

# JOURNAL

AMERICAN BANKRUPTCY INSTITUTE

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## Bankruptcy Court Rejects Cayman Proceedings of Bear Stearns Hedge Funds

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Editors' Note: Please see a related article on p. 26.

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? Recent cases answer the questions differ-



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ently. 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).<sup>1</sup> 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

### About the Authors

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.

domicile.<sup>2</sup> 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 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.<sup>3</sup> 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-Border Insolvency promulgated by the United Nations Commission on International Trade Law.<sup>4</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> *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).

<sup>4</sup> 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.

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.<sup>5</sup> 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."<sup>6</sup> 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,<sup>7</sup> 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).<sup>7</sup>

The summer 2007 financial press

<sup>5</sup> 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."

<sup>6</sup> §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....

<sup>1</sup> *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 1965997 (S.D.N.Y. July 5, 2007).

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 pool occurred on Aug. 1 with “Bear Stearns Hedge Funds filed for Bankruptcy.”<sup>7</sup> The bankruptcy filing was 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.<sup>8</sup> 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 demonstrated such evidence to the contrary: There are no employees or managers in the Cayman Islands, the investment manager for the funds is located in New York, the administrator that runs the back-office operations of the funds is in the

United States along with the funds’ books and records and prior to the commencement of the foreign proceeding, all of the funds’ liquid assets were located in United States.”

The Bear Stearns funds’ chapter 15 petitions asked, in the alternative, for recognition as foreign nonmain proceedings if the Cayman proceedings were not recognized as foreign main proceedings. The same evidence proved that the Bear Stearns funds had no establishment in the Cayman Islands, and consequently, the proceedings were ineligible for recognition as foreign nonmain proceedings. The stimulus for the funds to seek “nonmain” recognition was the *SPhinX* decision, which has been criticized and which Judge Lifland rejected as incorrect. The *SPhinX* funds bought and sold securities in a manner that tracked a hedge fund index. While the *SPhinX* funds were established as Cayman Islands entities, their hedge fund business was managed by a Delaware corporation located in New York; trades were executed through Refco Capital Markets Ltd. in New York; and corporate administration (including net asset value calculation) was conducted by an unrelated entity in New Jersey. Other than gaining tax advantages from their Cayman Islands’ domicile, the *SPhinX* funds had little to do with the Caymans: no employees, no physical offices, no directors or directors meetings, no assets, no securities or commodities trading—only minute books, statutory documents and investor documents necessary to comply with anti-money laundering requirements.

There were two attempts at chapter 15 recognition made by two sets of Cayman liquidators of *SPhinX*. Both were for the clear purpose of disrupting a settlement of litigation brought against *SPhinX* on behalf of Refco to recover allegedly preferential payments made by Refco to *SphinX*. The first Cayman liquidation case was dismissed when its provisional liquidators failed to block bankruptcy court approval of the settlement. The second Cayman case and the request for chapter 15 recognition is the subject of a reported decision by Hon. **Robert Drain**, also a U.S. Bankruptcy Judge in the Southern District of New York. Judge Drain indicates that, but for the improper purpose of the chapter 15 filing, he might have recognized the case as a foreign main proceeding because the funds were registered in the Caymans, they had to be wound up somewhere and no one really objected to a Cayman liquidation. However, the court declined to designate the *SPhinX* funds proceedings as foreign main

proceedings because they were filed for the improper purpose of obtaining the §362 automatic stay to block an appeal of the settlement.

En route to this conclusion, the judge decided that he could initially enter an order of recognition without deciding that the proceedings were main or nonmain. This approach ignores the statute and avoids the mandatory eligibility test: Does the debtor have its COMI or an establishment in the Cayman Islands? Having “recognized” the Cayman proceedings in the abstract and then declined to consider them foreign main proceedings, the court defaulted to the position that they are foreign nonmain proceedings. He then declined to grant any relief. Ultimately, the parties were left in the same position as if recognition had been denied due to the ineligibility of the Cayman proceedings. However, the proper interpretation and application of the statute were compromised. The bankruptcy court’s decision has been affirmed on appeal but on a record where no party presented the eligibility issue to the appellate court.<sup>10</sup>

Judge Lifland acknowledged his disagreement with the *SPhinX* 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.” In his conclusion, Judge Lifland included an invitation to the parties to commence “full” U.S. proceedings under chapter 7 or chapter 11 and left a protective injunction in place for 30 days to permit such a filing.

