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ARTICLE

US Court and Cayman Islands Court: Sharing Jurisdiction in the Interests of Comity

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In *re: Soundview Elite, Ltd., et al., Debtors* (Case No. 13-13098 (REG)) the United States Bankruptcy Court Southern District of New York had to consider, among other things, the question of whether the automatic stay under the United States Bankruptcy Code (the 'Code') applied in the case of three affiliated Cayman Islands domiciled investment funds (the 'Cayman funds') managed by an affiliate of New York based fund manager, Fletcher Asset Management Inc. The Cayman funds were placed into liquidation in the Cayman Islands on the same day that they filed bankruptcy proceedings under Chapter 11 of the Code ('Chapter 11') in New York.

Background

The Cayman funds were registered with and regulated by the Cayman Islands Monetary Authority ('CIMA'). Winding up petitions (the 'Cayman Petitions') were filed against the Cayman funds in the Grand Court of the Cayman Islands in August 2013 by investor members of the Cayman funds (the 'Redeemers'). The Redeemers asserted, among other things, that pursuant to section 92(d) of the Cayman Islands Companies Law, the Cayman funds were unable to pay their debts (which were in the nature of unpaid redemption amounts). A hearing of the Cayman Petitions in the Grand Court of the Cayman Islands was scheduled for later in the year (the 'Hearing Date'). On the Hearing Date but, crucially, before the time of the scheduled hearing before the Grand Court, the Cayman funds filed bankruptcy proceedings under Chapter 11 in New York. The Judge in the Grand Court hearing was informed that the filing of the Chapter 11 petitions had happened earlier that same day but appeared to have been given little knowledge of the details of the Chapter 11 filings. The Judge in the Grand Court hearing ordered the winding up of the Cayman funds and the appointment of Joint Official Liquidators ('JOLs') with respect to each of the Cayman funds. The Cayman Petitions were supported by CIMA.

Accordingly, the JOLs had been appointed over the affairs of the Cayman funds in the Cayman Islands whilst under the Chapter 11 proceedings in New York each of the Cayman funds remained in control of its business operations as a debtor in possession subject to the oversight and jurisdiction of the New York Court. Effectively the incumbent board of directors of each of the Cayman funds was still in charge of the relevant Cayman fund's affairs as far as US federal bankruptcy law was concerned. The JOLs filed motions in New York to dismiss the Chapter 11 proceedings in favour of liquidation proceedings in the Cayman Islands.

Analysis

Under section 362 of the Code, immediately upon the filing of the Cayman funds' Chapter 11 petitions an automatic stay of proceedings against the Cayman funds became effective. The United States Bankruptcy Judge (the 'US Judge') in the Chapter 11 proceedings was tasked with dealing 'with the overlapping, and in some respects conflicting, jurisdiction of the U.S. and Cayman Courts, with due regard for the comity that each court should provide the other'.[1] The US Judge had to determine, among other things, if the Chapter 11 filings by the Cayman funds were commenced validly and whether or not the automatic stay under section 362 of the Code applied in this case. The JOLs had filed a motion for the US Judge to grant relief from the stay in order to allow the Cayman liquidation proceedings to go ahead.

The US Judge held that: the automatic stay under section 362 of the Code became effective immediately upon the filing of the Chapter 11 petitions by the Cayman funds both in the United States 'and extraterritorially'[2] and therefore 'the further proceedings in the

Notes

1 Bench Decision of United States Bankruptcy Judge, Robert E. Gerber, on Motions to dismiss, for relief from Stay, For Appointment of Trustee, and on Sanctions for Contempt – Case No. 13-13098 (REG), p. 5.

2 Bench Decision of United States Bankruptcy Judge, Robert E. Gerber, on Motions to dismiss, for relief from Stay, For Appointment of Trustee, and on Sanctions for Contempt – Case No. 13-13098 (REG), p. 20.

Cayman Court were, from the perspective of U.S. law, in violation of the stay and thus void.'[3]

Section 97(1) of the Cayman Islands Companies Law also contains an automatic stay of proceedings when a winding up order is made by the Grand Court (rather than when a winding-up petition is filed with the Grand Court) or a provisional liquidator is appointed. This explains why, even though the Cayman Petitions had been filed with the Grand Court weeks before the Chapter 11 filings were made, crucially, at time that the Chapter 11 petitions were filed in New York, the Grand Court had not yet made winding orders with respect to each of the Cayman funds. The winding up orders were issued on the same day that the Chapter 11 petitions were filed but later in the day and so the US automatic stay pre-dated the Cayman automatic stay.

