

Cross-Border Bankruptcy Update: Do U.S. Bankruptcy Courts Have the Final Say?

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This article provides an update on some of the latest international bankruptcy cases decided by U.S. bankruptcy courts. This article focuses on two recent cases from the Southern District of New York Bankruptcy Court: *In re Basis Yield Alpha Fund* and *In re Monitor Single Lift I Ltd.* The trend among the bankruptcy courts indicates that the U.S. bankruptcy judges invoke the principles of comity and territoriality. Comity allows the court to efficiently and equitably distribute the assets of a debtor in a foreign insolvency proceeding while territoriality allows the court to maintain the integrity of the local laws.

Recently, the Bankruptcy Court for the Southern District of New York in *In re Basis Yield Alpha Fund* (Basis Yield) held that a bankruptcy court can examine all relevant facts in determining whether to grant recognition of a proceeding as a foreign main or nonmain proceeding.¹ In *Basis Yield*, the petitioners, the Joint Provisional Liquidators (JPLs) of Basis Yield Alpha Fund in a proceeding in the Cayman Islands, sought recognition in the U.S. bankruptcy court of Basis Yield's liquidation in the Cayman Islands as a "foreign main proceeding" pursuant to §1517(b)(1) of the Bankruptcy Code.² The court held that when a court engages in a recognition determination under §1517 of the Code, the court is not bound by the parties' failures to object and may consider any and all relevant facts, including facts not presented.³ Basis Yield was incorporated in the Cayman Islands in September 2005 as an exempted limited liability company pursuant to §193 of the Companies Law of the Cayman Islands and maintains a registered office there.⁴ In August 2007, the shareholders of Basis Yield authorized the filing of a petition to liquidate the

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fund pursuant to Cayman Islands law.⁵ Basis Yield is registered in the Cayman Islands and has a registered office and has two feeder funds domiciled there, and the financial books and records of the company are located in the Caymans.⁶

The court explained, however, that the petition contained several deficiencies, including the nature and extent of any business activity conducted by Basis Yield in the Cayman Islands, whether Basis Yield staffed any employees in the Caymans, whether Basis Yield had any assets in the

in the United States must grant comity to the foreign representative.¹¹ "[C]ongress provided that control of these questions would be concentrated in the bankruptcy court."¹² Section 1517 of the Code provides the requirements for an order granting recognition and sets forth the statutory directive that when the requirements are met, the court shall enter a recognition order.¹³ Therefore, in order to prevail, all three elements of §1517(a)(1)-(3) must be met which, include: (1) such foreign recognition is sought is for foreign main or nonmain proceeding; (2) the foreign representative applying for recognition is a person or body; and (3) the petition meets the requirements of §1515.¹⁴ The bankruptcy court found that the JPLs complied with §1517(a)(2) and (3).¹⁵ Section 1517(a)(1), however, required further examination by the court.

The court examined the requirements of §§1517 and 1502 for a main

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Caymans and the location from which Basis Yield's funds were in fact managed.⁷ The JPLs argued since Basis Yield's office is registered in the Caymans, the Caymans is presumed to be the center of main interests (COMI) under §1516 of the Code.⁸

The court began its analysis by reviewing the structure of chapter 15 of the Code and explaining that it is procedural in nature.⁹ Chapter 15 does not constitute a change in the basis approach of U.S. law, which has been one of recognizing comity.¹⁰

Recognition under §1509 of the Code provides that when a foreign representative petitions the bankruptcy court for a recognition decision, the specified consequences under the statute are that the representative obtains the capacity to sue and be sued in U.S. courts and may apply directly to a U.S. court for the appropriate relief, and that all courts

proceeding. A foreign main proceeding is defined in §1502(4) as a "foreign proceeding pending in the country where the debtor has the center of its main interests."¹⁶ The Code does not define COMI and does not prescribe the types of evidence the courts are to consider when determining the COMI.¹⁷ However, the following factors are probative: the location of the debtor's headquarters, the location of those who actually manage the debtor, the location of the debtor's primary assets, the location of the majority of the debtor's creditors or majority of creditors affected by the case, and the jurisdiction whose law would apply in most disputes.¹⁸ The JPLs in *Basis Yield* did not address any of the probative factors, which the court found "deafening."¹⁹

The court then examined §1516(c) of the Code, which provides that in the

¹ No. 07-12762, 2008 Bankr. LEXIS 67, at *2-3 (Bankr. S.D.N.Y. Jan 16, 2008).

