

International Corporate Rescue



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Did Judge Lifland's *Bear Stearns* Decision Start a Revolution?

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In a well-publicised September 2007 decision, Judge Lifland of the Bankruptcy Court for the Southern District of New York refused to recognise an offshore proceeding, even when no party objected, when the foreign representative failed to prove that the debtor's presence in the Cayman Islands amounted to either a Centre of Main Interests ('COMI') or an 'establishment' under Chapter 15. Now another judge from that court has followed suit, in *In re Basis Yield Alpha Fund (Master)*, No. 07-12762 (REG). The ruling may not be as negative as a first reading would suggest, but it does present a challenging evidentiary obstacle for future offshore debtors.

In a decision issued on 16 January 2008, Judge Robert E. Gerber refused to grant summary judgment to a foreign representative seeking Chapter 15 recognition. The debtor, Basis Yield Alpha Fund, was incorporated in the Cayman Islands and maintains a registered office there. When it received several default notices in the wake of the sub-prime lending downturn in the United States, Basis Yield filed for liquidation under the Cayman Companies Law in August 2007. The firm's joint provisional liquidators (JPLs) then sought recognition under Chapter 15 in New York.

Under Chapter 15, US bankruptcy courts can recognise either 'main' or 'nonmain' foreign proceedings. The foreign proceeding is to be recognised as 'main' if it is in the country of the debtor's COMI, and nonmain if in a country where the debtor has an 'establishment' as defined in the bankruptcy law. Basis Yield sought recognition, first, as a main proceeding, and in the alternative as a nonmain proceeding.

Although no party objected to the JPLs' request, Judge Gerber announced that 'recognition under section 1517 is not a rubber stamp exercise.' The Court then put the JPLs through their paces: After a hearing on the JPLs' request for a preliminary injunction, Judge Gerber called for an evidentiary hearing on whether recognition was appropriate. Before the court scheduled the evidentiary hearing, the JPLs moved for summary judgment on the issue – a procedure under US law for matters in which a party claims there is no genuine dispute of material facts. Thus, the Court had to consider whether the JPLs had submitted sufficient evidence for recognition.

In their submission the JPLs sought to establish that the debtor had a COMI or 'establishment' in the Cayman Islands. The JPLs noted that Basis Yield was incorporated and has a registered office there; that its only two investors are feeder funds domiciled there; and that its administrator, investment manager, attorneys, and books and records are all located in the Cayman Islands. The JPLs said nothing about any of the factors that courts had highlighted as relevant to this determination: the location of the debtor's headquarters, managers, primary assets, the debtors and creditors who would be affected by the case, and the jurisdiction whose law would apply. As Judge Gerber put it, 'The silence is deafening.'

The JPLs did not hide their strategy. Rather than putting in evidence along those lines, they argued that no such evidence was required. They argued that under the Bankruptcy Code's Section 1516, unless another party objects, courts are *required* to treat a debtor's registered office as its COMI. The statute they relied on reads, 'In the absence of evidence to the contrary, the debtor's registered office ... is presumed to be the center of the debtor's main interests.' The JPLs argued that this provision bound the court to recognise the Cayman Islands as Basis Yield's COMI, and the proceedings there as foreign main proceedings. Based on evidence that their registered office was in the Caymans, and with an absence of evidence to the contrary, the JPLs argued that Section 1516 created an irrebuttable presumption that the Court was bound to apply.

The Court rejected that argument for two reasons. First, the Court found 'evidence to the contrary.' Basis Yield had argued that there was nothing else in the record about its operations. The Court disagreed and cited Section 193 of the Caymans Companies Law, which forbids 'exempted companies' like Basis Yield from conducting any trade on the Islands except as necessary to further its business abroad. That Basis Yield was subject to this law, the Court reasoned, was evidence that it had neither a COMI nor an establishment in that jurisdiction.

Second, the Court rejected the notion that, even absent other evidence, the location of a debtor's registered office created an irrebuttable presumption that courts are bound to apply. Interpreting Section 1516's

text, which provides that the registered office location 'is presumed' to be the COMI, as not binding may be questionable, but the Court bolstered its interpretation with reference to the text's legislative history. Documentation supporting the UNCITRAL Model Law on Insolvency, from which Chapter 15 derived, supports the Court's view; the official guide to that document advises that Section 1516's presumption can be 'called into question *by the court or an interested party.*' The Court refused to let the lack of objections from any party make recognition mandatory. Instead, the Court cited its obligation to satisfy itself that the Caymans were Basis Yield's COMI or had an establishment under Section 1517, and finding an insufficient basis to do so on the record the JPLs had created, denied their request for summary judgment on the question of recognition.

Judge Lifland's *Bear Stearns* decision (which has been affirmed on appeal and will be discussed in the next issue) and Judge Gerber's *Basis Yield* decision send an important message to insolvency lawyers. While these decisions may affect how recognition proceedings are litigated, the decisions should not be read as signaling the end of Chapter 15 proceedings for offshore debtors.

While rejecting the JPLs' argument for recognition, Judge Gerber went out of his way to make clear what he

was *not* deciding. Judge Gerber did not decide that the Cayman Islands proceeding could not be recognised. In denying the JPLs' motion for summary judgment, the Court only decided that there were sufficient issues of fact to warrant further inquiry. Because a summary judgment proceeding requires a court to draw all reasonable inferences *against* the moving party, it is possible that an evidentiary hearing (like the one Judge Gerber initially requested) will yield a different result. As Judge Gerber's decision points out, the JPLs' summary judgment motion pointed to little beyond the location of the debtor's place of registration. The decision goes out of its way to make clear that further evidence may change the Court's mind.

Of course, Basis Yield – like many other offshore entities – may have little other evidence to present, even given this further opportunity. 'Exempted companies' under Cayman Islands law are forbidden from engaging in extensive on-island business; any fact that would help a potential debtor to increase its activity offshore for COMI or 'establishment' purposes could result in a violation of the Caymans' corporate laws. It will definitely be an exercise in threading the needle, as insolvency practitioners try to find that 'Goldilocks' level of Cayman Islands operation that is active but not too active.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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