The next chapter of this serial thriller may emerge from the recently filed and now pending chapter 15 petition of the Basis Yield Alpha Fund.<sup>11</sup> The Basis Yield chapter 15 petition states that the funds’ administration is conducted in the Caymans, but that it has more than \$50 million in the United States. It may be that Basis Yield actually has its COMI or an establishment in the Caymans but the record is currently incomplete. Stay tuned. ■

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<sup>10</sup> *In re SPhinX*, 2007 WL 1965597 (S.D.N.Y. July 5, 2007).

<sup>11</sup> *In re Basis Yield Alpha Fund*, Case # 07-12762 (Bankr. S.D.N.Y.).

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

<sup>8</sup> 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.

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

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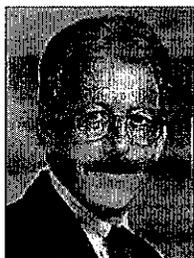
Issues and Information for Today's Busy Insolvency Professional

## SPhinX Chapter 15 Opinion Misses the Mark

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In the course of denying injunctive relief to the Joint Official Liquidators (JOLs) in Cayman Islands voluntary winding up proceedings of the hedge fund group SPHinX Funds, the U.S. Bankruptcy Court for the Southern District of New York wreaks havoc with three fundamental aspects of chapter 15.<sup>2</sup> In a 31-page opinion, the court neglects to apply the eligibility requirements for a foreign proceeding to qualify for recognition under chapter 15; discards chapter 15's purely objective, nondiscretionary standards for recognition; and severs the determination of whether a foreign proceeding is a foreign main proceeding or a foreign nonmain proceeding from its statutory home as part of the recognition determination.



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### Background

The SPHinX Funds bought and sold securities in a manner that tracked a hedge fund index. While the SPHinX Funds were established as Cayman Islands entities, their hedge fund business was managed by PlusFunds Group Inc., a Delaware corporation located in New York (Plus Funds); trades were executed through Refco Capital Markets Ltd. (Refco) in New York, and corporate administration (including net asset value calculation) was conducted by an unrelated entity in New Jersey. Other than gaining tax advantages from their Cayman Islands domicile, the SPHinX

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Funds had little to do with the Caymans: no employees, no physical offices, no directors or directors meetings, no assets, no securities or commodities trading—only minute books, statutory documents and investor documents necessary to comply with anti-money laundering requirements were maintained in the Cayman Islands.

Aflame with fraud allegations, Refco and its affiliates crashed into chapter 11

liquidation in the Cayman Islands. The JOLs were appointed, filed a second round of petitions for recognition under chapter 15 of the Bankruptcy Code on July 31, 2006, and sought provisional relief under §1519 of the Code enjoining further activity on the appeal.<sup>3</sup> The request for provisional relief was denied. The chapter 15 petition sought recognition of the Cayman Islands winding-up proceedings as foreign main proceedings. The automatic stay of §362 would apply on recognition of foreign main proceedings; presumably the JOLs thought that the automatic stay would enjoin the appeal.<sup>4</sup>

### Chapter 15 Analysis

Consideration of the JOL's petition

## The International Scene

on Oct. 17, 2005, shortly after paying \$312 million to PlusFunds on the SPHinX Funds' behalf. A preference suit by Refco against SPHinX Funds resulted in a settlement that certain SPHinX Fund investors opposed. Their opposition strategy included commencing involuntary winding up proceedings in the Cayman Islands and obtaining the appointment of Joint Provisional Liquidators. The Joint Provisional Liquidators filed chapter 15 cases and requested that the Refco bankruptcy court postpone the hearing on the settlement with SPHinX Funds while they looked into it. When the court refused the delay and approved the settlement, the involuntary winding up proceedings were dismissed and the chapter 15 cases withdrawn.

An apparently different cohort of SPHinX Fund investors appealed the approval of the settlement, effectively delaying its consummation, and also put the SPHinX Funds into a voluntary

for recognition of foreign main proceedings should have been guided by the following chapter 15 principles:

1. A foreign representative applies for recognition of a foreign proceeding by filing a petition under §1515(a).<sup>5</sup> The petition for recognition must be accompanied by evidentiary documents specified in §1515(b), and under §1516(b), the documents are presumed to be authentic in the absence of contrary evidence;<sup>6</sup>

<sup>3</sup> "§1519. Relief that may be granted upon filing petition for recognition—

(a) From the time of filing a petition for recognition until the court rules on the petition, the court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant relief of a provisional nature...."