² *Id.* at *2.

³ *Id.* at *2-3.

⁴ *Id.* at 3.

⁵ *Id.* at 4.

⁶ *Id.* at 5.

⁷ *Id.* at 6-7.

⁸ *Id.* at 10.

⁹ *Id.* at 12.

¹⁰ *Id.* at 12.

¹¹ *Id.* at 13-14 (citing 11 U.S.C. §1509 (2008)).

¹² *Id.* at 15.

¹³ *Id.* at 16-17 (citing 11 U.S.C. §1517 (2008)).

¹⁴ *Id.* at 18.

¹⁵ *Id.* at 19.

¹⁶ *Id.* at 22.

¹⁷ *Id.* at 22.

¹⁸ *Id.* at 22-23 (citations omitted).

¹⁹ *Id.* at 24.

absence of evidence to the contrary, the debtor's registered office or habitual residence is presumed to be the COMI.²⁰ The court explained that the JPLs were not entitled to the presumption because §1517 provides a qualification as a matter of law for two reasons.²¹ First, the court has the power to examine the facts underlying the request for recognition under §1517 of the Code and Federal Rule of Evidence 614.²² The court found that there was "evidence to the contrary" to decline to use §1516's presumption as a substitute for actual evidence.²³ Basis Yield was incorporated as an exempted company under §193 of the Cayman Companies law, which provides that the business of a company is carried on outside the Cayman Islands.²⁴ The court explained that without more facts, it could not rule on circumstances under which Basis Yield could engage in activities sufficient to satisfy the COMI standard and comply with the requirements of the exempted companies law of the Caymans.²⁵ Indeed, the court noted that Judge Lifland in a prior case held that "recognition as a main proceeding of a Cayman Islands insolvency for an 'exempted company' organized under §193" is "inappropriate."²⁶

Moreover, the court held that it had the power to satisfy itself that the requirements for §1517 of the Code have been met and had a duty to inquire under Federal Rule of Evidence 614 in determining its jurisdiction over the matter before it.²⁷ The court explained that its power to ascertain facts can neither be sidestepped by other parties' failure to object nor by insufficient pleadings by the petitioner.²⁸ The court performed a textual analysis of §§1517 and 1516. Both sections, the court noted, are silent as to whether a court's power to ascertain facts incident to a §1517 determination is revoked by parties' failures to object.²⁹ Likewise, §1516 does not state that the presumption is rebuttable or that the court shall presume the registered office is the COMI.³⁰ In relying on Judge Lifland's decision in *In re Bear Sterns High-Grade Structured Credit Strategies Master Fund Ltd.*, 374 B.R. 122 (Bankr. S.D.N.Y.

2007), *aff'd.*, — B.R.—, 2008 WL 2198272, No. 07-12383, at *14 (S.D.N.Y. May 27, 2008), the court explained that the parties' failures to object were not binding on the court in determining whether §1517 requirements were met.³¹ The recognition process is not a "rubber stamp" exercise.³² In addition, the court held that the §1516 presumption "exists for the purposes of speed and convenience, and to save stakeholders costs in straightforward cases, but does not tie the hands of a court to examine the facts more closely in any instances where the court regards the issues to be sufficiently material to warrant further inquiry."³³ Finally, the court held that Federal Rule of Evidence 614(a) provides a court with *sua sponte* power to call witnesses, which shows that the court "is not imprisoned within the case as made by the parties."³⁴

In refusing to grant recognition as a foreign main proceeding as a matter of law, the court concluded that the "JPLs inappropriately transform[ed] a labor saving presumption in instances where the basis for recognition is apparent to one that would tie the hands of a court to inquire into the actual facts, in cases where the circumstances require more scrutiny—making recognition turn not on compliance with the requirements of §1517, but on the happenstance of whether parties might or might not object. Such a result would be exactly *inconsistent* with one of chapter 15's expressly stated purposes, providing predictability to the financial community."³⁵

