

Chapter 15: S.D.N.Y Provides Additional Guidance to Foreign Representatives

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Judge Robert E. Gerber of the Southern District Bankruptcy Court in New York recently denied a motion requesting, on a summary judgment basis, recognition of foreign proceedings under chapter 15 relating to a hedge fund registered in the Cayman Islands. Judge Gerber warned the foreign representatives as early as September 2007, and ultimately ruled on Jan. 15, 2008, that recognition as a foreign main proceeding requires that a factual record be established, even in the absence of opposition to the recognition and other relief requested. The decision, in many respects, mirrors the reasoning of Judge Burton R. Lifland in the *Bear Stearns* cases that have been previously discussed in this forum.² The two decisions are indicative that the S.D.N.Y. Bankruptcy Court, a venue for many prospective chapter 15 filings, will not act as a “rubber stamp” on chapter 15 recognition applications.

Background: Basis Yield Alpha Fund



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The Basis Yield Funds invest in structured credit securities, including asset-backed securities, mortgage-backed securities, collateralized debt obligations and collateralized loan obligations. They are registered in the Cayman Islands as limited liability companies pursuant to §193 of the Companies Law of the Cayman Islands and have two investor feeder funds that are domiciled in the Cayman Islands; no further information was

¹ The views expressed herein are not necessarily those of Bingham McCutchen LLP.

² Judge Lifland's decision in the *Bear Stearns* cases is currently on appeal before the District Court in the Southern District of New York. Argument in front of Judge Sweet of the District Court was held on Jan. 17, 2008; the decision was reserved.

About the Authors

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provided to the court regarding the structure and business operations of the feeder funds. The Basis Yield Funds have a Cayman-based administrator and Cayman-based pre-filing attorneys and auditors. The books and records and investor register are located in the Cayman Islands.

After recent volatility in the global credit markets and specifically subprime lending defaults in the United States, the Basis Yield Funds were unable to satisfy margin calls. On Aug. 29, 2007, the Joint Provisional Liquidators (JPLs) for the Cayman Island liquidation proceedings of the Basis Yield Funds filed a petition pursuant to chapter 15 of the Bankruptcy Code. The JPLs moved for recognition of

Recognition and the Rebuttable Presumption

Section 1517(a)(1) requires that a proceeding can only be recognized as a foreign main or foreign non-main proceeding if the foreign representative is a person or body and the petition is

- ³ Judge Gerber's list of issues the JPLs should address was extensive:
- (a) in what jurisdiction or jurisdictions Basis Yield Alpha Fund (Master)(Basis Yield) is organized and/or registered, and as what kind of business entity (e.g., corporation, limited liability company, general or limited partnership, business trust, etc.);
 - (b) to what extent Basis Yield is registered or qualified to do business in any jurisdictions other than the jurisdiction in which it was organized (e.g., as a foreign corporation);
 - (c) where Basis Yield maintains offices, and what functions are performed at each such office;
 - (d) the number, locations and functions of any personnel employed by Basis Yield;
 - (e) the number, locations and functions of any personnel who are not employed by Basis Yield but who nevertheless perform services on its behalf;
 - (f) the extent to which other business entities (such as an investment advisor) exercise managerial control over Basis Yield operations, and if so, where any such entities are headquartered and conduct their business;
 - (g) the place or places at which investment or portfolio management for Basis Yield is conducted, and the number, locations and functions of persons who are responsible for Basis Yield investment or portfolio management;
 - (h) the place or places at which any Basis Yield administrative or backoffice operations are conducted, and the number, locations and functions of persons who are responsible for any such operations;
 - (i) the place or places at which assets of the Basis Yield estate are located, and the approximate value of the assets at each locale;
 - (j) the extent, if any, to which real property is leased or owned by Basis Yield, and if so, its location;
 - (k) the extent, if any, to which assets were transferred to or from the Cayman Islands before or after the initiation of the liquidation

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the Cayman proceedings as a foreign main or non-main proceeding pursuant to §1517(b)(1) and (b)(2) of the Code. On Sept. 5, 2007, Judge Lifland issued the decision denying recognition of the *Bear Stearns* Funds foreign proceedings in the Cayman Islands as either main or nonmain proceedings. On Sept. 12, 2007, Judge Gerber issued an order scheduling an evidentiary hearing on recognition for the Basis Yield Funds, noting that the JPLs should provide the court with sufficient evidence to support factual findings relating to recognition, and even listing specific issues that should be addressed at the hearing.³ However, when no objections to the recognition motion were filed, the JPLs declined the court's invitation to introduce further facts at an evidentiary hearing, and instead filed a motion requesting a summary judgment determination that the proceedings in the Cayman Islands were foreign main proceedings.

