CAMPELLS FUND FOCUS 2015

Judges Panel – Cross Border Insolvencies: State of Comity

Chapter 15 recognition: Have we reached a point at which the US Bankruptcy Court's approach to COMI in the context of Cayman Islands funds is settled and reflects the way in which investment funds are actually structured and operated? Are the expectations of shareholders and creditors being met?

Any attempt to answer this question must involve a review of the decisions of the U. S Bankruptcy courts relating to the grant of recognition to Cayman Islands funds.

An appropriate starting point and perhaps the nadir from the local perspective, is the controversial decision in the Bear Sterns case. There despite the fact that the Funds were incorporated in Cayman, had carried out from within the Islands the usual economic activities typical of offshore investment funds, were subject to the usual regulatory requirements within the Cayman Islands, and had been placed into liquidation by the Cayman Grand Court, the liquidators were denied both foreign main and non-main recognition by the S.D.N.Y Court.

In his oft-cited judgment, Judge Lifland declared that recognition under section 1517 is " not a rubber stamp exercise" but that the court must make an independent determination as to whether the foreign proceedings - in that case the liquidation proceedings before the Cayman Grand Court - meet the definitional requirements of the section of the Bankruptcy Code.

The S.D.N.Y. Court found (and was upheld on appeal) that as there was evidence that the Funds' LCCs had no employees or mangers in Cayman, that their investment manager was located in New York, that their books and records at least prior to the commencement of insolvency proceedings were in the United States as were all their liquid assets- these were all factors which reversed the statutory presumption that a debtor's center of main interest (COMI) is its place of registration. Accordingly, that the Funds neither had its COMI nor even an establishment, within the Cayman Islands.
A further far-reaching conclusion also upheld on appeal, was that for the purposes of Chapter 15 recognition, principles of comity were secondary and so the fact that the Funds were in liquidation before the Cayman court was irrelevant to the grant of recognition which depended first and foremost upon the statutory test of COMI or establishment being satisfied.

The Bear Sterns decisions were followed and applied by Judge Gerber in In re Basis Alpha Yield in 2008.
There the JPLs appointed by the Grand Court filed a petition for recognition of the Cayman proceedings as 'foreign main proceedings' relying on the statutory presumption that the country where the debtor's registered office was located was also its COMI and in the absence of any objections by any party, the JPLs moved for summary judgment.

Judge Gerber adopting the approach taken in Bear Sterns that the court must not be a rubber stamp, held that there was a genuine issue of fact to be raised by the court itself as to whether the Fund's status as an exempted company under Cayman law precluded its liquidators from asserting that the Cayman Islands was its COMI . It was found to be undisputed that the Funds registration as an exempted company was applicable only to companies whose business will be conducted "mainly outside the Islands" and this was evidence that contradicted the presumption that its COMI was the Cayman Islands.
This would be compelling logic to anyone who does not know that registration as an exempted company in the Cayman Islands, while precluding the carrying on of local business, in no manner prevents the

carrying on of foreign business from within the Islands and that this is of the essence of Cayman investment funds that they are able to offer subscription to investors from anywhere else in the world. It seems that this fact was not adequately explained to Judge Gerber.

These decisions gave serious concerns to the Cayman court which had come to regard the principles of comity and the universality of insolvency proceedings as settled principles. The denial of recognition as the result of a strict application of the COMI or establishment test seemed to run contrary to the precepts of the UNCITRAL Model LAW upon which Chapter 15 was patterned. As the Guide to the Enactment of the Model Law explains, the purpose of Article 17 in laying down the COMI test, is to indicate that, if recognition is not contrary to the public policy of the enacting state and if the application meets the requirements set out in the Article, "recognition will be granted as a matter of course".

As many of you in this audience will know, in the case of a Cayman Islands investment fund, too strict an application of the COMI or establishment test can operate to deny recognition and assistance to liquidators on entirely artificial bases and such that that the interests of investors can be unfairly hampered or even denied by the inability of liquidators to pursue the recovery of assets abroad.

But the result before the U.S Courts was not always outright denial of recognition in the early days of Chapter 15, as illustrated by In re Sphinx where, in 2006, although recognition as foreign main proceedings was denied, recognition of non-main proceedings was granted on the basis that Sphinx had an "establishment" in the Cayman Islands. The S.D.N.Y. Bankruptcy court opined in Sphinx that the granting of non-main proceedings recognition was a "better choice" and a "pragmatic solution" emphasising the importance of flexibility.

The Sphinx case may well have set the tone for the progress in the case law which we have seen during the last couple of years in respect of the recognition of offshore insolvency proceedings.

