

5 The authors have substantial experience of advising in relation to customer trust accounts, having acted as administrator/trustee and legal adviser to the Trustees of the Customer Trust Account in relation to *OT Computers Ltd (in Administration) v First National Tricity Finance Ltd* [2003] EWHC 1010 (Ch).

6 Above fn.5.

7 *Baden's Deed Trusts (No. 1)*, Re [1971] A.C. 424.

8 Above fn.3.

9 *Lewis's of Leicester Ltd*, Re [1995] 1 B.C.L.C. 428.

10 G. Thomas and A. Hudson, *The Law of Trusts* (Oxford: Oxford University Press, 2004).

11 Above fn.2.

12 Above fn.3.

13 Trustee Act 2000 Pt 1 s.1.

14 *Dubey v Revenue and Customs Commissioners* [2006] EWHC 3272 (Ch).

15 *Secretary of State for Trade and Industry v Gill*; sub nom. *UNO Plc, Re and World of Leather Plc, Re* [2004] EWHC 933 (Ch).

16 *Secretary of State for Trade and Industry v Taylor* [1997] 1 W.L.R. 407, *Secretary of State for Trade and Industry v Creegan* [2001] EWCA Civ 1742.

17 Above fn.9.

18 *Dalton (A Bankrupt)*, Re [1962] 2 All E.R. 499.

19 *Worthington (Deceased)*, Re [1954] 1 All E.R. 677.

SPECIAL BRIEFINGS

DEATH OF THE SPHINX—CHAPTER 15 CLOSES US DOOR ON RECOGNITION OF OFFSHORE HEDGE FUND LIQUIDATIONS

Gabriel Moss Q.C.

 Keywords to Follow

Introduction

In “Mystery of the Sphinx—COMI in the US”,¹ I applauded the decision of Judge Drain in the *SPhinX* case² in refusing to grant c.15 recognition for Cayman liquidation proceedings which had an improper ulterior purpose. However, I was very critical of the reasoning, which did not appear to follow the criteria laid down in c.15.

In “Beyond the Sphinx—is Chapter 15 the Sole Gateway?”³ I returned to this theme, looking at other US cases on c.15 and suggested that there was a need in the United States, in addition to the application of c.15, to recognise a residual common law mode of assistance along the lines of the Privy Council case of *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings Plc*.⁴ The legislative history of c.15 suggested that it was designed to be the sole means of assisting foreign insolvency proceedings and I pointed out that without the use of a residual common law jurisdiction this would mean that insolvency proceedings in the case of many typical offshore operations would not be recognised in the United States. This would apply in particular to a case with facts like those in like *SPhinX*, but with a genuine need for assistance rather than an ulterior purpose.

I tried to describe the typical situation as follows:

“Case (1)

In Case (1), all the other connections are with the United States. Accordingly, Case (1) is similar to the SPhinX case,

except that we will assume that there is a proper purpose seeking judicial assistance in the United States, e.g. to collect assets for distribution in the Cayman liquidation. We will assume that no creditor or other relevant party wants to start a proceeding in the United States, even though COMI is in the United States, because of the additional expense and trouble and all of the creditors are content with Cayman insolvency law and distribution rules (which they thought they were contracting into. . .). Since neither COMI nor an ‘establishment’ exists in Cayman, no assistance under c.15 can be given in Case (1). If c.15 is the sole entry point, no assistance at all can be given and the liquidators are stuck. The creditors would have to suffer the additional time, trouble and expense of starting separate proceedings in the United States and then attempting to coordinate the US and Cayman proceedings. This would be a complete and unnecessary waste of time and resources, to the detriment of creditors. If I am right in thinking that there is, or should be found to be, a residual common law discretion in the US Federal Bankruptcy Courts to assist even outside c.15, along the lines of the Cambridge Gas & Navigator case, the unnecessary delay and expense would be avoided and the US court could simply give judicial assistance to the Cayman liquidator to collect the assets in the United States and distribute them in accordance with Cayman law.”

Bear Stearns High-Grade Structured Strategies Master Fund Ltd⁵

As a result of the recent turmoil in sub-prime lending and in the financial markets, two Cayman-registered Bear Stearns funds filed winding-up petitions in the Cayman islands and joint provisional liquidators appointed in Cayman applied for recognition under c.15 of the US Bankruptcy Code.

To summarise the case, this was once again a *SPhinX* or “Case (1)” type situation but without the obstacle of an improper ulterior purpose. In an entirely orthodox reading of the statutory provisions, Judge Lifland found that there was neither a centre of main interests (COMI)

nor an “establishment” in Cayman and therefore recognition was not possible under c.15.