Bad faith

At the subsequent hearing of the motion to dismiss the Chapter 11 petitions before the US Judge in New York, the JOLs contended that bad faith was present in the Cayman funds' Chapter 11 filings and this, among other things, constituted the cause necessary to dismiss the Cayman funds' cases pursuant to section 1112(b) of the Code. The JOLs contended, among other things, that the Cayman funds had filed the 'Chapter 11 petitions to take advantage of the automatic stay'.[4] The JOLs pointed to the fact that the Chapter 11 petitions were filed only an hour or so prior to the hearing of the Cayman Petitions before the Grand Court, with the intention, the JOLs claimed, to 'block the imminent appointment of the liquidators in the Cayman Islands.'[5]

The US Judge agreed with the JOLs that that had indeed been the Cayman funds' intention but stated that 'these facts, in the absence of more, are insufficient ... to find either bad faith or unenumerated cause.'[6] The US Bankruptcy Judge held that the Cayman funds' Chapter 11 filings 'had a valid business purpose, and were not in bad faith.'[7]

Exercise of regulatory power by CIMA

The JOLs argued before the US Judge that CIMA's support of the Cayman Petitions was sufficient to trigger the exception to the automatic stay under the '*police power*' exception in section 362(b)(4) of the Code which states:

> 'The filing of a petition under section 301 ... of this title ... does not operate as a stay – ... of the commencement or continuation of an action or proceeding by a governmental unit ..., to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power;'

Several issues arose from the JOLs' arguments before the US Judge:

(i) Did CIMA's support of the Cayman Petitions amount to CIMA enforcing its regulatory powers over the Cayman funds? The US Judge held that CIMA's support of the Cayman Petitions filed by the Redeemers was not sufficient to trigger the exception to the automatic stay under the 'police power' exception of section 362(b)(4) of the Code. Interestingly, the US Judge intimated that his decision may have been different if the Cayman Petitions had actually been presented by CIMA pursuant to CIMA's statutory powers under the Cayman Islands Mutual Funds Law (As Revised) to petition for the winding up of regulated mutual funds. The US Judge stated as follows:

> 'I must reject the JOLs' argument that CIMA's support of an insolvency petition commenced by parties acting in their private interests was sufficient to trigger the exception to the automatic stay under the "police power" exception of section 362(b)(4). One need not get immersed into the "pecuniary purpose" or "public policy" tests of what constitutes the exercise of the "police power" by a governmental entity, because more fundamentally, CIMA did not "commence[] or continu[e]" anything. While it is at least possible that if CIMA had done so, my conclusion would be different, CIMA's participation in proceedings initiated by private parties did not amount to "the commencement or continuation of an action or proceeding by a governmental unit" as required by section 362(b)(4).'[8]

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3 *Ibid.*
4 Bench Decision of United States Bankruptcy Judge, Robert E. Gerber, on Motions to dismiss, for relief from Stay, For Appointment of Trustee, and on Sanctions for Contempt – Case No. 13-13098 (REG), p. 12.
5 *Ibid.*
6 *Ibid.*
7 Bench Decision of United States Bankruptcy Judge, Robert E. Gerber, on Motions to dismiss, for relief from Stay, For Appointment of Trustee, and on Sanctions for Contempt – Case No. 13-13098 (REG), p. 13.
8 Bench Decision of United States Bankruptcy Judge, Robert E. Gerber, on Motions to dismiss, for relief from Stay, For Appointment of Trustee, and on Sanctions for Contempt – Case No. 13-13098 (REG), p. 13.

(ii) Could CIMA subsequently exercise its regulatory power or authority under section 30(3)(e) of the Mutual Funds Law (As Revised) to appoint a controller over the assets and affairs of each of the Cayman funds *after* the JOLs had been appointed by the Grand Court? If yes, then it might have been possible that such action could trigger the 'police power' exception under section 362(b)(4) of the Code as the 'commencement or continuation of an action or proceeding' by CIMA to enforce its regulatory powers.

The Cayman funds presented expert evidence to the US Judge to support their contention that for a number of reasons a controller could not be appointed by CIMA pursuant to its powers under section 30(3)(e) of the Cayman Islands Mutual Funds Law, *after* the Cayman funds were in liquidation under Cayman law and *after* the JOLs had been appointed.

Legal consequence of a winding up order

The Cayman funds argued that (i) the making of the winding up order under Cayman Islands law and (ii) the distribution of the assets to those entitled to them are (based on a long line of case law authorities from England and Wales (which are of persuasive authority before the Cayman Islands courts), e.g. *Re Humber Ironworks and Shipbuilding Co* (1869) LR 4CH p 643 and *Wight v Eckhardt Marine GMBH* [2004] 1 AC 147) to be treated as notionally simultaneous.

Statutory trust

The Cayman funds also argued that the making of the winding up order under Cayman Islands law (based on a long line of case law authorities from England and Wales (which are of persuasive authority before the Cayman Islands courts), e.g. *Buschler v Talbot* [2004] 2 AC 298. and *Ayerst (Inspector of Taxes) v C&K Construction Ltd* [1976] AC 167, imposed a statutory trust over all the assets of each Cayman fund thereby making it impossible for any controller to exercise any function in respect of the Cayman fund or its assets once JOLs have been appointed.

