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Business Restructuring & Bankruptcy

Breaking New Ground in U.S. Cross-Border Insolvency Law

Russian Insolvency Proceedings Recognized under Chapter 15 of the United States Bankruptcy Code

Blank Rome LLP's bankruptcy team has the distinction of representing foreign representatives of Russian debtors in two recent Chapter 15 bankruptcy cases that are breaking new ground in U.S. cross-border insolvency law, including one involving one of Russia's largest banks. Blank Rome obtained, over the objection of multiple parties, the first U.S. recognition of a Russian bank insolvency proceeding. Continuing on its success, Blank Rome has been engaged in a second case by the Russian receiver for the bankruptcy estate of a Russian businessman who was the former majority shareholder of one of Europe's largest granite producers. In connection therewith, Blank Rome is representing the receiver in an appeal challenging recognition of the insolvency proceeding and is also seeking to enforce Russian court rulings finding that the debtor was not the victim of a *reiderstvo*,¹ i.e., corporate raiding tactics, which are used to pressure and/or steal businesses. The recognition of these Russian insolvency proceedings extend the jurisdictional reach of Russian courts, giving a tactical advantage to Russian receivers and creditors to investigate and uncover assets in the United States and recover money for distribution to creditors.

Russian Bank Insolvency Proceedings

Vneshprombank (also known as Foreign Economic Industrial Bank) was one of Russia's largest banks until it collapsed in December 2015, when audits uncovered a more than two billion dollar shortfall leading to allegations that its founder and president embezzled tens of millions of dollars. The president was arrested, the bank was declared insolvent, and a Russian governmental agency was appointed trustee for the bank.

In March 2016, the trustee learned that the former bank president may have used embezzled money to form limited liability companies ("LLCs") in New York to purchase several luxury apartments in Manhattan. The trustee engaged Blank Rome to commence a Chapter 15 case in the U.S. Bankruptcy Court for the Southern District of New York for the purpose of obtaining recognition of the Russian insolvency proceeding and conducting discovery to trace the source of money the LLCs used to purchase the apartments.

In February 2017, the U.S. Bankruptcy Court granted recognition of the Russian insolvency proceeding as a foreign main proceeding and granted additional relief permitting the trustee to take discovery to trace and recover the bank's stolen funds within the United States. In obtaining recognition of the bank's insolvency proceeding, Blank Rome successfully overcame challenges by third parties who argued that the U.S. government's policy against Russian aggression in the Crimea prevents recognition of a Russian bank insolvency proceeding. The U.S. court rejected those challenges, suggesting that politics does not impact the Universalist approach to cross-border judicial cooperation to recover assets for international creditors. The Vneshprombank case is one of the only Russian insolvency cases, and the first Russian bank insolvency case, to be fully recognized by a U.S. Bankruptcy Court.²

In October 2017, Blank Rome prevailed over objections from the LLCs that own the apartments and obtained orders from the U.S. court authorizing the Russian trustee to take broad-ranging discovery in the United States related to the purchase of the apartments including bank records and other financial information from the LLC owners and third parties. Blank Rome is currently assisting the trustee in tracing the source of funds used to purchase the apartments in the hope of recovering the bank's assets.

Russian Individual Bankruptcy Proceedings

Sergey Poymanov was a former owner of OJSC Pavlovskgranit, one of the largest Russian granite producers. In October 2015, after Mr. Poymanov failed to pay certain corporate loan obligations of the granite company that he personally guaranteed. The lenders commenced an insolvency proceeding against Mr. Poymanov in the Commercial (Arbitrazh) Court of the Voronezh Region, Russia.