<sup>4</sup> §1520. Effects of recognition of a foreign main proceeding—

(a) Upon recognition of a foreign proceeding that is a foreign main proceeding

(1) §§361 and 362 [automatic stay] apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States....

<sup>5</sup> §1515. Application for recognition—

(a) A foreign representative applies to the court for recognition of a foreign proceeding in which the foreign representative has been appointed by filing a petition for recognition.

<sup>1</sup> The author thanks Gabriel Moss, O.C. of 3-4 South Square, London, for his valuable input into this article.

<sup>2</sup> *In re SPHinX Ltd., et al*, Chapter 15, Case No. 06-11760 (Jointly Administrated) (Bankr. S.D.N.Y. 9/6/06).

2. After notice and hearing, §1517 dictates that the court must enter an order recognizing the foreign proceeding if the proceeding is a foreign main proceeding or a foreign non-main proceeding within the meaning of §1502 and the petition meets the §1515 requirements;

3. Both §§1502 and 1517(b) state that a foreign main proceeding is one pending in the country where the debtor has the center of its main interests (COMI), while a foreign non-main proceeding is one pending in a foreign country where the debtor has an establishment;<sup>7</sup>

4. 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;<sup>8</sup> case law in Europe, to which regard must be had under §1508, establishes that the presumption can be rebutted by showing that the "head office" functions were carried out in a jurisdiction other than where the registered office was located.<sup>9</sup>

5. Section 1502 defines "establishment" as "any place of operations where the debtor carries out a nontransitory economic activity." This definition (which is a little more widely expressed than that in the EC Regulation) arose from the rejection, in relation to the EC Regulation, of the presence of assets as a sufficient basis for taking local jurisdiction.<sup>10</sup> Put concisely, there must be a place of business for there to be an

"establishment."

Chapter 15 substituted a simple, objective standard for recognition in place of the subjective requirements of former §304, which was repealed. Section 304 did not have a recognition requirement as a first step, but rather focused on whether relief should be granted to a foreign representative in light of issues such as just treatment of claim holders in the foreign proceeding, fairness and convenience to U.S. creditors and the order in which proceeds of the foreign estate would be distributed. In contrast, under chapter 15, the court must initially determine whether the petition and the accompanying documents meet the requirements of §1515 and whether the foreign proceeding meets the definitional requirements of §§1502 and 1517.<sup>11</sup>

The legislative history of §1517 emphasizes the streamlined approach:

The decision to grant recognition is not dependent upon any findings about the nature of the foreign proceedings of the sort previously mandated by §304(c) of the Bankruptcy Code. The requirements of this section, which incorporates the definitions in §1502 and §§101(23) and (24), are all that must be fulfilled to attain recognition.<sup>12</sup>

In addition, since foreign proceedings are eligible for recognition only if they meet the definitional requirements of either a foreign main proceeding or a foreign non-main proceeding, there can be no recognition without the concomitant determination of qualification as a main proceeding or a non-main proceeding: If the foreign proceeding is not pending in a country where the debtor has its COMI or where it has an establishment, then the foreign proceeding is simply not eligible for recognition under chapter 15. As emphasized in the legislative history, recognition is a one step process that includes the designation of the foreign proceeding as main or nonmain:

The drafters of the Model Law understood that only a main proceeding or a non-main proceeding meeting the standards of §1502 (that is, one brought where the debtor has an establishment) were entitled to

recognition under this section. The Model Law has been slightly modified to make this point clear by referring to the §1502 definition of main and non-main proceedings, as well as to the general definition of a foreign proceeding in §101(23). A petition under §1515 must show that proceeding is a main or a qualifying non-main proceeding in order to obtain recognition under this section.<sup>13</sup>

The *SPhinX* opinion tortures this simple concept under the guise of chapter 15's supposed "flexibility":

