Court to set-aside its claims order.

The IRS argued that the Court could administer the IRS claim against Decoro separately from all other claims filed against Decoro. The IRS relied upon 11 U.S.C. § 1522. This Code section allows the Bankruptcy Court to issue orders to protect domestic creditors from relief afforded to a foreign representative. The IRS argued that “manifest injustice” would result if the IRS was required to file its claims in Hong Kong.

The Bankruptcy Court denied the IRS motion for relief from the claims order. The Court refused to invoke the protective provisions of section 1522 of the Bankruptcy Code, noting in its opinion that the IRS had not even attempted to file its claim in Hong Kong. The IRS has taken an appeal of the Court’s decision and has, to date, not filed its claim in Hong Kong.

From the administrative tasks of assembling the requisite papers initiating the petition to the handling of much more complex litigation matters involving jurisdiction, COMI, provisional relief and claims adjudication, the Decoro case has presented a panoply of model law issues. Space limitations prevent the detailing of all of the issues in this brief summary. It is difficult to imagine a better test case for practitioners fresh out of the INSOL Fellowship course and eager to test their skills. The course leaves its graduates very well prepared and is highly recommended for anyone who has ambitions to practice in the field of multi-jurisdictional insolvency. 🌐