The second case in the area of international bankruptcy law where the themes of comity and territoriality are illustrated is *In re Monitor Single Lift I Ltd.*³⁶ Bankruptcy Judge **Martin Glenn**, in the context of a §305(a)(1)³⁷ denial of abstention motion in another international bankruptcy case, demonstrated that U.S. bankruptcy courts have the final say in a cross-border bankruptcy matter. *In Monitor Single*, the bankruptcy court refused to grant an Ad Hoc Committee of Bondholders (committee) motion to abstain from hearing the Monitor Oil, PLC (PLC) matter, in favor of an

involuntary proceeding either in the United Kingdom or Cayman Islands.³⁸

The committee presented several arguments as grounds for the court to abstain from hearing the case.³⁹ First, the committee argued that PLC is a Cayman Islands corporation headquartered in London with its stock traded over the Norwegian exchange.⁴⁰ Second, PLC has no operations in the United States and its business consists of servicing oil-drilling operations in the North Sea.⁴¹ Third, one of PLC's key assets, an investment in a Power Buoy project construction, which suffered setbacks and was a contributing factor to the chapter 11 filing of the Monitor Group, is presently the subject of an administration proceeding in Scotland, to which the court should defer.⁴² Fourth, the committee argued that the professional fees would be less expensive in a U.K. proceeding than a U.S. proceeding, which would benefit the creditors of PLC.⁴³ Fifth, the committee argued that the creditors of PLC would be better served if the insolvency proceedings were commenced in the United Kingdom or in the alternative, the Cayman Islands because of: (1) PLC's limited connection to the United States, (2) the fairness of the proceedings in the United Kingdom or Cayman Islands and (3) the ability to maximize the value of the assets for the creditors by limiting the debtors' guaranty obligations to the second-lien lenders in a U.K. or Cayman Islands proceedings.⁴⁴

The bankruptcy court discussed the standards governing motions pursuant to §305(a)(1) of the Code. The court explained that "courts that have construed [§305(a)(1)] are in general agreement that abstention in a properly filed bankruptcy case is an extraordinary remedy, and that dismissal is appropriate under [§305(a)(1)] only in the situation where the court finds that both 'creditors and the debtor' would be 'better served' by a dismissal."⁴⁵ Furthermore, §305(a)(1) is not limited to involuntary cases, despite its limited use in voluntary proceedings.⁴⁶ The court stated that courts have developed a seven-factor test in determining whether to abstain by

²⁰ *Id.* at 25 (citing 11 U.S.C. §1516(c) (2008)).

²¹ *Id.* at 25.

²² *Id.* at 25-26.

²³ *Id.* at 26.

²⁴ *Id.* at 26-27.

²⁵ *Id.* at 28.

²⁶ *Id.* at 28 (citations omitted).

²⁷ *Id.* at 30.

²⁸ *Id.* at 31.

²⁹ *Id.* at 31.

³⁰ *Id.* at 32.

³¹ *Id.* at 34-36 (citations omitted).

³² *Id.* at 34-36 (citations omitted).

³³ *Id.* at 38.

³⁴ *Id.* at 42 (citing Fed. R. Evid. 614 Committee Notes for 1972 Proposed Rules).

³⁵ *Id.* at 44-45 (italics in original).

³⁶ 381 B.R. 455 (Bankr. S.D.N.Y. 2008).

³⁷ 11 U.S.C. §305(a)(1) (2008) states: "The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceeding in a case under this title, at any time if—the interests of creditors and the debtor would be better served by such dismissal or suspension."

³⁸ *Monitor*, 381 B.R. at 470-471.

³⁹ *Id.* at 460-461.

⁴⁰ *Id.* at 460.

⁴¹ *Id.* at 460-461.

⁴² *Id.* at 461.

⁴³ *Id.* at 461.

⁴⁴ *Id.* at 461.

⁴⁵ *Id.* at 462 (internal quotations omitted) (citations omitted).

⁴⁶ *Id.* at 464.

