

Business Track

Cross-Border Conundrums: How to Use Chapter 15 Effectively

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Chapter 15 Cases In 2011

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1. **In re Fairfield Sentry, Ltd.**, 458 B.R. 665 (S.D.N.Y. 2011)(Preska, C.J.)(Holding that claw-back lawsuits by BVI liquidators were non-core, reversing BK court order, and remanding to BK court to reconsider abstention request).
2. **In re Fairfield Sentry, Ltd.**, 2011 WL 4357421 (S.D.N.Y. 2011)(Daniels, J.)(Affirming foreign main recognition of Madoff feeder fund in holding that activities of foreign liquidators are relevant for COMI determination, activities around the time of the Chapter 15 petition is correct time for COMI determination, and sealing of large portions of foreign proceedings was not “manifestly contrary to public policy of the United States”).
3. **In re Ashapura Minechem, Ltd.**, 2011 WL 5855475 (Bankr. S.D. N.Y. 2011)(Peck, J.)(Court granted foreign main recognition to Indian administrative proceeding despite public policy argument regarding repeal of underlying Indian statute, limited participation by unsecured creditors in Indian proceeding, and allegations of conflicts of interest.)
4. **In re Qimonda, AG**, 2011 WL 5149831 (Bankr. E.D. Va. 2011)(Mitchell, J.)(Allowing rejection of U.S. patent license by foreign representative of German insolvency proceeding without protections of Section 365(n) would be “manifestly contrary to the public policy of the United States” under Section 1506).
5. **In re Loy**, 2011 WL 5118458 (Bankr. E.D.Va. 2011)(Santoro, J.)(Summary judgment denied to foreign representative in lawsuit versus debtor, spouse of debtor, and Chapter 7 trustee of debtor’s estate regarding sale of real property and avoidance of transfer).
6. **In re ABC Learning Centres, Limited**, 2011 WL 4899789 (Bankr. D. Del. 2011)(Gross, J.)(Finding violation of automatic stay imposed after Chapter 15 recognition granted).

7. **In re Daewoo Logistics Corp.**, 2011 WL 4706197 (Bankr. S.D.N.Y. 2011)(Lifland, J.)(Automatic stay imposed by Chapter 15 recognition ends when foreign proceeding closes. Action filed after closure of foreign proceedings for conduct after such closure is not stayed).
8. **In re Millennium Global Emerging Credit Master Fund Limited**, 458 B.R. 63 (Bankr. S.D.N.Y. 2011)(Gropper, J.)(Holding that (a) COMI and “establishment” determinations are as of the date of the commencement of the foreign proceeding not the Chapter 15 proceeding, (b) COMI of hedge fund was Bermuda despite fund manager in Guernsey, London-based investment manager, and no creditors or investors in Bermuda because only Bermuda was reasonably ascertainable by third parties).
9. **In re Glitner Banki HF**, 2011 WL 3652764 (Bankr. S.D.N.Y. 2011)(Bernstein, J.)(Discovery authorized under 1521(a)(4) less broad than FRBP 2004)
10. **In re Sivec**, 2011 WL 3651250 (Bankr. E.D. Okl. 2011)(Cornish, J.)(Foreign main recognition given to Italian proceeding but stay relief given to U.S. creditor to continue litigation in U.S. where creditor asserted right of set-off not protected in Italian proceeding.)
11. **In re Awal Bank**, 455 B.R. 73 (Bankr. S.D.N.Y. 2011)(Gropper, J.)(Foreign representative of Bahrain foreign proceeding may bring 553(b) set off claim under Chapter 15, may bring 553(b) set off claim under Chapter 11 case commenced after recognition with look-back period from date of Chapter 15 petition, and may omit disclosing individual creditor information in Chapter 11 schedules).
12. **In re Toft**, 453 B.R. 186 (Bankr. S.D.N.Y. 2011)(Gropper, J.)(Public policy exception prevented foreign representative from obtaining mail intercept and wire-tap of U.S.-based ISPs where debtor’s e-mail are stored despite similar relief available under German and English law).
13. **In re Loy**, 2011 WL 2619253 (Bankr. E.D. Va. 2011)(Santoro, J.)(Leave to appeal not given to debtor in conjunction with order denying without prejudice motion to revoke foreign main recognition where debtor claimed COMI in the U.S. but intended and did move to France during pendency of Chapter 15 proceedings).
14. **In re SNP Boat Service SA**, 453 B.R. 446 (Bankr. S.D. Fla. 2011)(Olson, J.)(Court denied French foreign representative’s motion for protective order based on French blocking statute, granted motion by creditor regarding discovery, and advised that recognition of French proceedings might be revoked if discovery is not provided by foreign representatives).
15. **In re Vitro SAB de CV**, 455 B.R. 571 (Bankr. N.D. Tex. 2011)(Hale, J.)(Under Section 1519, Court granted injunction in favor of debtor during pre-recognition gap-period but refused to extend such injunction to non-debtor subsidiaries who are guarantors)