This flexibility is evident not only in the policy statement in §1501(a) but also in Bankruptcy Code §1522, which provides that the court may grant or modify interim relief under §1519 or additional relief under §1521 "only if the interests of creditors and other interested entities, including the debtor, are sufficiently protected." 11 U.S.C. §1522(a).<sup>14</sup> Flexibility also is inherent in the various forms of relief that the court may grant, upon a proper showing, to a foreign representative.<sup>15</sup>

Chapter 15 also provides flexibility by acknowledging the possibility of a concurrent plenary case under other chapters of the Bankruptcy Code while a foreign proceeding is pending, permitting a foreign representative in a recognized foreign proceeding to commence (11 U.S.C. §1511) or participate in (11 U.S.C. §§1512, 1523) such a case, and providing for cooperation and direct communication between the bankruptcy court and foreign courts or foreign representatives and bankruptcy trustees and foreign courts or foreign representatives.<sup>16</sup>

Finally, chapter 15 demonstrates its flexibility in provisions that permit the court to condition relief (11 U.S.C. §1522(b)) or modify previously granted relief in light of changed circumstances.<sup>17</sup>

<sup>6</sup> §1515(b) A petition for recognition shall be accompanied by—  
 (1) a certified copy of the decision commencing such foreign proceeding and appointing the foreign representative;  
 (2) a certificate from the foreign court affirming the existence of such foreign proceeding and of the appointment of the foreign representative; or  
 (3) in the absence of evidence referred to in paragraphs (1) and (2), any other evidence acceptable to the court of the existence of such foreign proceeding and of the appointment of the foreign representative.

<sup>7</sup> §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;

The basic 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."

<sup>8</sup> §1516(c).

<sup>9</sup> *Daisytek* [2003] BCC 562; *Ci4Net* [2005] BCC 277; *Collins & Aikman* (Lawrence Collins J. 15 July 2005); *Hettlage ZIP 20/2004* p.962; *Mliekotej sra* ("Parmalat Slovakia"), (Unrep. 14 June 2004, Municipal Court of Fejer/Szekesfehervar); *MPOTEC GmbH* [2006] BCC 681; *Eurotunnel Finance Ltd.* (Paris Commercial Court, 2 August 2006); *Opinion of Advocate-General Jacobs in Eurofood* [2005] BCC 1,0201, paragraphs 111, 112.

<sup>10</sup> See Moss and Smith, "Moss, Fletcher and Isaacs: The EC Regulation on Insolvency Proceedings" at para. 8.26.

<sup>11</sup> 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."

<sup>12</sup> H. Rep. 109-31, p.114.

<sup>13</sup> H. Rep. 109-31, p. 114. §1501 states that chapter 15 is the United States adaptation of the UNCITRAL Model Law on Cross-Border Insolvency.

<sup>14</sup> *SPhinX*, *supra* at p. 13.

<sup>15</sup> *Id.* at p. 14

<sup>16</sup> *Id.* at p. 14

<sup>17</sup> *Id.* at p. 15.

Flexibility in granting, modifying or denying relief and in communicating and coordinating among multiple proceedings is a hallmark of chapter 15. All of the above quotations support flexibility in these areas, but none support a flexible approach to recognition. The perceived flexibility leads the court to wander from the narrow path to recognition, somehow finding a congressional intent to separate “recognition” from eligibility as a foreign main or foreign non-main proceeding: “Thus, in Bankruptcy Code §§1502(7), 1504, and 1517(a)(1) Congress separated the concept of ‘recognition’ from the concept of ‘recognition as a foreign main (or non-main) proceeding’ under §1517(b).”<sup>18</sup> Yet §1502(7), ironically quoted in full by the court, directly refutes any idea of “separation” and defines “recognition” as “the entry of an order granting recognition of a foreign main proceeding or foreign nonmain proceeding under this chapter.” Nothing in the other sections cited by the court deviates from this unified approach.

Severing recognition from the application of the definitional requirements of foreign main proceedings and foreign non-main proceedings results in the court ignoring whether the SPHinx Funds “are foreign proceedings that are eligible for chapter 15 recognition. The court makes findings that the Cayman Islands proceedings are ‘foreign proceedings’ under Code §101(23) and that the JOLs were appointed to administer the debtors’ winding up under the Companies Law and authorizing their commencement of these chapter 15 cases and thus the Cayman Islands proceedings are entitled to recognition.”<sup>19</sup> The court’s conclusion, however, fails to consider whether the foreign proceedings meet the definitional requirements of §1502 as foreign main proceedings or foreign non-main proceedings.

