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# Sector Focus

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## Chapter 15 update: all change or no change?

A recent decision by the Bankruptcy Court for the district of Delaware, to recognise the liquidation of a Cayman Islands company and grant relief to its liquidators, has been hailed by some commentators as a milestone in the development of Chapter 15 jurisprudence. However, a closer review of the case, *In re Saad Investments Financing Company (No 5) Limited*, reveals that the decision was a triumph of pragmatism over principle; while it will be good for business (certainly as far as insolvency practitioners and Delaware lawyers are concerned), it may be bad for jurisprudence and the promotion of certainty in this area of the law. In truth, both the circumstances and outcome of this Chapter 15 case do little more than underline the ongoing difficulties for foreign representatives from jurisdictions like the Cayman Islands who are in need of Chapter 15 relief – difficulties which ultimately must be resolved by legislative intervention and amendment.

### THE FACTS

The debtor ('SIFCO') was a privately-owned investment company incorporated in the Cayman Islands. SIFCO was a wholly-owned subsidiary of Saad Investments Company Limited ('SICL'), another Cayman company formed to hold investment assets on behalf of its beneficial owner Maan Al-Sanea, a Saudi national and chairman of the Saudi-based Saad Group of companies. According to the evidence filed on behalf of the petitioners, SIFCO's principal assets were 'a portfolio of 57 private equity vehicles and one hedge fund ('the Funds')'. The Funds were registered in several jurisdictions around the world, with some 38.7 per cent in value being registered in the Cayman Islands and 28.5 per cent in Delaware. As part of a financing agreement between SICL and Barclays Bank plc, SICL had transferred its interest in the Funds to SIFCO as in specie contributions for the issue of Class B shares to Barclays.

The Grand Court of the Cayman Islands ordered SIFCO to be wound up on the petition of Barclays and appointed official liquidators over it. Two months later, the liquidators filed a petition in the US Bankruptcy Court for the District of Delaware, seeking recognition of the Cayman liquidation under chapter 15 of the Bankruptcy Code (a) to protect SIFCO's assets in the USA from potential seizure or attachment by third parties in connection with a mass of litigation involving Mr Al-Sanea and the Saad Group of companies, and (b) to take advantage of the breathing spell provided by the automatic stay to evaluate SIFCO's investments in each of its US funds without triggering defaults under investment

agreements of certain funds by failing to satisfy capital calls made by the general partners of those funds.

### THE DECISION

It should be noted that the petition for recognition was unopposed, and no reasoned decision was delivered by the court. However, it is apparent from the transcript of proceedings that the court relied heavily on the petitioners' written submissions. One of their key arguments was that the relevant time for determining a debtor's COMI is the time that the Chapter 15 case is commenced, that 'the Court is to examine the COMI factors at they existed at the time of the filing the Chapter 15 petition, without reference to SIFCO's operational history'. This argument enabled the petitioners to rely on the following activities by the Cayman liquidators themselves in establishing that the company's COMI was the Cayman Islands: 'The management and administration of the Debtor is being conducted entirely by the Petitioners from the Petitioners' headquarters in the Cayman Islands'; 'No activity being conducted in respect of the management, administration or operations of the Debtor anywhere apart from the activities of the Petitioners in the Cayman Islands'; 'The Petitioners have obtained or are in the process of obtaining, electronic versions of all of the Debtor's financial records from SFS' [SFS being a Swiss company that provided investment management services to SIFCO].

Of course, these facts do not describe the 'administration of a debtor's business on a regular basis' (75 of the authoritative Virgos-Schmit Report), but the activities of office-holders pursuant to statutory powers and the consequences in law of a winding up order.

At the same time, the Petitioners downplayed (or ignored altogether) these adverse facts which militated against COMI being established in the Cayman Islands: SIFCO was an investment vehicle set up by Maan Al-Sanea, a Saudi national and chairman of the Saudi-based Saad Group of companies; SIFCO's directors were Mr Al-Sanea, his wife and a consultant to the Saad Group, all of whom were resident in Saudi Arabia or Bahrain; SIFCO's investment management services were provided by a Swiss company ('SFS'), which was subcontracted by its parent SICL (whose board of directors was similarly composed of Saudi or Bahraini residents). Over 60 per cent in value and 70 per cent in number of SIFCO's assets comprised shares in private equity vehicles and hedge funds registered in countries other than the Cayman Islands (28.5 per cent in value and 34 per cent in number were registered in Delaware).

The Delaware Court, in an *ex tempore* oral decision, concluded that

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### Biog box

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SIFCO's COMI was in the Cayman Islands, and that its liquidation should be recognised as a foreign main proceeding. The learned judge remarked that 'given the fact that this is an uncontested matter, I don't think I need to review for the record all the findings'.

