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U.S. Bankruptcy Court Declines to Recognize Bear Stearns' Cayman Liquidation

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by [Karen Ostad](#), [Julie Dyas](#)

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Troubled offshore funds may have to become more creative in looking to protect their U.S. assets from creditors, if a controversial new bankruptcy court decision is upheld. A U.S. bankruptcy court in New York has declined to recognize the Cayman Islands liquidation proceedings filed by two Bear Stearns hedge funds whose Cayman liquidators had sought to protect against seizure of U.S. assets by filing petitions for protection under Chapter 15 of the Bankruptcy Code. Chapter 15 is a comparatively new addition to U.S. law, and the meaning and effect of that law are still being tested.

Ruling that the funds were limited liability companies formed under the Cayman Islands "exempted companies" laws and ran their businesses through New York, the U.S. bankruptcy court held that the Cayman proceedings were not eligible to be recognized as "foreign main proceedings" entitled to broad protections under Chapter 15. The court ruled that the Cayman proceedings were also not eligible to be recognized as "foreign non-main proceedings" entitled to less broad or automatic protections. Instead, the court said the Cayman court appointed liquidators of the funds could only file involuntary Chapter 11 petitions for the funds.

Bear Stearns High-Grade Structured Credit Strategies Master Fund, LTD. and Bear-Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund, LTD. filed highly publicized liquidation proceedings in the Cayman Islands on July 31, 2007, following severe devaluation of their sub-prime mortgage-based asset portfolios and High-Grade's inability to meet margin calls from many of its trade counterparties. The funds filed petitions for recognition of the foreign proceedings in the U.S. under Chapter 15 of the Bankruptcy Code at the time that they initiated the Cayman liquidation proceedings. The funds sought recognition from the U.S. bankruptcy court that the Cayman proceedings were the "foreign main proceedings" which are entitled to broad protections for their U.S.-based assets, including application of the automatic stay. In the alternative, the funds sought recognition for the Cayman liquidation as "foreign non-main proceedings," which are also entitled to broad protections at the discretion of the court.

In a controversial Opinion issued on August 30, 2007 by Bankruptcy Judge Burton R. Lifland, the court declined to recognize the funds' Cayman liquidation proceedings, whether as "foreign main" or "foreign non-main." Instead, Judge Lifland invited the funds' foreign representatives to commence an involuntary Chapter 11 proceeding, if protection for U.S. assets was desired. Judge Lifland held that a Cayman exempted company could not, under Cayman Law, have the requisite "center of main interest," or COMI, in the Caymans, as exempted companies must inherently transact business abroad. As for the Bear Stearns funds, Judge Lifland opined that the funds' COMI was likely in New York, despite registration in the Cayman Islands, as the funds' day-to-day operations and assets were New York-based. Without a COMI in the Cayman Islands, Judge Lifland declined to deem the Cayman liquidation proceedings as the funds' main proceeding.

Even more controversial and in a departure from a recent ruling of another bankruptcy judge, Judge Lifland also declined to extend "foreign non-main" status to the Cayman proceedings, finding that not only was there no COMI in the Cayman Islands, but that there was not even a legal "establishment" in the Caymans — a technical requirement for "foreign non-main" treatment. Judge Lifland did offer some temporary relief to the funds by extending the preliminary injunction staying litigation against

the funds and issuing other protections for their U.S.-based assets, for a period of 30 days. This relief affords the funds time to file an involuntary Chapter 11 petition, if desired, and to consider an appeal. Parties-in-interest have ten days to appeal the decision.

Judge Lifland's decision is likely to be viewed with some deference by other courts, given that Judge Lifland was a member of the United Nations Commission on International Trade Law ("UNCITRAL") committee which drafted the UNCITRAL Model Law on Cross-Border Insolvency, which Chapter 15 adopts. Judge Lifland noted that his decision is a departure from prior decisions, including *In re SPhinX*, in which "foreign main" status was denied, but "foreign non-main" status was granted to another group of Cayman-based funds which had filed for Chapter 15 relief.

The ruling states that denial of the Chapter 15 relief does not leave the funds without a U.S. remedy. The liquidators, as "foreign representatives" are eligible to file involuntary Chapter 11 petitions under Section 303(b)(4) of the Bankruptcy Code, which the court held preceded the adoption of Chapter 15 and operates separately from it. An involuntary Chapter 11 filing triggers an automatic stay and, if the filing is recognized, an order for relief is entered which treats the filing like a voluntary Chapter 11.

In addition, the court noted that the liquidators are free to commence other actions in U.S. courts which are not based on Chapter 15. One such action might be to seek comity from a U.S. court with respect to the Cayman liquidation proceedings and to seek an injunction of actions in the U.S. based on the argument that the Cayman proceedings (including the stay of suits against the fund) should be honored in the U.S. This is likely also to be controversial and, if successful, would be a more limited form of relief than what is available under Chapter 15. In any event, the decision reinforces the notion that offshore entities need to consider all of their options in structuring appropriate relief requested in the U.S.

[A pdf copy of Judge Lifland's decision is attached.](#)