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dismissal or suspension:

(1) the economy and efficiency of administration;

(2) whether another forum is available to protect the interests of both parties or there is already a proceeding in state court;

(3) whether federal proceedings are necessary to reach a just and equitable solution;

(4) whether there is an alternative means of achieving an equitable distribution of the assets;

(5) whether the debtor and the creditors are able to work out a less expensive out-of-court arrangement;

(6) whether a nonfederal insolvency has proceeded so far in those proceedings that it would be costly and time consuming to start afresh with the federal bankruptcy process; and

(7) the purpose for which bankruptcy jurisdiction has been sought.⁴⁷

The court cautioned that not all of the seven factors are given equal weight in every case, and that concerns of comity and deference to a pending foreign proceeding are more important than any one particular factor.⁴⁸ “Greater importance is given to weighing the benefits and burdens of exercising jurisdiction over the alternate forum.”⁴⁹ The court found that since there was a lack of a pending foreign insolvency proceeding involving PLC as a debtor, the principle of comity in the bankruptcy context did not require the court to give further consideration to the administration proceedings.⁵⁰

The court then proceeded to apply the seven-factor test to the PLC matter and found that the factors weighed against abstention. In examining factors one, two and three, the court explained that it could not conclude that the Power Buoy project neither consisted of most of the value of the Monitor Group nor would have a determinative effect on the court’s decision.⁵¹ In addition, although the committee sought abstention of one of the debtor entities, some expenses would occur while court-appointed administrators or liquidators in the alternative forum became familiar with PLC’s

affairs.⁵² Moreover, there was little evidence to support the committee’s argument that abstention would be more economical because the billing rates of London lawyers were similar to the New York lawyers and that joint proceedings in Scotland would be more efficient.⁵³ The court continued to explain that the committee’s arguments for economy and efficiency ignored PLC’s basis for filing a chapter 11 in the United States, which was to utilize §365 of the Code to permit the debtor to assume valuable contracts for the estate.⁵⁴ Although there may be more administrative expense costs in the chapter 11 proceedings, they are offset by the value in preserving valuable contracts in the U.S. bankruptcy proceedings, according to the court.⁵⁵ In sum, the court found that factors one and three weighed against abstention because a foreign alternative proceeding would result in the loss of a valuable contract and factor two weighed against abstention because there was no adequate alternative forum for proceeding with PLC’s liquidation or reorganization.⁵⁶

Pursuant to factor four, although the United Kingdom or the Cayman Islands would provide for an equitable distribution of the estate’s assets, proceedings under the U.S. bankruptcy courts are more attractive due to the protections of §365 of the Code.⁵⁷ Factor five did not have to be examined because all the parties agreed that no out-of-court workout was possible.⁵⁸ Factor six also weighed against abstention because there was no progress in either the Cayman Islands proceeding or the Scottish proceeding.⁵⁹ Both the Cayman Islands proceedings and the Scottish proceedings were filed only hours before the U.S. chapter 11 petition, and neither proceeding had progressed any further, according to the court.⁶⁰ Factor seven, finally, did not weigh in favor of granting abstention.⁶¹ The committee did not introduce evidence that the Monitor Group filed the bankruptcy for an

improper purpose.⁶² Rather, the debtor admitted that the bankruptcy was filed in order to obtain the benefits of preserving “valuable contract rights.”⁶³ As a result, since the committee did not meet the seven-factor test for abstention and issues of comity were not presented, the court denied the committee’s motion to abstain pursuant to §305(a)(1) of the Code.

Conclusion

Both *Basis Yield* and *Monitor Single* illustrate the likelihood that a bankruptcy case involving foreign creditor rights will be heard by a court in the United States and not solely by the foreign bankruptcy court. These decisions support the shift from a subjective, comity-based process to the more objective chapter 15 process. Indeed, they show that while a court may grant recognition, it may subject that recognition to any conditions consistent with a grant of comity. It follows then, that a court may also not grant recognition based upon a strict application of the objective criteria laid out in chapter 15. ■

⁴⁷ *Id.* at 464-465 (internal quotations omitted) (citations omitted).

⁴⁸ *Id.* at 465.

⁴⁹ *Id.* at 465.

⁵⁰ *Id.* at 466-467.

⁵¹ *Id.* at 467.

⁵² *Id.* at 467.

⁵³ *Id.* at 468.

⁵⁴ *Id.* at 468-469.

⁵⁵ *Id.* at 469.

⁵⁶ *Id.* at 469.

⁵⁷ *Id.* at 469.

⁵⁸ *Id.* at 470.

⁵⁹ *Id.* at 470.

⁶⁰ *Id.* at 470.

⁶¹ *Id.* at 470.

⁶² *Id.* at 470.

⁶³ *Id.* at 470.