16. **In re Sivec**, 2011 WL 2445754 (Bankr. E.D. Okl. 2011)(Cornish, J.)(Court granted provision relief of automatic stay under Section 1519 thereby staying pending district court lawsuit).
17. **In re Fairfield Sentry Limited**, 452 B.R. 64 (Bankr. S.D.N.Y. 2011)(Lifland, J.)(Court held avoidance actions under BVI law were core proceedings and refusing to abstain), reversed **In re Fairfield Sentry, Ltd.**, 458 B.R. 665 (S.D.N.Y. 2011)(Preska, C.J.).
18. **In re Fairfield Sentry Limited**, 452 B.R. 52 (Bankr. S.D.N.Y. 2011)(Lifland, J.)(Section 108's tolling provisions applied in Chapter 15 case with date of recognition being the "order for relief").
19. **In re Loy**, 448 B.R. 420 (Bankr. E.D.Va. 2011)(Santoro, J.)(Court denied motion to revoke recognition of English proceedings without prejudice and held such motion was not barred by laches).

BVI, Cayman and Bermuda: Cross-border cases 2011

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In the area of cross-border insolvencies, a number of interesting and important decisions came out of BVI's Commercial Court and the Court of Appeal in 2011. Before summarising these however, it is worth making mention of the Commercial Court decision on recognition in late 2010.

1. In *Picard v. Bernard L Madoff Investment Securities LLC* (BVIHCV 140 of 2010), the Commercial Court considered an application by the New York appointed trustee for recognition in BVI. The application was made pursuant to Part XIX of the BVI Insolvency Act 2003. Bannister J refused the application. He noted that cross-border insolvency matters are dealt with in Part XVIII and Part XIX of the Act. Part XVIII is an enactment of the UNCITRAL code, but is not currently in force. Part XIX allows a foreign representative from a 'relevant' country to seek the assistance of the BVI court (the United States being a relevant country for these purposes). Bannister J held that the two parts were mutually exclusive and therefore while Part XVIII was not in force, foreign representatives are confined to Part XIX. As such, the common law concept of recognition has no place under BVI legislation.

2. In a judgment given on 21 September 2011 in *Fairfield Sentry Limited (In Liquidation) v Bank Julius Baer & Co. Ltd and 33 Others* (BVIHCV2010/030) the Commercial Court decided that an investor or former investor in a fund, that has surrendered its shares on redemption, has a good defence to a claim to claw back redemption payments on the basis that they were made under a mistake.

In his judgment dated 20 April 2011 Mr Justice Bannister in the Commercial Court in BVI directed a trial of four preliminary issues, which may be summarised as follows:

1. Whether any, and if so which, of a number of documents provided by Fairfield to its investors was a certificate within the meaning of Article 11(1) of the Articles of Association of Fairfield.
2. If so, whether any was a certificate as to the Net Asset Value per share or as to Redemption Price within the Articles.
3. If so, whether provision of such certificate to a redeeming or redeemed member precluded Fairfield from asserting that money paid exceeded the true Redemption Price.
4. Whether a redeeming member, in surrendering its shares, gave good consideration for the payment of the Redemption Price.