In this sense, the zenith may well have been attained in the Fairfield Sentry liquidation -USBC, S.D.N.Y. 22 July 2010 - where the SDNY Court , again, remarkably, in the person of Judge Lifland, granted recognition as foreign main proceedings to the liquidation of the Madoff related fund in the BVI, on the basis, inter alia, that post-liquidation, the COMI of the fund had become established in the BVI by the liquidators' establishment of an office there and by the collecting in of assets in the BVI. This decision was affirmed on appeal by the Second Circuit Appeals Court which also held that the appropriate date for the determination of the COMI, was the date of the filing of the application for recognition under Chapter 15, not the date of the filing of the petition to wind up in the BVI The far-reaching effects of this decision will be immediately apparent to practitioners in the field of investment funds. From the point of view of the courts, it also signals a welcome return to the spirit of comity, as concerns over whether a debtor has contrived to manipulate its COMI would be misplaced where the court of its place of registration has accepted jurisdiction by way of insolvency proceedings.

An even more recent and in some ways encouraging expression of comity was forthcoming from the S.D.N.Y Court in In re Soundview Elite Ltd and others 503 B.R. 571 (2014). In that case, JOLs of Cayman Funds applied for the dismissal of Chapter 11 debtor-in-possession proceedings which had been filed at "the eleventh hour" by the directors of the Fund (at least one of whom was himself suspected of the fraudulent conduct that destroyed the Funds). The Chapter 11 filing was made although the directors were on notice of the petition to the Cayman court which had not yet been heard and so prior to the appointment of the JOLs. the JOLs application for dismissal of the Chapter 11 filing was opposed by the

directors who cross-petitioned for a finding of contempt against the JOLS on the basis that they had violated the automatic stay imposed by the U.S. Bankruptcy Law by the JOLs' filing of the petition before the Cayman court.

In a very elegantly written judgment, Judge Gerber while refusing the JOLs application for dismissal of the Chapter 11 filing and expressing his concerns that the JOLs may themselves have acted in contempt of his court by pressing with the petition before the Cayman court, nonetheless decided that his court, in the interests of comity, would retroactively lift the automatic stay on other proceedings so as to validate actions taken by the Cayman Islands court. In so doing he made specific reference to the concerns of the Cayman court as expressed in my written ruling of 13 December 2013. Further, in the interests of comity, he decided that although the Chapter 11 proceedings required the participation of a Chapter 11 trustee, he would direct the trustee to enter into a cross-border protocol with the JOLs.
As he put it at para 65 of his judgment, citing as a paradigm, the earlier protocol directed in the Cayman case of In re Lancelot Investors Fund Ltd [2009] CILR 7: ".. in my view, addressing stakeholder needs and concerns requires maintenance of the chapter 11 cases alongside the Cayman insolvency proceeding. And that, in turn, requires the creation of a joint protocol, with fiduciaries in the United States and the Cayman Islands working hand in hand, akin to the protocol developed in Lancelot"

The Berau Capital case is yet a further indication of the renewed robust willingness to embrace comity. There Chapter 15 recognition was given to Berau's Singapore insolvency proceeding on the basis that it satisfied Bankruptcy Code section 109(a) because it held property in New York -an attorney's retainer of only USD10.000 plus certain intangible property rights in New York. I share the view that this decision makes it more likely that foreign companies holding New York securities which are governed by New York law, will be able to utilize Chapter 15 even if they otherwise have no US connections

From this brief overview of the cases it might be too soon to say that the approach of the U.S Courts to the recognition of Cayman insolvency proceedings is settled or that the expectations of investors will be met by the co-operation of the US Courts. However, the jurisprudential signals are quite encouraging and there is every good reason to believe that the principles of comity developed by the courts to ensure the orderly conduct of insolvency proceedings in the interests investors, will continue to prevail.

Looking at the matter from the point of view of a Cayman judge presented with an application by liquidators for leave to apply to commence Chapter 15 proceedings, I would now-a-days be more assured of a positive reception by the US Courts, perhaps in the same way I would be, were I asked to allow a comparable application to a Commonwealth court that observes the same principles of comity. Whether I would I would actually grant the order would then depend, among other things, on the good commercial sense of what is proposed to be undertaken in the USA.

2. Using forum shopping to stymie an insolvency process in another jurisdiction: what should a court do when faced with a filing in another jurisdiction?

The word "stymie" implies forum shopping in the most pejorative sense.

It was the kind of behaviour that concerned the Cayman liquidators and justified the action taken by the Cayman court in the Soundview case. And even while he did not dismiss the directors' Chapter11 filing, Judge Gerber ensured that those proceedings would not stymie the Cayman liquidation by his

appointment of the independent trustee and his directions that he entered into a cross-border protocol with the Cayman JOLs.

