

**FINDING THE CENTER:
THE INSOLVENCY OF HEDGE FUNDS
AND OTHER OFFSHORE ENTITIES**

Daniel M. Glosband— Moderator
Goodwin Procter LLP; Boston

Karen B. Dine
Pillsbury Winthrop Shaw Pittman LLP; New York

Hon. Arthur J. Gonzalez
U.S. Bankruptcy Court; New York

Robin F. Phelan
Haynes and Boone LLP; Dallas

Stuart Sybersma
Deloitte; Cayman Islands

www.abiworld.org

Chapter 15 is an entirely new chapter of the United States Bankruptcy Code

- Effective October 17, 2005 as 11 U.S.C. Sections 1501-1532
- Adopts UNCITRAL Model Law on Cross-Border Insolvency and replaces former Section 304, *Cases ancillary to foreign proceedings*
- Primary use through September 2006: incoming ancillary cases



Fundamental Differences from Section 304

- Chapter 15 is the sole route for a foreign representative of a foreign proceeding to gain access to courts in the United States other than for the limited purpose of collecting the debtor's accounts receivable
- Requests for relief to courts other than the bankruptcy court that grants recognition must be accompanied by a certified copy of the order granting recognition Section 1509(c)



- Unlike the subjective factors for Section 304 relief, Chapter 15 recognition occurs on proof of the existence of the foreign proceeding and the appointment of the foreign representative
- In addition to governing “**inbound**” foreign proceedings, it governs the “**outbound**” authority of the bankruptcy court and its representatives to act in a foreign country



Objectives of Chapter 15

- To provide effective mechanisms for dealing with cases of cross-border insolvency with the objectives of...
- Cooperation between courts/authorities in cross-border insolvency cases
- Greater legal certainty for trade and investment



- Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested entities, including the debtor
- Protection and maximization of the value of the debtor's assets; and
- Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment



Eligible Foreign Proceeding/Representative

- Collective proceeding in a foreign country for reorganization or liquidation
- Under law relating to insolvency/adjustment of debt: debtor subject to control/supervision of foreign court
- Debtor has **center of main interests** or **establishment** in the foreign country



- Excluded: consumers, regulated entities
- Foreign representative is a person or body authorized to administer the case or act as foreign representative



Chapter 15 Eligibility: Main vs. Nonmain

- A foreign proceeding pending in the country where the debtor has the center of its main interests will be a foreign main proceeding
- A foreign proceeding pending in a country where the debtor has an establishment



- Center of main interests determination less significant than in European Community
 - (a) Produces automatic effects,
 - (b) limits scope of subsequent U.S. case under another chapter but
 - (c) can be modified or terminated



Jurisdiction and Venue

- United States Bankruptcy Courts can hear and determine chapter 15 cases
- Venue is determined by a hierarchy:
 - District where the debtor has its principal place of business in the United States
 - If none, in the district in which there is an action pending against the debtor
 - Otherwise, where venue will be consistent with the interests of justice and the convenience of the parties



Chapter 15

Construction

- Chapter 15's international origin and implications affect its construction
 - International obligations of the United States will prevail if they conflict with chapter 15
 - The court may decline to take an action under chapter 15 “if the action would be **manifestly** contrary to the public policy of the United States.”
 - In interpreting chapter 15, the court must consider its international origin and the goal of uniform application among adopting countries



Recognition of Foreign Proceeding

- A chapter 15 case is commenced by filing a petition for recognition of a foreign proceeding under Section 1515
- A foreign representative can file the petition for recognition directly with the court
- Section 1515, the permanent and interim Federal rules of bankruptcy procedure and official forms govern the application for recognition
- Court shall decide on the application for recognition “at the earliest possible time”



Recognition Procedure: Evidence

- The petition must be accompanied by (1) evidence of the existence of the foreign proceeding and of the appointment of the foreign representative and (2) a statement identifying all other known foreign proceedings of the debtor (all translated into English); presumed valid
- Interim Rule 1007(a) also requires a list containing the name and address of all administrators in foreign proceedings of the debtor, all parties to litigation in the U.S. with the debtor and all entities against whom provisional relief is being sought
- Any substantial change of status of the foreign proceeding or foreign representative and the existence of any additional foreign proceeding must be promptly reported



Pre-Recognition Relief

- Limited emergency relief between petition for recognition and entry of order granting recognition
- May stay execution against debtor's assets; suspend right to transfer, encumber or otherwise dispose of assets; permit discovery and additional relief available to a trustee
- Assets that are perishable, susceptible to devaluation or otherwise in jeopardy may be delivered to foreign representative
- Police or regulatory actions generally not stayed