This was very much as predicted in “Beyond the Sphinx—Is Chapter 15 the Sole Gateway?”. Unfortunately, no consideration appears to have been given to the use of a residual common law basis for recognition. However, Judge Lifland did point out that as a result of a drafting anomaly, the provisional liquidators in the unrecognised Cayman liquidation proceedings would be able to apply for the opening of main proceedings in the United States on behalf of the company. That option however involves precisely the waste of time and resources which using a residual common law basis for recognition would avoid.

Factual situation in the Bear Stearns case

The Bear Stearns funds were both Cayman Islands exempted limited liability companies with registered offices in the Cayman Islands. They invested in the types of securities which had come under suspicion in the recent financial crisis. The funds were administered by a Massachusetts corporation. The administrator did all the real work involved in running the funds. It kept the books and records. A New York corporation acted as investment manager for the funds. Assets other than investments were located in New York. The investor registers were held in Ireland by an affiliate of the administrator.

Accordingly, the only connection with Cayman was the nominal one of being registered there, together with the presence of auditors in Cayman.

In the first half of 2007, the funds suffered from the sub-prime lending crisis and this led to the filing of winding-up petitions in Cayman. On July 31, 2007, the Cayman Grand Court appointed provisional liquidators. The provisional liquidators applied for recognition under c.15 for the Cayman proceedings. Recognition was sought for the Cayman proceedings as a foreign main alternatively as a non-main proceeding. The provisional liquidators’ argument appeared to be that since there were no objectors and since the registered offices were in the Cayman Islands the US court should simply recognise the Cayman proceedings as main proceedings on the basis of the presumption that COMI was in the place of the registered office.

The ruling of Judge Lifland

Judge Lifland adopted an entirely orthodox and straightforward reading of the provisions of c.15.

First, he recognised that, contrary to the approach of one of his fellow judges in *Schefenacker Plc, Re*,⁶ recognition under c.15 had to be either recognition as a main proceeding, if the relevant criteria are met, or as a non-main proceeding if an “establishment” were found to exist in the relevant jurisdiction.

Secondly, Judge Lifland held that the provisional liquidators could not simply rely on the presumption based on the registered office combined with the lack of any objection. The judge was obliged to look at the facts and see if the statutory criteria applied.

On the basis of the provisional liquidator’s own pleadings, the companies’ COMI was in the United States and not in Cayman. The only connection with Cayman

was that the funds had their registered offices there. The situation was similar to the case of the “letterbox” companies mentioned by the European Court of Justice in the *Eurofood* case.⁷

Judge Lifland also noted that COMI was in the United States on the basis of the description of COMI in Recital 13 to the EC Regulation on Insolvency Proceedings (1346/2000) as being the place where the funds conducted the administration of their interest on a regular basis and which was therefore ascertainable by third parties.

Judge Lifland specifically, and it is submitted evidently correctly, refused to follow the dicta in the *SPhinX* case which had suggested that if the interested parties had not objected to the Cayman Islands proceeding being recognised as a main proceeding then recognition might have been granted, even without the statutory criteria being demonstrated.

Judge Lifland went on to find, again obviously correctly, that there is no basis for holding that the funds had an “establishment” in Cayman. He pointed out that it would be particularly difficult to find that there was an “establishment” given that the status of an “exempted” Cayman company was that it was prohibited, under Cayman Company Law, from engaging in business in the Cayman Islands except in furtherance of the business carried on outside the Cayman Islands.

On the evidence, no relevant non-transitory economic activity was conducted in the Cayman Islands. Once again, Judge Lifland refused to follow the result in *SPhinx*, although as I pointed out in “Mystery of the Sphinx—COMI in the US”, Judge Drain had not in that case explained how the facts as set out by him, which did not reveal any “establishment” as defined, gave him a basis for that finding.

The *SPhinX* case had gone up on appeal to the District Judge, whose judgment dealt only with the question of the ulterior purpose of the application and had upheld Judge Drain’s finding on that. The appellate judgment did not deal in any way with Judge Drain’s recognition of the Cayman proceedings as a non-main proceeding. It has to be remembered however that the ulterior purpose sought to be achieved in *SPhinX* required an automatic stay to come into effect and therefore could only be achieved by a recognition as a main proceeding: recognition as a non-main proceeding did not help the applicants and appeared merely to be a gesture of co-operation to the Cayman courts offered by Judge Drain. There appears to have been no argument on this point on the appeal. Judge Lifland was thus able to depart from both Judge Drain’s decision and the District Judge’s decision on the question of “establishment”, since neither court had dealt with the statutory requirements for finding an “establishment”.

The consolation prize

Having refused to recognise the Cayman proceedings either as main or non-main proceedings, Judge Lifland pointed out that, as a result of a legislative anomaly, when c.15 was brought in, s.303 of the Bankruptcy Code had not been repealed. Section 303(b)(4) of the Bankruptcy Code:

“specifically provides that an involuntary case may be commenced under Chapter No. 7 or No. 11 of the Bankruptcy Code by a foreign representative of the estate in a foreign proceeding so that a foreign representative “is not left remediless upon non-recognition.”