The concept of the imposition of a statutory scheme was explained by Lord Hoffman in the case of *Buschler v Talbot* [2004] 2 AC 298.

> 'The winding up of a company is a form of collective execution by all its creditors against all its available assets. The resolution or order for winding up divests the company of the beneficial interest in its assets. They become a fund which the company thereafter holds in trust to discharge its liabilities: *Ayerst v C&K (Construction) Ltd*. it is a special kind of trust because neither the creditors nor anyone else has a proprietary beneficial interest in the fund. The creditors have only a right to have the assets administered by the liquidator in accordance with the provisions of the [legislation].'

The Cayman funds argued that when Lord Hoffman referred to the company holding its assets on trust to discharge its liabilities, he meant, in a compulsory liquidation, the JOLs, holding the assets of each Cayman fund on trust for the relevant Cayman fund as the only persons entitled to administer them. Each of the Cayman funds as a legal entity continues to exist until the end of the liquidation process when it is dissolved, but all its assets are held legally on its behalf by the JOLs on statutory trust for the creditors and investors.

The Cayman funds argued that since under Cayman Islands law on the making of a winding up order by the Grand Court, each of the Cayman funds is:

(a) divested of all beneficial interest in its assets; and

(b) all such assets are notionally distributed to the creditors and shareholders entitled to them (in accordance with the statutory scheme contained in Part V of the Companies Law) at the very moment the winding up order is made (with the JOLs empowered to administer such assets until actual distribution takes place),

there could be no available assets after the making of a winding up order (i.e. which would not be caught by the statutory scheme under Part V of the Companies Law) over which a controller could assume control and administer in the best interests of the investors and creditors.

This line of argument before the US Judge was not disputed by counsel for the JOLs and accordingly the US Judge did not need to address the issue of whether CIMA could have appointed a controller after the JOLs had been appointed.

The US Judge held that actions in the Grand Court after the Chapter 11 filings by the Cayman funds, including the appointment of the JOLs, were 'from the perspective of U.S. law, void.' Notwithstanding this however, the US Judge granted relief from the US automatic stay and ratified 'otherwise void acts in the Cayman Islands',[9] having due regard for the comity that the New York court and the Grand Court 'should provide the other.' The US Judge took into account (i) the fact that both the Grand Court and the New York court

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9 Bench Decision of United States Bankruptcy Judge, Robert E. Gerber, on Motions to dismiss, for relief from Stay, For Appointment of Trustee, and on Sanctions for Contempt – Case No. 13-13098 (REG), p. 28.

were of the view that independent fiduciaries should take control of the Cayman funds in place of the Cayman funds' respective board of directors, and (ii) that the needs and concerns of the Cayman funds' stakeholders (and CIMA to the extent that it had any further responsibilities with regard to the Cayman funds) are paramount. The US Judge held that the liquidation proceedings in the Cayman Islands should continue, the JOLs should remain in place, but a Chapter 11 trustee should be appointed, and upon the appointment of the Chapter 11 trustee, an international protocol (which is provided for under Order 21 of the Companies Winding Up Rules of the Cayman Islands) is to be worked out between the Chapter 11 trustee and the JOLs, subject to the approval of the Grand Court and the New York court to provide for the division of responsibilities between the JOLs and the Chapter 11 trustee.

Conclusion

There have been recent examples of the Cayman Islands courts being keen to promote comity in cross border insolvency proceedings (e.g. *Irving H Picard and Bernard L Madoff Investment Securities LLC v Primeo Fund (In Liquidation)*.[10] The *Soundview Elite, Ltd.* case is another good example of the willingness of the US courts to share jurisdiction in the interests of comity in cross border insolvency cases. The US Judge stated the position as follows:

> 'It's my desire, as a U.S. bankruptcy judge, to render comity to Cayman needs and concerns to the extent I can, and I'm confident that the Cayman Court, now that it knows my needs and concerns, would do the same for me. That's especially so since we share common goals – maximizing value for stakeholders in the cases on our watch; ensuring the faithful performance of corporate responsibilities in those cases (and appointing independent fiduciaries when necessary); and, to the extent applicable, recognizing regulatory needs and concerns.
>
> Because I'm willing to share my jurisdiction in the interests of comity, and I suspect that the Cayman Court would do the same, I don't think it's necessary to decide what I would do if the situation were otherwise.
>
> Ultimately the best course is for a comity driven approach under which each court cedes any applicable primacy to the other, by relief from the stay, which each nation's law authorizes its judges to grant.'[11]

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10 CICA 1/2013 and 2/2013, Unreported Judgment

11 Bench Decision of United States Bankruptcy Judge, Robert E. Gerber, on Motions to dismiss, for relief from Stay, For Appointment of Trustee, and on Sanctions for Contempt – Case No. 13-13098 (REG), pp. 32-33.

International Corporate Rescue

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