

Bankruptcy Court Rejects Cayman Proceedings of Bear Stearns Hedge Funds

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The refusal by a U.S. bankruptcy judge to provide assistance to Cayman liquidation proceedings of failed Bear Stearns hedge funds raises the question of what country should conduct the bankruptcy of a hedge fund that is registered offshore but that conducts all of its business in the United States. If funds choose to file for bankruptcy in their country of registration, will the U.S. bankruptcy court acquiesce and assist offshore proceedings by staying U.S. litigation and protecting U.S. assets? If the U.S. court demurs, must the funds seek protection in U.S. bankruptcy proceedings?



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Recent cases answer the questions differently. The Bear Stearns decision denied the funds' petitions because the Cayman cases did not meet chapter 15's eligibility requirements; nonetheless, it granted a 30-day stay to

permit the filing of U.S. proceedings for the funds. A case involving similarly structured funds, *SPhinX*, arguably misapplied the statute by accepting the eligibility of the Cayman proceedings for U.S. assistance (and then declining to provide any).¹ Ignoring the technical distinctions, it is United States 2, Cayman 0.

These rulings do not suggest that Cayman registration is an unsound idea. Cayman commentators say that the "mix of regulatory, tax, speed, efficiency and cost considerations" still support Cayman as a domicile.² Instead, the cases reflect a U.S. legislative policy to provide the assistance of its bankruptcy courts only to those foreign bankruptcy proceedings that are premised on a tangible presence of the debtor in the foreign jurisdiction. If the debtor is really a U.S. business with only

About the Author

Dan Glosband is one of the draftsmen of both the UNCITRAL Model Law on Cross-Border Insolvency and Chapter 15 of the Bankruptcy Code, Ancillary and other Cross-Border Cases.

its technical domicile offshore, then the debtors' bankruptcy should be a U.S. affair.

Adopting this view, Hon. **Burton R. Lifland**, U.S. Bankruptcy Judge for the Southern District of New York (S.D.N.Y.) denied the chapter 15 petition of two Cayman-registered Bear Stearns hedge funds and found that the Cayman proceedings were not eligible for recognition and relief under chapter 15 of the U.S. Bankruptcy Code.³ Chapter 15, ancillary and other cross-border cases were added to the Code in 2005 and implemented the United States' adaptation of the Model Law on Cross-

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Border Insolvency promulgated by the United Nations Commission on International Trade Law.⁴ Chapter 15 was designed to facilitate cooperation and coordination between U.S. bankruptcy courts and their foreign counterparts, including providing assistance to eligible foreign insolvency proceedings.

Much of chapter 15 is structured to complement foreign proceedings and to assist foreign representatives of those foreign proceedings that meet specified definitional requirements and that take place in a country where the debtor has either its center of main interests (COMI) or a place of business operations, termed an establishment.⁵ Chapter 15 establishes an objective test for recognition of a foreign proceeding and provides two alternative bases on which recognition can be granted: a foreign proceeding in

the debtor's COMI will be recognized as a "foreign main proceeding," while a foreign proceeding where the debtor has an establishment will be recognized as a "foreign nonmain proceeding."⁶ Relief is broader and more automatic upon recognition of a foreign main proceeding. For example, the United States' automatic stay applies and the foreign representatives are granted many of the powers of a U.S. bankruptcy trustee. If the debtor has neither its COMI nor an establishment in the country of the foreign proceeding, then U.S. law should not recognize the foreign proceeding; implicitly, says the United States, the bankruptcy should be elsewhere. Judge Lifland endorsed this view of the law, relying in part on the author's previous *ABI Journal* article criticizing the *SPhinX* decision (discussed below).⁷

The summer 2007 financial press limned the plunge of the Bear Stearns funds into liquidation. Like a slow-

motion video of a diving competition, the headlines captured the fall. On June 20, 2007, the funds stepped onto the platform with "Two Big Funds at Bear Stearns Face Shutdown," a bounce followed on June 21 with "Bear Stearns Staves Off Collapse of Two Hedge Funds," the arc down began on June 25 with "Wall Street Fears Bear Stearns Is Tip of an Iceberg," and finally the splash into the into the pool occurred on Aug. 1 with "Bear Stearns Hedge Funds filed for Bankruptcy."⁸ The bankruptcy filing was

¹ *In re SPhinX Ltd., et al*, chapter 15, Case No. 06-11760 (Jointly Administered) (Bankr. S.D.N.Y. 9/6/06); *aff'd*, 2007 WL 1965597 (S.D.N.Y. July 5, 2007).

² Tim Ridley, Chairman of Cayman Islands Monetary Authority, as quoted in "U.S. Ruling Could Impact Hedge Funds," by James Dimond, *cayCompass.com*, 9/5/07.

³ *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd. (In re Provisional Liquidation)*, Case No. 07-12383; *In re Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd. (In re Provisional Liquidation)*, Case No. 07-12384; Decision and Order Denying Recognition (Bankr. S.D.N.Y. Aug. 30, 2007); Amended Decision and Order Denying Recognition (Bankr. S.D.N.Y. Sept. 5, 2007).

⁴ The draftsmen of the Model Law and chapter 15 included the author of this article, Prof. **Jay Westbrook** of the University of Texas Law School, Judge Lifland and a consulting group of insolvency professionals, representatives of governmental entities and academics.

⁵ The definition of "foreign proceeding" is in §101(23), the general definition section of the Bankruptcy Code: "Foreign proceeding" means a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation." The foreign representative must also be a person or body that meets the definitional requirements of §101(24): "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

⁶ §1502. Definitions

(4) 'foreign main proceeding' means a foreign proceeding pending in the country where the debtor has the center of its main interests;

(5) 'foreign nonmain proceeding' means a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment....

⁷ Glosband, Daniel M. "SPhinX Chapter 15 Opinion Misses the Mark," 25 *Am. Bankr. Inst. J.* 44, 45 (Dec./Jan. 2007).

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a two-step, two-country exercise: a winding up proceeding under the Cayman Companies Law in the Grand Court of the Cayman Islands accompanied by a chapter 15 petition for recognition of a foreign proceeding.

Why the Bear Stearns funds chose the Cayman venue is not clear. Perhaps the Cayman case would be cheaper without expensive U.S.-style committees; perhaps investigation or litigation involving affiliates would be less likely; or perhaps the proceedings would be less transparent

and attract less media coverage. Cayman lawyers say that management is not “favored” to the detriment of creditors and investors and that Cayman courts can handle complex cross-border cases.⁹ Regardless of motivation, the Bear Stearns funds filed for liquidation in the Cayman Islands, and the Cayman liquidators sought to have the Cayman proceedings recognized as foreign main proceedings or, if denied, as foreign nonmain proceedings. In either case, they sought injunctive protection of the funds

and their U.S. assets, the right to take discovery and the turnover of U.S. assets to the Cayman liquidators.

The liquidators premised their request for recognition as foreign main proceedings on the funds’ Cayman registration and domicile. Chapter 15 contains no definition of center of main interests, but contains a presumption that, in the absence of evidence to the contrary, the debtor’s registered office is its COMI. Judge Lifland found abundant evidence to the contrary in the funds’ chapter 15 pleadings: “The verified petitions have

⁸ Headlines, respectively: 6/20/07 *Wall Street Journal*; 6/21/07 *New York Times*; 6/25/07 *Wall Street Journal*; 8/1/07 Associated Press.

⁹ Ben Mays, Maples & Calder, and Tom Ridley quoted in Dimond article, *supra*.