Viewing the main/non-main determination as a separate step, the court meanders further afield. Despite the repeal of §304 and Congress’ confirmation that the subjective considerations of §304(c) no longer apply to a recognition decision, the court suggests that a determination of the debtor’s COMI should be guided by “the interests of the debtor’s estate, creditors and other parties, absent evidence that they support a “primary” proceeding for an improper purpose.”<sup>20</sup> Acknowledging the pre-

sumption that the debtors’ COMI is in the Cayman Islands, where they are registered, the court considers the types of factors that may be relevant to rebuttal of the presumption: Location of a debtor’s headquarters and those who manage its business, location of its primary assets, location of a majority of creditors, the jurisdiction whose law would apply to most disputes. Chapter 15’s flexibility, in the court’s view, requires that the objective facts “should be viewed in light of chapter 15’s emphasis on protecting the reasonable interests of parties in interest pursuant to fair procedures and the maximization of the debtor’s value. Because their money is ultimately at stake, one generally should defer, therefore, to the creditors’ acquiescence in or support of a proposed COMI.”

The concept of COMI has its origin in Council Regulation (EC) No. 1346/2000 of 29 May 2000 On Insolvency Proceedings of The Council of the European Union (EC Insolvency Regulation), where it plays a much more significant role.<sup>21</sup> Recognition as a foreign main proceeding under chapter 15 does not have dispositive jurisdictional implications among a community of countries, it just produces automatic effects under §1520 that can be modified for cause. Even if a foreign proceeding is recognized as a foreign non-main proceeding, relief identical to the automatic effects can be granted on a discretionary basis.<sup>22</sup>

Under the EC Insolvency Regulation, objective factors ascertainable by third parties such as creditors dictate the COMI determination<sup>23</sup> and the repeal of §304 was intended to introduce the same approach under chapter 15.<sup>24</sup> The U.S. Bankruptcy Court for the Eastern District of California had no difficulty applying this approach to determine that St. Vincent and the Grenadines was the COMI of insurance companies that conducted regular (albeit, fraudulent) business operations at their registered offices in Kingstown, St. Vincent. In rejecting a creditor’s argument that the debtor’s COMI was the United States because most of the creditors were there, the court looked to the EC Regulation for

guidance as required by §1508.<sup>25</sup>

The objective facts found by the SPHinx court, other than place of registration, put SPHinx Funds’ COMI in the United States. The objective facts did not show any “establishment” in Cayman Islands. This should have ended the matter. The Cayman Islands proceeding, while a foreign proceeding, is not eligible for chapter 15 recognition at all. The foreign proceeding is not pending in a country where the debtor has the center of its main interests, thus it is not eligible for recognition as a foreign main proceeding under §1517(b)(1); the debtor has no establishment in the Cayman Islands, thus the foreign proceeding is not eligible for recognition as a foreign non-main proceeding under §1517(b)(2).<sup>26</sup>

Instead of declining to enter the order of recognition, the court sought guidance on COMI determinations under the EC Insolvency Regulation. That trans-Atlantic inquiry should have resulted in a return to the application of objective factors but instead led to an incomplete discussion of a single case that the SPHinx Funds court concluded “left open whether the presumption may be rebutted in respect of a debtor that conducts some business in the location where it is registered (even if, as in the case of the SPHinx Funds, most, if not all, of that business pertains to maintaining its status as an entity registered in that location)...”<sup>27</sup>

In fact, there is a relative abundance of authority under the EC Insolvency Regulation. As mentioned above, the cases emphasize that the presumption based on the location of the registered office can be rebutted by pointing to objective facts ascertainable by outsiders such as creditors, usually the performance of “head office functions” in another country. The present case is clearer on the facts than any of the cases cited above, since no function whatsoever was performed in the Cayman Islands other than required formalities to stay registered there and every other objective fact pointed to other jurisdictions, and in particular the United States.

Following its brief trip to Europe, the court returned to its subjective musings on COMI: Someone needs to manage the debtors’ winding up, and no one has questioned the JOLs ability to accomplish

<sup>21</sup> Available at [www.eu-lex/eur-lex/pri/en/oj/dat/2000/l\\_160/l\\_16020000630en00010018.pdf](http://www.eu-lex/eur-lex/pri/en/oj/dat/2000/l_160/l_16020000630en00010018.pdf). A determination by a court in an EC Member State (the EC Insolvency Regulation term for an EC country) that it has jurisdiction to open a main insolvency proceeding has preemptive effect throughout the EC.

