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## Second Circuit Stands By Expansion of Section 363 Review in Chapter 15 Proceedings

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**January 26, 2015** - On Wednesday, January 14th, 2015, the Second Circuit declined to grant an *en banc* review of its holding requiring a full Section 363 review of a claims sale in a Chapter 15 proceeding in the case of *In Re: Fairfield Sentry Ltd.* This decision left intact the Second Circuit's earlier holding that dramatically expanded the ability of a bankruptcy court in a Chapter 15 proceeding to weigh in on issues related to the disposition of property within the United States and sharply curtailed the required deference to the foreign court in these proceedings.

The underlying dispute centered on the sale of a \$230 million claim by the bankruptcy estate of Fairfield Sentry Limited to Baupost Group LLC, a hedge fund. Fairfield was an investment fund that had invested 95% of their assets in the Madoff ponzi scheme that collapsed in 2008, and following the Madoff bankruptcy Fairfield entered into its own liquidation in the British Virgin Islands, which was recognized under Chapter 15 in 2010. Subsequently, Fairfield sold its claims in the Madoff liquidation for approximately 32 cents on the dollar, but three days after the signature of the trade confirmation, the announcement of new recoveries in the Madoff liquidation increased the value of the claim to over 50 cents on the dollar.

Following approval of the sale in the British Virgin Islands over the objections of the Fairfield Trustee, the Bankruptcy Court denied an application for section 363 review on the basis that the SIPA claim was not property within the United States, and that comity dictated deferring to the British Virgin Islands court that had approved the sale. The District Court, on appeal, affirmed the Bankruptcy Court.

The Second Circuit's initial decision on September 26, 2014 held that the claim in the Madoff proceeding was property within the United States and subject to Chapter 15 review as the claim was subject to attachment or garnishment by US courts, and accordingly under Section 1502(8) constituted property within the jurisdiction of the United States. Furthermore, the Second Circuit held that the Bankruptcy Code clearly required a section 363 review due to the language that stated that section 363 applied in a Chapter 15 proceeding "to the same extent" as

a Chapter 7 or Chapter 11 proceeding. Accordingly, the Second Circuit held that the principle of comity remained strongly applicable in Chapter 15 proceedings, it did not override the requirement for an independent section 363 review of the sale.

Furthermore, the Second Circuit noted that the section 363 review must include the significant increase in the value of the claim following the sale rather than merely analyzing the transaction at the moment of the sale. This requirement, given the significant increase in the value of the claim, makes it significantly more difficult for the buyer, Baupost Group, to secure approval of the sale.

Following the original order, Baupost moved for reconsideration *en banc* or, in the alternative, a an amendment of the decision to preserve Baupost's alternative arguments that no section 363 hearing was required. Specifically, Baupost argued (i) that section 363 was discretionary rather than mandatory, (ii) that the bankruptcy court, in its recognition of the British Virgin Islands proceeding order, had entrusted to the Fairfield Trustee the "administration or realization of any property located in the United States" making review unnecessary, and (iii) that the sale of the SIPA claim was in the ordinary course of business. The Second Circuit directed the Fairfield Trustee to respond to these three alternative arguments. The response argued that each of these three arguments had been presented to the Bankruptcy Court or the District Court and either explicitly or implicitly rejected. Following this response, the Second Circuit denied Baupost's motion without further comment.

As a result of this decision, parties should be aware that their transactions with foreign bankruptcy companies will likely be subject to both a standard review in the foreign bankruptcy court, as well as a full section 363 review in the United States. This will likely be most significant in cases where the foreign court's review will not take into account subsequent developments, while the Second Circuit's decision requires the US courts to take those developments into account when determining if approval should be granted.

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