Mr. Poymanov claims to be the victim of an alleged *reiderstvo* by the lenders who forced him into involuntary insolvency proceedings. To circumvent the insolvency proceeding, Mr. Poymanov assigned his legal *reiderstvo* claims to a newly-created U.S. company, PPF Management LLC ("PPF"), which in turn filed a complaint in New York federal court seeking

approximately \$750 million in damages against more than 20 defendants, including the lenders and the receiver in Mr. Poymanov's Russian bankruptcy case. PPF's complaint alleges a conspiracy among lenders and the receiver of his estate to engage in a *reiderstvo* against Mr. Poymanov, his ex-wife, and his granite company in order to dissolve the company and seize its assets.

In July 2017, the U.S. Bankruptcy Court for the Southern District of New York recognized Mr. Poymanov's insolvency proceeding pending in Russia. To avoid the effects of the automatic stay³ on the New York litigation, PPF contested recognition under Chapter 15 on the bases that (i) Mr. Poymanov was not an eligible debtor under section 109(a) of the Code because he had no property in the United States, and (ii) recognition would be manifestly contrary to U.S. public policy. PPF was unsuccessful in both arguments.

First, PPF argued that a retainer held in a U.S. bank account was not Mr. Poymanov's property. The Court found that PPF failed to refute the demonstrated evidence that the funds were Mr. Poymanov's property prior to their transfer into the U.S. bank account. In so holding, the Court validated the expansive definition of property set forth in section 109(a) of the Bankruptcy Code.

Second, PPF argued that the Russian insolvency proceeding against Mr. Poymanov was a sham—merely a means for the defendants in the *reiderstvo* action to affect their scheme—and that recognizing it would vitiate public policy. The Court found that PPF failed to provide any evidence that the proceeding was a sham, that the receiver engaged in criminal activity or bad faith dealing, or that there was any impropriety or corruption attributable to the Russian judicial process. Absent such evidence, the Court concluded that the foreign proceeding was not manifestly contrary to U.S. public policy.

In July 2017, a Moscow Commercial Court found, as a matter of Russian law, that the purported assignment of the *reiderstvo* claims from Mr. Poymanov to PPF is invalid. The Moscow Commercial Court concluded that the claims have

been fully litigated and rejected in prior judicial proceedings in Russia and therefore do not exist. That ruling was upheld by the Russian appellate court. Blank Rome is currently engaged in the process of seeking recognition of the Russian court rulings and enforcing the automatic stay imposed by the U.S. Bankruptcy Court's recognition of the debtor's insolvency proceeding to enjoin PPF's New York litigation.

In addition, PPF filed an appeal of the U.S. Bankruptcy Court's recognition order. Blank Rome is also representing the receiver in the appeal.

Impact

The use of the United States Bankruptcy Code, and particularly Chapter 15, may be a powerful tool to help creditors and trustees of insolvent companies and banks recover assets in the United States. Based on the United Nations' Model Law on Cross-Border Insolvencies, Chapter 15 was enacted to promote cooperation between U.S. courts and foreign courts during international insolvency proceedings and to promote greater legal certainty for international trade and investment.

1. *Reiderstvo* is the international term for a corporate raiding technique that has been described as the "acquisition of business assets and public expropriation through a series of illegal bullying tactics that allow raiders to sell off a company's assets, often to a state controlled entity, and rapidly launder the proceeds, making massive profits and destroying businesses in the process." 162 Cong. Rec. E792-93 (May 25, 2016) (statement of Rep. Christopher H. Smith).
2. *Compare In re CJSC Automated Services*, Case No. 09-16064 (JMP) (Bankr. S.D.N.Y. Nov. 23, 2009) (granting recognition to investigate claims that were not pursued) with *In re Rebgun (Yukos Oil Co.)*, Case No. 06-10775 (RDD) (Bankr. S.D.N.Y. Feb. 28, 2008) [ECF #145] (dismissing Chapter 15 case after provisional relief granted but prior to recognition).
3. Upon recognition of a foreign main insolvency proceeding, an automatic stay is imposed enjoining certain litigation proceedings from continuing.

For additional information on how Chapter 15 of the United States Bankruptcy Code may benefit foreign creditors and trustees of insolvent companies and banks, please contact:

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