Judge Lifland further pointed out that s.303(b)(4) does not require the foreign proceeding to be recognised. To this could be added the saving in s.1509(f) of the Bankruptcy Code which provides that a failure of a foreign representative to obtain foreign recognition under c.15 did not affect any rights he might have to sue in a court in the United States to collect or recover a claim which is the property of the debtor.

As a result of the ability of the foreign representatives in unrecognised proceedings to file for bankruptcy proceedings in the United States, Judge Lifland continued the preliminary injunction for 30 days to give interested parties an opportunity to file a petition under c.7 or c.11 of the Bankruptcy Code. However if they did not do so, the injunction would lapse at the end of the 30 days.

An appeal has been lodged by the provisional liquidators against the decision, according to media reports.

Comment

The Bear Stearns case illustrates a typical problem which is particularly acute in the present financial crisis. Neither the provisional liquidators nor any creditor of the Bear Stearns’ funds appear to have any wish to create the further expense and complication of having separate main proceedings in the United States which would need to be co-ordinated with those in Cayman. However, by reason of an approach which regards c.15 as the sole gateway to recognition, the pragmatic common sense of the provisional liquidators and

creditors was completely thwarted. No argument appears to have been presented to Judge Lifland based on a residual common law ability to “recognise”, in reality to give judicial assistance to, foreign insolvency proceedings and thereby to avoid unnecessary expense, complication and potential conflict between jurisdictions.

Although Judge Lifland’s decision is faultless in terms of applying the criteria of c.15, it is very unfortunate that he appears to have been given no opportunity to consider the practical solution of following the Privy Council decision in *Cambridge & Navigator*, which would have enabled him to use US law remedies to assist the Cayman proceedings and to have avoided the expense delay and complication of US main proceedings which appear to have been desired by no one.

There are potentially many significant cases involving huge sums of money which fall within the *SPhinX* or “Case (1)” types of situation described above and yet, the US courts have not developed a satisfactory mode of assisting such foreign insolvency proceedings and to that extent have moved backwards from the great success of the predecessor to c.15, s.304.

Gabriel Moss Q.C. is Chairman of the Editorial Board of Insolvency Intelligence

1 (2007) 20 *Insolvency Intelligence* 4.

2 *SPhinX Ltd, Re* 351 B.R. 103 (Bankr. S.D.N.Y. 2006).

3 (2007) 20 *Insolvency Intelligence* 55.

4 [2006] 3 All E.R. 829; [2006] B.C.C. 962.


5 Judge Burton R. Lifland, United States Bankruptcy Court for the Southern District of New York, Amended Decision and Order, September 5, 2007.

6 Case No.07-11482, Order, pursuant to ss.105(a), 1507, 1517 and 1521 Recognising Company Voluntary Arrangement as Either Foreign Main Proceeding or Foreign Non-main Proceeding, Enforcing Company Voluntary Arrangement in the United States and Granting Other Appropriate Relief, dated June 14, 2007, ECF 81, and www.nysb.uscourts.gov.

7 *Eurofood IFSC Ltd, Re* [2006] E.C.R. I-3813; [2006] B.C.C. 397.

FUTURE CONTINGENT CLAIMS

Felicity Toube

 Keywords to Follow

Readers will no doubt be aware of the decision 18 months ago handed down by David Richards J. in one of the many *Federal Mogul* cases (*T&N Ltd, Re*).¹ The judge held that future asbestos claims were not provable contingent claims in a liquidation if the cause of action had not already accrued at the date of liquidation, but that they were admissible in a s.425 scheme or company voluntary agreement (CVA).

The reaction to the judgment was swift and decisive; an amendment to r.13.12 of the Insolvency Rules 1986 which made such claims provable if all the elements necessary to establish the cause of action exist at that date except for actionable damage. One year on from the coming into force of this amendment, it is worthwhile remembering why we needed it in the first place.

T&N: the facts

T&N had been engaged in the mining of asbestos for a number of years. Once the hazardous nature of asbestos became well known, the volume and scale of personal injury and other asbestos-related claims against T&N rose to the point where T&N faced liabilities on a massive scale. A large number of the Federal Mogul Group companies, including T&N, were therefore placed into administration.

Under a settlement agreement, T&N proposed that it would enter into CVAs which provided for the payment of specific amounts to certain creditors. It was essential that the CVAs would bind both present and future claimants. The administrators of T&N Ltd and other companies in the T&N group therefore applied to the court for directions in relation to certain issues arising in connection with a proposed scheme of arrangement and/or CVA.

The term “future asbestos claim” was defined in the administrators’ application to mean any personal injury claim against any of the T&N companies where:

- (1) the claimant was exposed to asbestos which could cause an asbestos-related disease or diseases;