Thus, the Soundview case (and the Lancelot case whose protocol it adopts) stands as a good example of the appropriate response to an attempt to stymie the insolvency process by improper forum shopping.

Recognition and affirmation of the presumption in favour of the place of incorporation as the proper forum for the liquidation of an investment fund can also be a very effective way of preventing this mischief. This was done most authoritatively by the Privy Council in a recent judgment the Shell Pension Fund case [2014 UKPC 41] on appeal from the BVI.

In the case, Shell Pension Fund had attempted by way of garnishee proceedings taken in Holland, to attach assets belonging to the Fairfield Sentry Fund which was in liquidation in the BVI. These were assets which were then held by the Dutch CITCO Bank as custodian (at its branch in Ireland). This blatant attempt at forum shopping by Shell seeking to steal a march on other investors, was restrained by a world-wide anti-suit injunction granted by the PC in aid of the BVI liquidation and Shell was required to prove its claim in the liquidation, along with those of all other claimants and in keeping with the principles of universalism. In its judgment the PC declared: "There appears to the Board to be nothing to suggest that allowing Shell an advantage over other comparable claimants would be consistent with the ends of justice. Nor, in the circumstances, should Shell find this surprising.

It invested in a company incorporated in the British Virgin Islands and must, as a reasonable investor, have expected that, if that company became insolvent, it would be wound up under the law of that jurisdiction."

Of course, it must be recognised that not all forms of forum shopping are necessarily bad or must be discouraged. Even taking steps to change the COMI of a company in anticipation of imminent insolvency proceedings may not necessarily be a bad thing. If the objective is to benefit from advantages which a different legal regime would offer for the restructuring of the entity to preserve value for shareholders, or as in the case of the US Chapter 11 debtor-in -possession regime, to get "breathing space' for refinancing; then a change of forum or "forum shopping" may be both necessary and permissible. So also if the objective is to maximise returns for investors or creditors because a different legal regime has a more modern or effective provisions to aid with recovery of assets or for schemes of arrangement and compromise.

It was with such an objective in mind that the Cayman court appointed liquidators of Singularis applied to the Bermuda court for assistance.

They needed information from the former auditors which might assist them in the recovery of assets but as the auditors were amenable to the Bermuda court's jurisdiction and not the Cayman court's, the JOLs applied in Bermuda for compulsive orders. The Bermuda court had statutory powers to compel auditors to provide the requisite documents although the auditors asserted a proprietary right to them and ordered that they be provided in aid of the Cayman insolvency proceedings, invoking an analogous common law power to do so in the name of comity. The orders were appealed against by the auditors all the way to the Privy Council. The PC, while acknowledging the existence of the analogous common law power, nonetheless struck down the orders on the basis that the application to the Bermuda court involved impermissible forum shopping by the Cayman liquidators, because, as they understood the position, the liquidators could not have obtained the similar relief from the Cayman court not only

because it had no personal jurisdiction over the auditors but also because it lacked the power to make similar orders.

Their Lordships expressed their, reason per Lord Sumption, in this way:

'It does not appear to the Board to be a proper use of the power of assistance to make good a limitation on the powers of a foreign court of insolvency jurisdiction under its own law"

It seems from Lord Sumption's approach that in every case where common law judicial assistance is sought, it will have to be demonstrated that the order that is sought was of a kind that was in like terms obtainable in the requesting court, apart from any issue of the lack of personal jurisdiction over the respondent. One can see that this could become a very serious restriction on the granting of judicial assistance in aid of foreign insolvency proceedings.
Indeed, it has already given rise to concerns for the Grand Court recently when liquidators applied for the issuance of letters of request to a number of foreign courts for the recognition of the liquidation in their jurisdictions and to enable the liquidators to take action to recover assets within them.

In issuing the letters to Hong Kong where the courts' power of recognition is still at common law, the court (per Mangatal J) granted the request being assured that an earlier letter of request sent by Foster J in the China Milk case had been granted by the Hong Kong Court) but took the prudent step of including in the letter, the assurance that were a similar request sent to Cayman, her court would have the power to make the like orders to those requested in aid of her appointed officials:

"This court grants its assurance that there is no limitation on the powers that it exercises under the insolvency laws of the Cayman Islands that would not enable it to make the orders sought of the sort requested of the High Court (of Hong Kong)" [In re Centaur, FSD 55 of 2014 (MJ), 27th October2015].

This was an exercise of discretion by reliance on the common law power to issue letters of request to foreign courts. While Cayman has not adopted outright the UNCITRAL Model Law, Part xvii of the Companies Law now augments the Grand Court's inherent powers to grant incoming requests for recognition to foreign court-appointed liquidators.

Hon Anthony Smellie
Chief Justice
The Cayman Islands
19th November 2015.