- proceedings in the Grand Court of the Cayman Islands (the “Cayman Islands Proceeding”), and, if applicable, the circumstances surrounding any such transfers;
- (l) the identity and location of the members of the Basis Yield governing body before the appointment of the JPLs, and the place or places at which the Basis Yield governing body met personally within the last several years—or, to the extent meetings were in whole or in part conducted telephonically, the place or places from which the members of the governing body called in;
 - (m) the number and location of Basis Yield creditors;
 - (n) the number and location of equity investors in Basis Yield (or, if more applicable, in the Basis Yield feeder funds) and the relative percentages of the applicable equity that investors in each locale hold;
 - (o) the extent to which Basis Yield had or now has contractual agreements with entities that are (1) organized under the laws of the Cayman Islands, (2) have offices in the Cayman Islands or (3) employ residents of the Cayman Islands;
 - (p) the locale or locales at which Basis Yield maintains its financial records and, if applicable, equity investor registries, and, if different, where they were maintained before the commencement of the Cayman Islands Proceeding;
 - (q) the extent, if any, to which Basis Yield is required to keep books or records in the Cayman Islands; the extent to which Basis Yield does so; and the extent to which books or records not required to be kept in the Cayman Islands are nevertheless maintained there;
 - (r) the locale or locales of obligors with respect to any Basis Yield receivables;
 - (s) The extent to which Basis Yield is a party to any contractual agreements that set forth the law to be applied in the event of any disputes thereunder;
 - (t) the nature and extent of nontransitory economic activity carried out by Basis Yield in the Cayman Islands; and
 - (u) the extent, if any, to which Basis Yield is subject to the prohibitions of Companies Law (2004 Revision) of the Cayman Islands §193, and, if applicable, the extent to which Basis Yield's activities, or the locale thereof, are affected by the provisions of §193.

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accompanied by the proper certificates and statements. *See* 11 U.S.C. §1517(a). For a proceeding to be recognized as a foreign main proceeding, a court must make a finding that the foreign proceeding is pending in a jurisdiction where the entity has its center of main interests. *See* 11 U.S.C. §1519(b)(1). There is a rebuttable presumption that in the absence of evidence to the contrary, the center of main interests of an entity is the location where it is registered. *See* 11 U.S.C. §1516(c). In this case, the JPLs sought to rely on the presumption that the center of main interests is in the Cayman Islands because that is the site of registration, and contended that because there were no objections filed, the presumption could not be rebutted. The court found, however, that the failure of the JPLs to present facts to the court and the JPLs failure to answer the specific questions posed by the court constituted evidence to the contrary and was sufficient to rebut the presumption.

Judge Gerber specifically addressed §193 of the Cayman Companies Law, noting that compliance with that statute raises “red flags” as to whether a company can have its center of main interests in the Cayman Islands. The Basis Yield Funds status as an “exempted company” under §193, according to the statute itself, means that the entity does “not trade in the Islands...except in furtherance of the business of the exempted company carried on outside the Islands.” *See* §193, Companies Law of the Cayman Islands (2004). In the decision, the court noted that it remained unclear whether any company that complied with §193 could possibly meet the requirements of having a center of main interests in the Cayman Islands under chapter 15.

Judge Gerber declined to adopt the JPLs’ theory that a court is bound to recognize a foreign proceeding as a main proceeding if the entity has a registered office in the foreign jurisdiction, and no party objects to the relief requested. Judge Gerber noted the deficiency of facts surrounding whether any business activities took place or any employees, managers or assets were located in the Cayman Islands. He also noted that he was not informed whether the funds were managed out of the Cayman Islands or

from another location. Accordingly, Judge Gerber could not find that the Cayman proceedings were either foreign main proceedings or foreign non-main proceedings, and thus he was not able to grant recognition of the chapter 15 petition without a further hearing.

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Comment

Provisional liquidators coming to the New York Bankruptcy Court for recognition hearings should be prepared to present detailed evidence demonstrating the center of main interests of their foreign debtors, even if there are no parties objecting to the recognition. Unless and until the district court reverses Judge Lifland’s decision in *Bear Stearns* or Judge Gerber’s decision in *Basis Yield*, this requirement of evidence supporting a center of main interests finding for recognition hearings will likely continue to be the standard in the S.D.N.Y. bankruptcy courts. If practitioners were not on notice after Judge Lifland’s decision, they should certainly be on notice now. This is not to say that the New York Bankruptcy Court is an unfriendly venue for chapter 15 filings; the judges in New York are perhaps the most familiar and experienced judges in the country with respect international insolvency matters.

In the case of the *Basis Yield Funds*, Judge Gerber specifically listed in this decision, as he did previously in the order setting the evidentiary hearing, the issues relevant to a determination to grant recognition of a foreign proceeding under chapter 15. *See* footnote 2. The factual issues identified in Judge Gerber and Judge Lifland’s decisions, together, can be used as an outline of the issues that should be addressed in a recognition hearing. ■