### COMMENT

It should not be great news in itself that the liquidators of a Cayman Islands (or other 'offshore') company have obtained Chapter 15 recognition: such orders have continued to be made in qualifying cases since the launch of the Chapter 15 regime – for example, the liquidation of Lehman Re Ltd in Bermuda, which was recognised as a foreign main proceeding by the Southern District of New York in September 2009. Perhaps its apparent newsworthiness is a reflection of the fear cast into practitioners' minds by the New York court's decisions in 2008 regarding the *Bear Stearns* and *Basis Yield Alpha* cases, although in truth those related to a particular species of company, a hedge fund, which has peculiar structural and operational characteristics.

Nevertheless, the facts of this case had characteristics which, if presented differently and/or to a different court, may well have led to a different result. Certainly, the Delaware court declined to undertake a rigorous examination of the factual record or legal arguments, as the New York court had insisted in the *Bear Stearns* and *Basis Yield Alpha* cases, although the court did not go so far as to endorse the earlier approach taken in the *SPhinX* case (in which a lack of objection could qualify a proceeding for recognition by default). The result may be said to demonstrate a pragmatic and commercial approach by the Delaware court – supportive of that state's leading role in the offshore funds industry (where most of the onshore feeder funds for US investors are set up); whether cause or effect, it is likely to lead to flood of applications being made to that court. This appears to vindicate the writer's prediction of forum shopping by foreign representatives, and will reignite the debate as to whether or not forum shopping of this kind is in any event legitimate.

However, it is hard to overlook the analytical flaw in the Delaware court's decision to accept a 'bootstraps' argument which pointed to the activities of foreign representatives in order to establish the COMI of companies which they are in the process of winding up: taken to its logical (but absurd) conclusion, that reasoning would entitle every foreign representative who carries out his statutory functions in liquidating a company to obtain recognition as a foreign main proceeding, irrespective of what that company's COMI-relevant activities may have been prior to the liquidator's appointment. This would to all intents and purposes do away with the COMI test altogether, and would effectively turn the rebuttable presumption that a debtor's COMI is its place of incorporation into an irrebuttable presumption (since usually, if not always, the place of incorporation is also the jurisdiction which vests the foreign representatives with their powers to undertake functions in the name of or otherwise on behalf the debtor).

The petitioner's argument (untested by opposing counsel) was itself grounded on dubious reliance on a slender line of authorities (both US & UK) which addressed arguments about how much weight should be given to one or more changes in COMI during the operational lifetime of a debtor company. In that context, it should not be controversial (as

those cases hold) that 'the centre of main interests is to be determined in the light of the facts as they are at the relevant time for determination [ie the time of opening recognition proceedings]. But those facts include historical facts which have led to the position as it is at the time for determination'. At the same time, the court must guard against abuse, so that a debtor cannot not rely on acts it might take unilaterally to change its COMI between the date of the original winding up petition and the date when the liquidators' recognition application is heard, which may be a period of many months: there should be no distinction in principle between such manipulation by a debtor and by its liquidators.

### THE FUTURE?

This case is not a true precedent for hedge funds, as some commentators have suggested: as the facts noted above show, SIFCO was organised differently and for a different purpose. Recognition for hedge fund liquidations is likely to remain bedevilled by the Court of Appeal decision in *Bear Stearns* and the list of relevant factors laid down in the *Basis Yield Alpha* case.

The case may have set a precedent for seeking recognition in other jurisdictions which are perceived to be friendlier towards foreign representatives of collective and other investment vehicles which were incorporated offshore but did business or had assets in the USA. As a matter of principle, 'forum shopping' is undesirable in any case, to the extent that it generates inconsistent outcomes and conflicting judgments for similar cases. However, in the Chapter 15 context the position is worse: petitioners may now expect different results from different districts of the same federal bankruptcy court. This does not meet practitioners' need for consistency or certainty, and ultimately devalues the jurisprudence that emerges from each of the district courts – especially since the nature of Chapter 15 cases is such that relatively few go on appeal to a level where harmonising decisions can be made.

Against this background, the work of the US delegation to the UNCITRAL Working Group is to be commended: they are seeking to promote consistency of treatment and certainty of outcome in Chapter 15 cases, by proposing legislative amendments to the Bankruptcy Code which give clearer guidance to the courts when addressing the controversies and difficulties identified in recent recognition cases. The most obvious of these is the current absence of any definition of COMI in the Model Law: it is clear that the rebuttable presumption alternative has not been successful, creating more questions than it tried to answer. Finding a better solution will be high on the UNCITRAL Working Group's agenda in its 2010 sessions.

What Chapter 15 (and all cross-border insolvency legislation) needs is to strike an appropriate balance between on the one hand vesting courts with gatekeeper powers and discretion to do justice in individual cases, and on the other hand creating a predictable statutory regime for office-holders who are in need of foreign judicial assistance in the management of insolvent estates. It was thought that the former s 304 regime under the US Bankruptcy Code was too discretionary and hence unpredictable; the fact that foreign representatives in cases like *SIFCO* have had to resort to imaginative approaches, in order to get the right result for their estates, suggests that the pendulum has swung too far in the opposite direction. ■