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In re Fairfield Sentry, Ltd: More Guidance for Administrators Seeking Ancillary Recognition in the US

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A recent US District Court decision involving BVI-based Fairfield Sentry, Limited ('Sentry') provides additional texture to the growing body of US decisional law addressing what it takes to achieve ancillary recognition of a 'main case' under Chapter 15 of the US Bankruptcy Code. *In re Fairfield Sentry, Ltd*¹ also provides some guidance for liquidators and other administrators considering their prospects for such recognition in the US.

The case

Sentry, a British Virgin Islands-organised entity, served as a vehicle for mainly non-U.S. persons and certain tax-exempt U.S. entities to invest with Bernard L. Madoff Investment Securities, Inc. ('BLMIS'). Fairfield Greenwich Group ('FGG'), based on Manhattan's Upper East Side, served as Sentry's investment manager.

In December 2008, it became publicly known that BLMIS had for many years been operated by Bernard L. Madoff as a massive Ponzi scheme. Madoff's scheme affected funds held on behalf of Sentry. In the wake of this disclosure, Sentry ceased its routine operations and changed its business purpose to 'preserv[ing] and realiz[ing Sentry's] assets for purposes of ultimate, orderly and equitable distribution, in compliance with the BVI insolvency law, to creditors and other lawful claimants.'

From December 2008 through April 2009, Sentry's Board of Directors took a number of steps to communicate with its shareholders and protect their interests in the wake of BLMIS's collapse. Specifically, the Board communicated with shareholders from its BVI offices. It also established a 'Litigation Committee' of independent and non-New York, non-US based directors, and which was empowered to litigate on Sentry's behalf and which governed Sentry's affairs until the Commencement of the BVI Proceeding. Further, Sentry began to sever its contractual relationship with FGG and related affiliates and individuals, who had

long standing affiliations with Madoff. This relationship was formally terminated in May 2009.

In April 2009, ten of Sentry's shareholders requested that the BVI court appoint a liquidator over Sentry. On 21 July 2009, the BVI court appointed Kenneth Krys and Christopher Stride, both BVI residents and BVI-licensed insolvency practitioners, as joint liquidators of Sentry (the 'Liquidators').

The dispute

On 14 June 2010, nearly a year after their appointment, the Liquidators filed a petition seeking Chapter 15 recognition of the BVI Proceeding in order to *inter alia*,

'(i) facilitate the Liquidators' enhanced access to United States courts in connection with the pursuit of claims on behalf of Sentry, (ii) afford the Liquidators the right to seek discovery to identify parties that bear liability to Sentry and the claims against those parties; (iii) provide protection of the recoveries made by the Liquidators in the United States from piecemeal attack; (iv) provide a means to facilitate a consensual resolution of the BLMIS Proceeding against Sentry that would benefit the stakeholders of both Sentry and the Madoff estate; and (v) provide a means to ensure that recoveries will be distributed in an orderly and equitable manner through the BVI proceeding in accordance with BVI insolvency law.'²

Two Sentry investors, who had commenced their own derivative action on Sentry's behalf in New York Supreme Court, objected.

The decision below and the appeal

Pursuant to a published decision,³ Judge Burton Lifland issued an order on 22 July 2010 recognising Sentry's

Notes

1 B.R. ___, 2011 WL 4357421 (S.D.N.Y., September 16, 2011).

2 2011 WL 4357421 at *2.

3 See *In re Fairfield Sentry, Ltd.*, 440 B.R. 60, 67 (Bankr. S.D.N.Y. 2010).

liquidation proceeding as a foreign main proceeding pursuant to 11 U.S.C. §1517(b)(1), and staying Appellants' purported derivative action as well as all actions concerning Sentry's rights and assets, except the BLMIS Trustee's pending adversary proceeding against Sentry.

The New York investors appealed Judge Lifland's decision to US District Court, alleging legal error in (1) finding that Sentry's centre of main interests ('COMI') is the British Virgin Islands when it is instead New York; (2) failing to deny main recognition of the BVI Proceeding pursuant to the Chapter 15 public policy exception; and (3) staying the investors' derivative action in New York Supreme Court.

The decision

On appeal, District Judge George Daniels identified the sole legal issue as whether or not Sentry's BVI proceeding was a 'main' or 'non-main' proceeding under US law. Classification as a 'main' or 'non-main' proceeding depends, in turn, on whether or not the proceeding is pending in the jurisdiction which is also the debtor's COMI.

Though the foreign representative seeking recognition of a 'main proceeding' has the benefit of a presumption in favour of this finding whenever the debtor's registered office is in the same jurisdiction, US courts will weigh relevant evidence to the contrary.