<sup>22</sup> §§1520-1522.

<sup>23</sup> *Bandi v. Bank of America, N.A. (In re Eurofood IFSC Ltd.)*, Case 341/04, (para 33), 2006 E.C.R. \_\_\_ 2006 WL 1142304 (E.C.J. May 2, 2006) [2006] BGC 397 (European Court of Justice).

<sup>24</sup> See H. Rep. 109-31, p. 113.

<sup>25</sup> *In re Tri-Continental Exchange Ltd.*, 2006 WL 2671336 (Bankr. E.D. Cal. 2006).

<sup>26</sup> If SPHinx Funds has assets in the United States that require administration, a chapter 7 liquidation case can be filed. 11 U.S.C. §109(a).

<sup>27</sup> *Id.* at 24; *Eurofood*, *supra*. 2006 E.C.R. \_\_\_ 2006 WL 1142304 (E.C.J. May 2, 2006).

<sup>18</sup> *Id.* at p. 18.

<sup>19</sup> *Id.* at p. 20.

<sup>20</sup> *Id.* at p. 16.

the task fairly (although it is not clear from the opinion that there is anything of substance in the Cayman Islands to be wound up); the winding-up proceedings will primarily affect investors who have not opposed the petition for recognition as a foreign main proceeding; there are no other pending insolvency proceedings involving the debtors; Cayman Islands regulations require a winding up there. Balancing all of these factors, the court might be inclined to find the debtors' COMI in the Cayman Islands and recognize the proceedings as foreign main proceedings (noting, however, the limited practical effect of such recognition and the court's ongoing duty to protect parties in interest).

Notwithstanding that a simple "'location of administration of the debtor's interests test' could well result in a different outcome...because these are liquidation cases in which competent JOLs under the supervision of the Cayman court are the only parties ready to perform the winding up function, and, importantly, the vast majority of the parties in interest tacitly support that approach, normally the court would recognize the Cayman Islands proceedings as main proceedings."<sup>28</sup> The court then reverses direction and declines to designate the SPhinX Funds foreign proceedings as foreign main proceedings because they were filed for the improper purpose of obtaining the §362 automatic stay to block the appeal of the settlement: "Indeed, given that the JOLs did not articulate a proper basis, or even actively pursue a request, for any other relief under chapter 15—for example, an injunction or turnover of property—with the exception of a request for further discovery primarily relating to the appeals (transcript citation omitted), this litigation strategy appears to be the only reason for their request for recognition of the Cayman Islands proceedings as foreign main proceedings."<sup>29</sup> This analysis summons the ghost of §304 and is wholly irrelevant to a recognition decision, which is just a validation of the existence of the foreign proceeding, its compliance with the definitional requirements of §1502 and confirmation that the foreign representative also meets the definitional criteria.

## Conclusion

In the end, the court's deviations from the statute and congressional intent

caused no harm to the *SPhinX Funds* parties. No stay of the appeal was entered and no other relief was granted. If recognition had been denied, as it should have been, the result would have been the same. However, there may be great harm to the future of chapter 15 if other courts follow the *SPhinX Funds* opinion. Recognition is not severable from the determination of the nature and eligibility of the foreign proceeding; the petition for recognition and the determination of the nature of the foreign proceeding—main or non-main—should be based on objective considerations. No flexible, subjective considerations should apply to the decision to enter or decline an order of recognition. If an order of recognition enters because the foreign proceeding meets the objective requirements of §1517, requests for relief by the foreign representative and requests by creditors and other interested parties for protection or modification of relief require consideration of motives, interests, benefits and other subjective factors. At that point, the court will have the ability to act with the full range of flexibility that it has identified as informing chapter 15.

Finally, the judgment creates a wholly unnecessary, serious and regrettable breach with European case law on the meaning of key concepts taken from a European statute. It threatens to break the very unanimity that is meant to be at the heart of the Model Law and the goal of uniform interpretation throughout the world reflected in §1508. ■

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<sup>28</sup> *Id.* at 27.

<sup>29</sup> *Id.* at 28.