On the Article 11 point the defendants identified a number of documents that they argued were certificates, including contract notes, monthly account statements and e-mails.

Mr Justice Bannister found that none of the documents delivered by Fairfield to its investors were certificates of the directors within Article 11(1), not least because none of the documents were given or signed by (or on behalf of) the directors. Rather, he thought they were documents issued by Fairfield itself.

In light of this finding and the way the issues were formulated, Mr Justice Bannister did not need to deal with issues 2 and 3.

In his decision on issue 4, Mr Justice Bannister stated that the redemption of shares was a bargain and sale for which the consideration received by Sentry was the surrender of the rights of the redeeming shareholder. He did not consider that the bargain could be vitiated by the discovery of the fact that BLMIS was a Ponzi scheme. He said that he could also not understand how Sentry could recover the redemption price in circumstances where *restitutio in integrum* was no longer possible.

Mr Justice Bannister accepted that *Aiken v Short* (1856) 1 H&N 210 and *Barclays Bank Ltd v WJ Simms Son & Cooke Southern Ltd* [1980] QBD 677 were authority for the proposition that a party will not be able to recover payment made by mistake where the payer has received consideration from the payee. He therefore held that it was not open to Fairfield to seek to recover the price it paid for the purchase of the shares of redeeming investors simply because it calculated the NAV upon information which had subsequently proved unreliable for reasons unconnected with any of the redeemers.

As a result, one representative defendant applied for summary judgment. The liquidators of Fairfield argued that the decision on preliminary issue 4 did not entitle the defendants to judgment. In particular they sought to argue that they were able to continue their claim that Fairfield was entitled to set aside the redemptions on the ground that the payment of the redemption monies was effected under a mutual mistake.

In a further judgment given on 10 October 2011 Mr Justice Bannister found that the mutual mistake point remained open to Fairfield and was not determined by his decision on the second preliminary issue, which did not consider whether the redemption contracts were void. Nevertheless, applying the principle in *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2003] QBD 679, he went on to give judgment to the defendants on the basis that there was not a relevant mutual mistake. The question to be asked was whether the fact, contrary to the assumed understanding of both parties, that BLMIS was a Ponzi scheme meant that Sentry was unable to perform the contract which arose when a redemption notice was served in accordance with its Articles of Association. He did not consider performance to be impossible. He therefore concluded that Sentry was bound to fail on its claims as formulated.

Mr Justice Bannister also refused an attempt by the liquidators to adjourn the summary judgment application on the basis that further evidence might come to light showing that particular redeemers did not receive redemption monies in good faith.

The judgments have been appealed to the Court of Appeal.

3. Claims seeking to claw back redemption proceeds also came before the Commercial Court in *Marty Steinberg and Others v Banque de Patrimoines Prives Geneve et al* (BVIHCV 2009/0253). The issue before the court was whether to set aside service of the Claim Form out of the jurisdiction on two defendants and whether to set aside an extension of time for service of the Claim Form. Both the order giving permission for service and the order extending time for service were set aside and the Statement of Claim was struck out. First, it was found that no ground for service out was made out because the claim for restitution was not a claim made “to enforce, rescind, dissolve or otherwise affect a contract” within CPR 7.3(3) as it then was. Secondly, it was found that the claimants had failed to establish that they had a good cause of action as the claim was made more than six years after the relevant payments were made. The court rejected the claimants’ attempt to rely on Section 25 of the Limitation Ordinance which provides that in an action for relief from the consequences of a mistake the period of limitation shall not run until the plaintiff has discovered the mistake or could with reasonable diligence have discovered it. In particular, the court did not accept that the directors of the fund could not with reasonable diligence have correctly calculated the NAV, in circumstances where they in fact claimed to have been misled by the dishonesty of the fund’s own agent. Thirdly, and lastly, the court found that the claimants had failed to give any reason for needing to extend time for service of the Claim Form on the applicant defendants.

