

Location of Letterbox Company's Registered Office Is Not its COMI

"The process by which the financial problems of insolvent hedge funds are resolved appears to be of transcendent importance to the investment community and perhaps even to society at large."

The U.S. District Court so identified the wider implications of the case concerning Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd. and the Bear Stearns High-Grade Structured Credit Strategies Enhanced Leveraged Master Fund, Ltd. (the "Funds"). In a recent decision on appeal¹, the District Court affirmed the U.S. Bankruptcy Court's ruling that denied the Funds' request for recognition and relief under Chapter 15 of the U.S. Bankruptcy Code. Essentially, the District Court agreed with the Bankruptcy Court that if a foreign debtor does not have its centre of main interests or at least an establishment in the country where the foreign insolvency proceeding is pending, relief under Chapter 15 will not be available to that debtor. Thus, the fact that the Funds were "exempted" companies under Cayman law, and were thereby statutorily limited in conducting business operations in the Cayman Islands, was integral to the District Court's decision.

Chapter 15

Chapter 15 of the U.S. Bankruptcy Code governs cross-border bankruptcy cases commenced in the U.S. after October 2005 and is based upon the UNCITRAL Model Law on Cross-Border Insolvency. A principal purpose of Chapter 15 is to foster cooperation between U.S. and foreign courts involved in cross-border insolvency cases. To this end, Chapter 15 was designed to facilitate the process of recognising foreign insolvency proceedings in the U.S.

The protections and relief provided in Chapter 15 are available only if a foreign proceeding is recognised. Certain relief under Chapter 15 (including the automatic stay) is available automatically upon recognition if the foreign proceeding is recognised as a "foreign main proceeding." Such relief is available only upon request if the foreign proceeding is recognised as a "foreign nonmain proceeding". For more details regarding Chapter 15 generally, see our briefing note "U.S. Bankruptcy Code - a new chapter on Cross-border proceedings in the U.S. - October 2005".

The District Court's Decision

The joint official liquidators of the Funds appealed an order of the U.S. Bankruptcy Court entered on 5 September 2007 which denied recognition of the winding up proceedings commenced in the Cayman Islands. The appeal was unopposed, although certain entities not a party to the litigation filed amicus briefs in support of the Bankruptcy Court's decision.

Key Issues

- District Court in Bear Stearns bankruptcy case upholds Bankruptcy Court's decision on appeal
- Recognition of foreign proceeding turns on stringent and objective eligibility requirements
- Post-recognition relief turns on flexible and pragmatic approach
- Chapter 15 recognition process promotes predictability and reliability
- COMI of exempted Cayman Island registered funds is in the U.S.
- No Chapter 15 relief for exempted Cayman Islands Hedge Funds that did not carry on business in the Cayman Islands

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¹ In Re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd. and the Bear Stearns High-Grade Structured Credit Strategies Enhanced Leveraged Master Fund, Ltd. (Chapter 15 Case No 07-12383/Civil case 07-8730).

On appeal, the District Court affirmed the Bankruptcy Court's decision refusing to recognise the Cayman Island liquidation proceedings as "foreign main proceedings." To qualify as a "foreign main proceeding", the insolvency proceeding must take place in the location where the debtor has the centre of its main interests. Although Chapter 15 provides that a debtor's COMI is presumed to be where the debtor has its registered office, this presumption is rebuttable by evidence to the contrary.

On appeal, the Cayman liquidators argued that the presumption that a debtor's COMI is where it has its registered office was designed to simplify and streamline the Chapter 15 recognition process, and that because no one objected to the liquidators' petition for recognition, the Bankruptcy Court's denial of recognition was contrary to the spirit of cooperation embodied by Chapter 15. The District Court rejected this argument and pointed out that although the petition was unopposed and no party in interest put forth evidence to rebut the presumption that the Funds' COMI was in the Cayman Islands, the Bankruptcy Court nevertheless was obligated to adhere to statutory requirements. The Court held that a judge is more than a mere moderator and should not accept all propositions as true simply because one party says so and because no one else appears to object. Thus, the District Court held that the Cayman Islands proceedings were not "foreign main proceedings" because the facts set forth below demonstrate that the Funds' centre of main interests ("COMI") was in fact in the U.S.; not in the Cayman Islands.

- The Funds' investment manager was located in New York
- Back-office operations were carried out by an administrator in the U.S.
- Prior to the commencement of the Cayman Island proceedings, the Funds' liquid assets were located in New York

Accordingly, these factors were sufficient to rebut the presumption that the Funds' COMI was in the Cayman Islands, where it maintained its registered office, despite the fact that the Cayman liquidators' petition was unopposed.

The District Court also affirmed the Bankruptcy Court's holding that the Cayman Islands proceedings did not qualify as "foreign nonmain proceedings" due to the fact that the Funds did not have a sufficient economic presence in the Cayman Islands before the insolvency proceedings were commenced. Because the Cayman Island proceedings did not qualify as either "foreign main proceedings" or "foreign nonmain proceedings", the proceedings could not be recognised under Chapter 15. Accordingly, the Funds' were precluded from obtaining relief under Chapter 15.

The appeal opinion summarises the history and operation of Chapter 15. The District Court is careful to distinguish Chapter 15 from its predecessor, section 304 of the U.S. Bankruptcy Code. In doing so, the Court contrasted the recognition process under section 304, which was discretionary and subjective, and based on principles of comity, with the recognition process under Chapter 15, which is objective and stringent, and not based on principles of comity.

Comment

The District Court's opinion will no doubt be welcomed by U.S. advisers and academics as it carefully and analytically sets out its reasoning and gives practical insight into how U.S. courts should consider petitions for recognition under Chapter 15.

From a European perspective, although the judgment explicitly refers to its decision on COMI being consistent with the ECJ's determination of what a COMI is in its ruling in the Eurofoods IFSC Ltd case, the approach for recognition under the framework of the European Regulation on Insolvency Proceedings ("EUIR") is quite different. Recognition of the opening of main proceedings is (absent any public policy concerns) automatic under the EUIR.

What seems clear from the opinion in this case is that companies that do not either maintain a centre of main interests, or carry out sufficient economic activity, in the country in which the foreign insolvency proceeding is commenced should not count on assistance from U.S. Bankruptcy Courts under Chapter 15. As the Summer vacation period fast approaches, it may perhaps be worth remembering that sunny climes may not always offer the refuge we may have hoped for!

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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