'Although the Bankruptcy Code does not state the type of evidence relevant to the COMI determination, courts typically consider the following *Sphinx* factors: the location of the debtor's headquarters; the location of those who actually manage the debtor (which conceivably could be the headquarters of a holding company); the location of the majority of the debtor's creditors or a majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes. *Bear Stearns II*, 389 B.R. at 336 (citing *In re Sphinx, Ltd.*, 351 B.R. 103, 117 (Bankr. S.D.N.Y. 2006); see, *Ran*, 607 F.3d at 1023. A debtor's COMI has also been equated with the concept of a "principal place of business." *Bear Stearns I*, 374 B.R. at 129 (citing *Tri-Continental Exchange Ltd.*, 349 B.R. 627, 633-34 (Bankr. E.D. Cal. 2006). Finally, courts also consider the expectations of third parties with regard to the location of a debtor's COMI. *In re British Am. Isle of Venice*, 441 B.R. 713, 720 (Bankr. S.D. Fla. 2010).'⁴

Using this analytical framework, Judge Daniels found:

- **In the case of a protracted liquidation, the fact that Sentry's primary business used to be in the US was no bar to subsequently finding COMI in the BVI.**

Responding to the appellant-shareholders' argument that COMI should be in New York rather than in the BVI because – prior to liquidation – Sentry's 18-year history had been centered in New York, Judge Daniels relied on several recent decisions to find that

'[C]ourts have recognized that where a debtor's activities for an extended period of time have been conducted only in connection with winding up a debtor's business, the activities of a debtor's liquidators are both relevant and important to the COMI determination. See *British Am. Isle of Venice*, 441 B.R. at 713 (holding that a debtor's liquidation proceeding in the British Virgin Islands was a foreign main proceeding under Chapter 15 of the Code); *In re British Ins. Co., Ltd.*, 425 B.R. 884, 915 (Bankr. S.D. Fla. 2010) (stating in *dicta* that 'there may be instances where a foreign representative remains in place for an extended period, and relocates all of the primary business activities of the debtor to his location (or brings business to a halt), thereby causing creditors and other parties to look to the judicial manager as the location of the debtor's business [and] lead[ing] to the conclusion that the center of main interest has been lodged with the corporate representative'); *Betcorp Ltd.*, 400 B.R. at 266 (holding that a voluntary winding up in Australia was a foreign main proceeding under Chapter 15).'⁵

In the same vein, the Bankruptcy Court's consideration of Sentry's place of business at and around the time of the Chapter 15 filing was appropriate because, despite the potential for forum-shopping created by a 'snapshot' analysis of the debtor at the time recognition is sought, the complaining investors introduced 'no evidence to support a finding of an opportunistic shift of Sentry's COMI or any biased activity or motivation to distort factors to establish a COMI in the BVI. Notably, the shareholders initiated the Liquidation proceedings in the BVI – not the Liquidators.'⁶

- **A comparative lack of public access to court records is not, standing alone, 'manifestly contrary to US public policy'.**

The objecting shareholders also complained that the BVI liquidation proceedings were 'cloaked in secrecy,' and therefore 'manifestly contrary to US public policy.' Judge Daniels, disagreed, finding that despite

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⁴ 2011 WL 4357421 at *4.

⁵ *Id.*

⁶ 2011 WL 4357421 at *6.

the well-entrenched American policy of public access to court records, such policy was not inviolable – even in the US. Denial of public access is specifically recognised in American bankruptcy proceedings when such denial is necessary to ‘protect an entity with respect to a trade secret or confidential research, development, or commercial information.’ II U.S.C. § 107 (b).

In Sentry’s BVI liquidation,

‘The BVI Court ordered that the proceeding be sealed because Sentry’s applications to the BVI Court include explanations of their litigation strategy and/or information protected by attorney-client privilege ... Where the sealing of court files is determined by a court to be necessary, the sealing itself does not run contrary to the fundamental policies and purposes of either a United States statutory or constitutional right. Though the sealing here may be broader than specifically provided by the Code or other United States statutory authority, “[t]he mere fact of conflict between foreign law and U.S. law, absent other considerations, is insufficient to support the invocation of the public policy exception,” *Qimonda*, 433 B.R. at 570. Appellants have failed to demonstrate that the sealing of the proceedings renders them fundamentally unfair. Accordingly, this Court finds that the sealing of the BVI Proceeding is not contrary to United States public policy such that the section 1506 exception should be invoked.’⁷

Accordingly, Judge Daniels affirmed the Bankruptcy Court’s recognition of the Sentry matter.

Fairfield Sentry’s impact

Judge Daniels’ appellate decision in *Fairfield Sentry* is meaningful in at least three respects:

- **Where possible, administrators overseeing a non-US liquidation may consider ‘aging’ their proceedings before seeking recognition in the US.**

Though, as noted the *Sentry* decision, appearances of ‘gamesmanship’ should be avoided, liquidators considering recognition of an ancillary case in the US should consider the possible strategy of ‘aging’ their proceedings prior to seeking recognition in the US. Where circumstances permit this approach, doing so affords liquidators the ability to build a record of evidence which will better support a finding of COMI in the liquidator’s jurisdiction.

- **US-based creditors and other litigants who wish to contest recognition of foreign proceeding involving an out-of-business debtor whose majority business was in the US may wish to accelerate their prosecution of claims against the debtor.**

Conversely, those creditors concerned about the imposition of a foreign ‘main proceeding’ upon pending litigation – or those who desire the comparative transparency of an involuntary Chapter 11 case commenced under US law – may be well-advised to prosecute their claims promptly.

- **Representatives contemplating recognition in the US may wish to consider the level of confidentiality actually required of proceedings in their home jurisdiction.**

Finally, the *Sentry* decision provides some additional guidance to those liquidators operating in jurisdictions whose access to court records may differ from the access normally provided in the US. Though the ‘US policy’ exception to recognition requests is construed narrowly in US Bankruptcy Courts, carefully aligning the right of access to court records with those commonly recognised in the US can nevertheless aid in avoiding the disputes encountered by Sentry’s liquidators.

Notes

7 2011 WL 4357421 at *9 and preceding discussion.

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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