4. In *Westford Special Situations Fund v. Barfield Nominees Limited and Another* (HCVAP 2010/014), the Commercial Court had made a winding-up order on the application of members seeking unpaid redemption proceeds on the basis that they were creditors and their claims were not barred by Section 197, which provides that a member or past member cannot claim in a liquidation for a sum due to him in his character as a member. The Court of Appeal gave judgment on 28 March 2011. The Court of Appeal decided that a redeeming investor does not become a creditor for the purposes of the Insolvency Act, by reason of Section 197. As such the redeeming investor did not have standing to apply as a creditor for the appointment of liquidators to the fund.

Cayman Islands

1. *Re AJW Master Fund II, Ltd*¹

This was an application by liquidators of an offshore feeder fund to replace the liquidators of the master fund.

The offshore feeder fund had been put into official liquidation on an investor's petition. Days prior to the hearing of the offshore feeder winding-up petition, management had put the master fund into voluntary liquidation. The master liquidators applied for a Court supervision order which was granted on paper the day before the hearing of the feeder winding-up petition.

The judge who determined the master liquidators' application for Court supervision, Quin J, was told that the hearing of the offshore feeder winding-up petition had "no bearing" on the supervision application. Henderson J, the judge who heard the offshore feeder winding-up petition, was not aware of the supervision order which had been made at master level the day before. Henderson J held that the practitioners who had been appointed as liquidators at master level were conflicted, and appointed liquidators from a different firm. This had the unfortunate result that different liquidators were appointed at master and feeder level.

The liquidators of the offshore feeder fund then applied for the removal of the master liquidators on the basis that there should be one set of liquidators appointed to both funds, that the master liquidators were conflicted and that investors had expressed concerns about their relationship with former management (which was under investigation by the SEC), as well as the timing of their appointment.

¹ Unreported, judgment dated 30 May 2011, Jones J

Jones J removed the master liquidators and made the following observations:

1. Best practice is for the same liquidators to be appointed at both master fund and feeder fund level where both funds are the subject of insolvency proceedings.
2. Best practice is to assign the cases to the same judge.
3. The process by which a voluntary liquidation can be converted to an official liquidation “on the papers” is analogous to an *ex parte* application, which means the applicant has an obligation of full and frank disclosure;
4. In a master-feeder structure, investors in both offshore and onshore feeder funds will be treated as having a direct interest in the master fund, even though they are not directly members of the master fund. These investors will have standing to apply to set aside an improperly obtained supervision order, and also to appear and be heard on the hearing of the petition to wind up the master fund notwithstanding the fact that they are neither creditors nor contributories of the master fund.

2. *Weaving Macro Fixed Income Fund Limited v Stefan Peterson and Hans Ekstrom*²

In this case, the Grand Court found a fund’s independent directors guilty of wilful default in the discharge of their duties, and ordered them to pay damages to the fund’s liquidators in the sum of US\$111 million, representing the losses suffered

² Unreported, judgment dated 26 August 2011, Jones J

by the fund which were caused by their default .

The facts were extreme: the directors in question were the brother-in-law and stepfather of the investment manager, and had been appointed by him to meet minimum legal requirements. During their tenure they failed to exercise any independent supervisory function and failed to spot fraudulent activity by the investment manager. The Court held that, since investment management, administration and accounting functions are delegated to professional service providers, hedge fund directors must exercise a high level supervisory role. Because these directors knew that they had a duty to supervise, and had intentionally neglected their duties, the directors were found guilty of wilful default and were therefore not entitled to the benefit of exculpatory provisions contained in the Company's Articles of Association.