Automatic Relief on Recognition of Foreign Main Proceeding

- Bankruptcy Code automatic stay takes effect
- Code sections on use, sale or lease of property, avoidance of post-petition transactions and post-petition effect of security interests apply
- Principles of adequate protection of interests in property apply
- Foreign representative can operate the debtor's business, unless court orders otherwise
- Stay exceptions: commence action in foreign country to preserve claim, commence title 11 case, file claims or take actions in such a case



Discretionary Relief:

- Broad relief available upon recognition of a foreign main or nonmain proceeding to effectuate purpose of chapter 15, protect debtor's assets or creditors' interests
- Assets may be entrusted for administration or realization
- Interests of creditors and other interested entities (including the debtor) must be sufficiently protected



- Court may impose conditions, including security or a bond, both on relief granted or on the operation of the debtor's business
- The court may modify or terminate the relief granted



Rights of Foreign Representative Upon Recognition

- Apply directly to a State or Federal court and the court SHALL grant comity or cooperation (not necessarily relief)
- Participate in debtor's bankruptcy case and intervene in proceedings in which debtor is party
- Commence case under chapter 7 or 11 (an “involuntary” if nonmain

proceeding)

American Bankruptcy Institute



- Upon recognition, the foreign representative has standing to assert avoidance actions in a case pending under another chapter of Title 11
- Filing for recognition or to commence or dismiss a case under another chapter does not subject foreign representative to jurisdiction for other purpose



Cooperation and Communication

- Courts must “cooperate to maximum extent possible” with foreign courts and foreign representatives; may communicate directly with foreign court or foreign representative after notice and hearing
- Trustee, other authorized person must similarly cooperate; may communicate directly with the foreign court or foreign representative
- Cooperation by “any appropriate means” including appointment of persons to act, coordination of administration and supervision of assets and affairs, agreements or protocols



Coordination of Concurrent Proceedings

- Post-recognition of foreign main proceeding, case under another chapter of Bankruptcy Code can be commenced only if debtor has assets in United States
- “Subsequent” case preceded by notice to chapter 15 court, subject to mandates for coordination and cooperation, to dismissal or suspension if “the purposes of chapter 15 would be best served by such dismissal or suspension”
- Jurisdiction restricted to assets within the territorial jurisdiction of the United States



Coordination, continued

- If there is both a chapter 15 case and a local full proceeding, cooperation and coordination is subject to guidelines based on sequence in which cases were filed
- If a case under another chapter is pending when an application for recognition is filed, relief must be consistent with relief in the plenary case; no automatic relief on recognition of foreign main proceeding



Coordination, continued

- If a case under another chapter commenced after petition for recognition, any relief in chapter 15 case reviewed and modified or terminated if inconsistent with local proceeding; automatic stay in foreign proceeding modified or terminated if inconsistent with relief in case under other chapter
- Case under other chapter can be dismissed or suspended if interests of creditors and debtor better served
- If representatives of more than one foreign proceeding seek recognition, foreign main proceeding will be given primary importance



Tri-Continental Exchange

- Liquidators in St. Vincent and Grenadines (SVG) filed chapter 15
 - Sought recognition as a “foreign main proceeding” in debtor’s center of main interest (COMI)
 - Presumed to be place of registration but can be rebutted
 - Debtor registered and had principal place of business in SVG



- Ran an insurance scam in U.S. and Canada from SVG
- Recognized as a foreign main proceeding, assets turned over for administration; later hearing on distribution



Sphinx Funds: Cayman Liquidators Filed Chapter 15

- Sought recognition as a foreign main proceeding
- Sought provisional (pre-recognition) relief to stay an appeal
- Funds registered in Cayman, all business activity in U.S.
- Nothing in Cayman but corporate minute books, statutory documents



- Cayman case filed by investors so liquidators could block settlement of preference claim by Refco estate, enhance investors' leverage
- Chapter 15 limited to recognition as either foreign main proceedings or foreign nonmain proceedings
- Main proceedings where debtor has its COMI; nonmain, where debtor has establishment



- Court treated “recognition” as severable step from “main or nonmain”
- Recognized, then said nonmain; not treat as main because of improper purpose of Cayman filing; ultimately denied relief
- Should have been no recognition; no COMI, no establishment



- **SPhinX** Affirmed on Appeal: District Court agrees facts rebut presumption of Cayman COMI based on debtor's registration
 - Court influenced by failure of liquidators to seek any relief other than automatic stay effect of foreign main proceeding recognition
 - Improper purpose and objective factors point to COMI not in Cayman



- “Pragmatic considerations” and “flexibility” support recognition as nonmain proceeding
 - No mention that debtors had no establishment in Cayman



Bear Stearns Funds

- Funds filed for liquidation in Cayman Islands
 - Cayman Provisional Liquidators immediately sought chapter 15 recognition and temporary relief staying litigation and freezing assets
 - Bankruptcy Judge Lifland granted temporary relief but ultimately denied recognition
- Like SPhinX, minimal presence in Cayman



