

# focus

## on

# Insolvency Law

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The logo for Fraser Milner Casgrain LLP, consisting of the letters 'FMC' in white on a dark blue square background.

FRASER MILNER CASGRAIN LLP

### **ALBERTA RECEIVER RECOGNIZED IN COLORADO UNDER CHAPTER 15 OF THE U.S. BANKRUPTCY CODE**

Ernst & Young Inc. was appointed by the Court of Queen's Bench of Alberta as the Receiver and Manager of an Alberta Corporation named Klytie's Development Inc., its Colorado subsidiary, and the two primary shareholders of the debtor companies.

Klytie's Development Inc. and its two principal shareholders had pled guilty to various violations of the Securities Act (Alberta) and had essentially confessed to running a fraudulent scheme whereby they raised funds through the companies by misleading investors into believing that the companies owned substantial real estate holdings which were part of an investment fund with a guaranteed rate of return. In fact, Klytie's Development Inc. and its Colorado subsidiary owned virtually no property and the investors' money largely disappeared. The victims of this scam were located primarily in Alberta, Colorado and Israel.

At the time the Receivership Order was granted in Alberta, numerous Colorado investors had taken action in the Colorado State Court for recovery of the amounts owed to them. In addition, the Colorado Securities Commission had commenced regulatory proceedings against the Colorado subsidiary and the individual shareholders, and had frozen certain of the their assets. However, no insolvency proceedings had been commenced in the United States against any of the entities.

The Receiver applied to the United States Bankruptcy Court for the District of Colorado ("US Bankruptcy Court") and sought recognition under Chapter 15 of the United States Bankruptcy Code ("Chapter 15"). The Receiver's application in Colorado

alleged that the Alberta receivership was a collective judicial proceeding arising under the common law of Canada relating to insolvency, and therefore the Alberta proceedings constituted a "foreign main proceeding" under the Chapter 15 Bankruptcy Code because (i) Klytie's Development Inc. was incorporated in Alberta, (ii) the operations of Klytie's Development Inc. and its Colorado subsidiary were conducted primarily from Calgary, Alberta, and (iii) the principal assets of Klytie's Developments Inc. and its subsidiary were located in Alberta.

In commencing its analysis the US Bankruptcy Court observed that Chapter 15 was enacted as part of the *Bankruptcy Abuse Prevention Consumer Protection Act* of 2005 ("BAPCPA"), and that Chapter 15 essentially implements the Model Law of Cross Border Insolvency promulgated by the United Nations Commission on international Trade Law. Chapter 15 was included in BAPCPA to facilitate cooperation between the United States Courts, trustees, examiners, debtors in possession and the Courts and other competent authorities of foreign countries, to provide greater consistency in the law for trade and investment, and to promote fair and efficient administration of cross-border insolvencies, while protecting the interests of all creditors and other interested parties, including the debtor.

One of the main issues before the US Bankruptcy Court was the definition of a "foreign main proceeding", which is defined under Chapter 15 to mean proceedings pending in the country where the debtor has its centre of its main interests ("COMI").

Under Chapter 15, in the absence of evidence to the contrary, the debtor's registered office is presumed to be the debtor's COMI. However, the US Bankruptcy Court also noted that the COMI presumption in the legislation may be overcome,

particularly in the case where a company is registered in a certain jurisdiction, but is not carrying on business in that jurisdiction. Furthermore, Chapter 15 does not prevent the calling for or assessing of other evidence in respect of the debtor's COMI, which may refute the presumption.

In this case there was no issue as to whether or not Ernst & Young Inc. was a "foreign representative", or that the Alberta receivership was a "foreign proceeding" as defined in Chapter 15. The main issue was whether or not the debtors' COMI was Alberta, particularly in respect of the Colorado subsidiary.

In resistance to the Receiver's application the Colorado Securities Commission also argued that the recognition of the Alberta receivership proceeding as a "foreign main proceeding" would be contrary to public policy and would harm the recovery efforts already commenced by investors in Colorado.

### **COMI**

The US Bankruptcy Court recognized that determining the COMI is necessarily driven by the facts of each particular case, and quoted the following, which could be considered a test, from a case called *Tri-Continental*, 349 B.R. at 635:

In the European Union, the broadest grant of jurisdiction is to the Courts of the Member State, where the "centre of the debtor's main interest is situated". In the regulation adopting the EU convention, the concept is elaborated as "the place where the debtor conducts the administration of his interest on a regular basis and is therefore ascertainable by third parties.

The US Bankruptcy Court also reviewed the case law which considered whether the debtor really had any "establishment" in the jurisdiction, and whether there was any "non-transitory economic activity" there. From those cases the US Bankruptcy Court found additional factors relevant to the COMI question to be (1) the location of those who manage the debtor, (2) the location of the majority of the debtor's creditors or the majority of creditors effected by the case, and (3) the jurisdiction whose law would apply to most disputes.

In the Klytie's case, the US Bankruptcy Court concluded that the most important factors were the location of those who managed the business (Alberta) and the location of the principal assets of each entity (Alberta). Less important was the location of the debtor in this case, because both Klytie's Development Inc. and its Colorado subsidiary were nothing more than a fraudulent scheme. The US Bankruptcy Court also determined that the location of the creditors was not decisive in this case, since the creditors were located in Alberta, Colorado and Israel.

### **Public Policy**

And finally, the US Bankruptcy Court considered the public policy argument advanced by the Colorado Securities Commissioner and found that the test in respect of the issue is whether it would be "manifestly contrary to the public policy of the United States" to recognize the Receiver as a foreign representative and the Alberta proceedings as a foreign main proceeding. The US Bankruptcy Court observed that the legislative history of Chapter 15 indicated that this particular exception is to be applied narrowly, and should be invoked only when the most fundamental policies of the United States are at risk. The US Bankruptcy Court ultimately found that there was nothing contrary to the public policy of the United States to allow the Receiver to administer the estates of the debtor companies and the individual shareholders for the benefit of all creditors equally, notwithstanding that there may be some costs in doing so.

Fraser Milner Casgrain represents the Receiver in Alberta. The citation for the decision of the US Bankruptcy Court is:

*Re Klytie's Devs., Inc., et. al.*, Chapter 15 Case No. 07-22719 MER (Bankr. D. Colo. Feb. 8, 2008)

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