The judgment contains the first detailed judicial commentary on the obligations of a fund director during the life cycle of a fund (establishment; ordinary course of business; financial crisis and liquidation). It is however subject to appeal, which is scheduled to be heard in April 2012.

Bermuda

1. *Founding Partners Global Fund* [2011] SC (Bda) 19 Com (8 April 2011)

A Cayman incorporated insolvent fund with Cayman court-appointed liquidators had assets based in a Bermuda bank account. The Bermuda Court was asked to consider whether the US appointed Receiver (and receivership) could be recognised as the main insolvency proceeding and not the joint liquidators for the purpose of taking control of the Bermuda based assets. The Court was asked to recognise the United States as the center of main interests (COMI) for the fund and the receivership as the main insolvency proceedings. The Court rejected the Receiver's application and recognised the Receiver's appointment only to the extent that for the purposes of US law he had been duly appointed and authorised to collect the assets of the Company located in the US. The Court was not prepared to go so far as to recognise the US Receiver as the representative of the Company for all purposes, including exercising control over the company's assets.

2. *PwC v. Kingate Global Fund* [2011] CA (Bda) 6 Civ (16 March 2011)/ *PwC v. Kingate Global Fund, Ltd*, [2011] CA (Bda) 11 Civ (17 June 2011)

The Bermuda Supreme Court, Commercial Division delivered two decisions in 2011 concerning the Court's jurisdiction to wind-up foreign companies and/or afford recognition to liquidators of foreign companies.

There were two Kingate mutual funds, ("the Kingate Funds") which were incorporated in the British Virgin Islands (BVI). PwC in Bermuda acted as auditors of the Kingate Funds.

The Kingate Funds were Madoff feeder funds. Upon discovery of Madoff's fraud, the Kingate Funds were put into liquidation by the BVI court and BVI liquidators were appointed by the BVI court. The liquidators of the BVI funds sought disclosure of PwC's audit work papers which were protected from disclosure under the terms of engagement between PwC and the Kingate Funds. Under section 195 of the Bermuda Companies Act, a liquidator of a Bermuda company could apply to Court for disclosure of PwC's work papers.

The BVI liquidators obtained a winding up order of the Kingate Funds from the Bermuda Court and the Bermuda Court appointed liquidators of the Kingate Funds. The Bermuda appointed liquidators of the Kingate Funds applied under Section 195 of the Companies Act for copies of PwC's audit work papers.

PwC opposed the Bermuda appointed liquidators application on the grounds that the Bermuda Court did not have jurisdiction to wind-up a foreign company.

The Bermuda Court ruled that PwC's objections on jurisdiction grounds amounted to an impermissible collateral attack on the winding-up order and allowed the Bermuda appointed liquidators' disclosure application. In the alternative, the Bermuda Court ruled that it did have jurisdiction to wind-up a foreign mutual fund that had administrative or accounting services provided in Bermuda. The Court, also, ruled that it had a jurisdiction to wind up an overseas company that did business in Bermuda through an agent under the External Companies (Jurisdiction in Actions) Act 1885.

PwC appealed the above decision to the Bermuda Court of Appeal. Pending that appeal, the BVI Liquidators applied to the Bermuda Court to obtain recognition of their office as liquidators in Bermuda and to obtain disclosure of PwC's work papers on the strength of the Bermuda's Court recognition.

The Supreme Court ruled on the recognition application that if it transpired on appeal that the Bermuda Court did not have jurisdiction to wind-up the Kingate Funds, it would not have jurisdiction to order disclosure of the PwC work papers as it would not recognize foreign liquidators to that extent. Those decisions went to the Bermuda Court of Appeal which upheld only the procedural ruling on PwC's application being a collateral attack on the winding up order. The important issues regarding the Bermuda Court's jurisdiction in respect of foreign liquidators is, therefore, yet to be resolved at appellate level.

PwC have applied to the Privy Council for leave to appeal the Court of Appeal's decision. That appeal application is pending.