- Funds registered in Cayman but administrator, investment manager, assets all in U.S.
- Sought recognition as foreign main proceeding
 - Relied on presumption that COMI is place of registration and absence of objections
- Alternatively, sought recognition as foreign non-main proceeding



- Unlike SPhinX, Judge Lifland applied statutory eligibility standards
 - COMI must be in country of foreign proceeding for recognition as foreign main proceeding
 - Must be establishment in country of foreign proceeding for recognition as foreign non-main proceeding
- Presumption of COMI in place of registration is for speed, convenience “in the absence of evidence to the contrary”



- Liquidators pleadings are evidence that COMI is in U.S., not Cayman
 - Absence of objections not determinative; Court not a “rubber stamp”
 - Non-main recognition not an alternative either; there is no establishment in Cayman
- Judge Lifland confirms objective statutory structure for eligibility



- Specifically rejects SPhinX bankruptcy court and SDNY decisions:
 - “I recognize that portions of this holding are at odds with the decisions in *SPhinX*, both the bankruptcy court’s decision and the district court’s affirmance. However, neither of those courts addressed the “establishment requirement.”



Basis Yield Alpha Fund: Cayman Liquidators Filed Chapter 15

- Filed petition seeking recognition as a foreign main proceeding a day before Bear Stearns decision
- Fund registered in Cayman Islands. Additionally, Administrator, Investment Manager, auditor, legal counsel, minute books, and statutory documents in the Cayman Islands



Basis Yield Alpha Fund

(cont)

- Foreign Representatives filed to protect assets in the US but has no activity in the US other than having certain assets and counterparties with offices in US
- Following the granting of a preliminary injunction, the Court issued an Order noting its intent to conduct evidentiary hearing and identifying 22 categories of information that the Court considered relevant to the determination on recognition



Basis Yield Alpha Fund

(cont)

- Foreign Representatives moved for summary judgment with respect to recognition contending that they had provided the evidence required by the statute to support recognition and, as there was no evidence to the contrary, they were entitled to recognition as a matter of law based on the statutory presumption that the COMI is in the country where the company is registered.



Basis Yield Alpha Fund (cont)

- The Court denied summary judgment finding that the Foreign Representatives had not submitted sufficient evidence for the Court to determine COMI is in the Cayman islands as a matter of law
- The Court agrees with Judge Lifland that the mere fact no party has objected does not bind the Court or obligate it to accept the facts as presented by the Foreign Representatives



Basis Yield Alpha Fund (cont)

- Court has obligation to look beyond recitation of facts by Foreign Representative to determine whether there is evidence to the contrary with respect to COMI
- Judge Gerber sees the fact that company is an exempted liability company pursuant to section 193 of the Companies Law (2004 Revision) as “evidence to the contrary” with respect to COMI being the registered office of the company



Basis Yield Alpha Fund (cont)

- Judge Gerber reinstates his Order requiring the 22 categories of evidence in support of recognition be presented at evidentiary hearing



In re Loy: COMI of an Individual

- Loy in Bankruptcy in England, living in U.S. under temporary visa
- English trustee petitions for recognition of English proceeding as foreign main proceeding
 - Seeks to sell property in Virginia, files *lis pendens*
- Court notes that recognition must include determination that foreign proceeding is either a foreign main proceeding or a foreign nonmain proceeding
 - Cites Bear Stearns



- Loy argues that chapter 15 recognition was required before recording of *lis pendens*; recognition should be denied under doctrine of “unclean hands”
 - Similar argument failed in In re lida (9th Cir. BAP 2007)
- Court notes that chapter 15 individual debtor’s COMI is presumed to be debtor’s habitual residence



- Court finds that evidence supports the presumption; U.S. residence temporary; debtor's visa expires during the month that the decision issued; England is debtor's habitual residence
- Ownership of property in the U.S. insufficient to rebut the presumption
- Since *lis pendens* was non-judicial, prior recognition not required; may also be within Section 1509 exception for right to sue to collect a claim



APPENDIX

- In re Basis Yield Alpha Fund (Master), 2007 WL 4723359 (Bankr. SDNY, January 16, 2008)
- In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122 (Bankr. SDNY, 2007)
- In re Loy, 380 B.R. 154 (Bankr. E.D. VA, 2007)
- In re SPhinX, Ltd., 351 B.R. 103 (Bankr. SDNY 2006)
- In re SPhinX, Ltd., 2007 W.L. 1965597 (SDNY July 5, 2007)
- In re Tri-Continental Exchange, Ltd., 349 B.r. 627 (Bankr. E.D. Cal. 2006)

