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Bear Stearns High-Grade Structured
Credit Strategies Master Fund Ltd. and
Bear Stearns High-Grade Structured
Credit Strategies Enhanced Leverage
Master Fund, Ltd.

Decision by the Bankruptcy Court on 5
September 2007, affirmed on appeal by
the District Court, 22 May 2008

Case Study Series - 3

Acknowledgement

INSOL is pleased to present the third case study in this series on the controversial case of Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd. (In Provisional Liquidation) ("High-Grade Fund") and Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd. (In Provisional Liquidation) ("Enhanced Fund").

The liquidators of the Bear Stearns Overseas Funds commenced liquidation proceedings in the Cayman Islands and at the same time filed petitions in the United States Bankruptcy Court for the Southern District of New York seeking orders under Chapter 15 to recognize the liquidation proceedings of the Funds in the Grand Court of the Cayman Islands as foreign main proceedings, and if the foreign proceedings are not eligible for recognition as foreign main proceedings, to recognize such proceedings as foreign nonmain proceedings. The USA courts denied recognition on the grounds that the foreign proceedings are not pending in a country where the Funds have their COMI or where they have an establishment and therefore did not qualify for recognition as main or nonmain proceedings.

The implications of this decision to foreign creditors are significant. It shows that foreign entities may not always be able to get relief under Chapter 15 proceedings and consequently may not be able to protect their assets situated in the USA.

INSOL International would like to thank Mr. Andrew De Natale and Irina Gomelskaya of Stroock & Stroock & Lavan LLP, USA for preparing this excellent case study. We appreciate the time they have spent on writing this study.

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INSOL International
2-3 Philpot Lane, London EC3M, UK
Tel: +44 (0) 207 929 6679 Fax: +44 (0)207 929 6678
www.insol.org

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Chapter 15 Proceedings of Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd. and Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd.

A. Case name and date of decision

Case Names: Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd. and Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd.

Dates of Decisions: By the Bankruptcy Court: 5 September 2007, affirmed on appeal to the District Court, 22 May 2008.

B. Case information

Kristen Beighton and Simon Lovell Clayton Whicker ("Foreign Representatives" or "Petitioners"), as Joint Provisional Liquidators of Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd. ("High-Grade Fund") and Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd. ("Enhanced Fund" and together with High-Grade Fund, the "Funds" or the "Foreign Debtors") filed petitions in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") pursuant to section 1515 of title 11 of the United States Code (the "Bankruptcy Code") for entry of orders recognizing the liquidation (the "Foreign proceedings") of the Funds in the Grand Court of the Cayman Islands (the "Cayman Court") as foreign main proceedings pursuant to section 1517 of the Bankruptcy Code, and thereby granting related relief pursuant to section 1520 of the Bankruptcy Code and granting additional relief pursuant to section 1521(a) of the Bankruptcy Code. In the alternative, if the Court found that the foreign proceedings were not eligible for recognition as foreign main proceedings, Petitioners sought recognition of the Foreign proceedings as foreign nonmain proceedings, as defined in section 1502(5) and sought relief under section 1521 of the Bankruptcy Code.

U.S. Proceeding

Petitioners: Kristen Beighton and Simon Lovell Clayton Whicker, as Joint Provisional Liquidators

Petition Date: July 31, 2007

Case numbers: 07-12383 and 07-12384

Bankruptcy Court: Bankruptcy Court for the Southern District of New York

U.S. Judge: The Honorable Burton R. Lifland

Petitioners' Counsel: Fred S. Hodara, Esq., Akin Gump Strauss Hauer & Feld LLP

U.S. Trustee: Diana G. Adams, United States Trustee for Region 2

Foreign Proceeding

Case number: 324 of 2007

Date Filed: July 30, 2007

Court: Grand Court of Cayman Islands

Judge: Honorable Madam Justice Levers

Counsel: Sandra Corbett, Walkers, Attorneys-at-Law

C. Background summary

The Foreign Debtors were incorporated in the Cayman Islands and maintained their registered offices in that country. Both entities were “exempted” limited liability companies under section 193 of the Companies Law of the Cayman Islands, which allows qualifying companies to trade in the Cayman Islands provided that the goal of the company’s activities is to further business outside of the Cayman Islands and not to compete with business establishments conducting local business within the Cayman Islands. The Funds were open-ended investment companies that invested in many types of securities, including in: (i) investment-grade structured finance securities; (ii) asset-backed securities (“ABSs”); (iii) synthetic ABSs; (iv) mortgage-backed securities; (v) global structured asset securitizations; (vi) derivatives; (vii) options; (viii) swaps; (ix) swaptions; (x) futures; (xi) forward contracts; (xii) equity securities; and (xiii) currencies.

Prior to the appointment of the Foreign Representatives as joint provisional liquidators (“JPLs”) on July 31, 2007, the Foreign Debtors shared the same set of five directors. Two of the five directors were independent directors, i.e., they were unaffiliated with any entity affiliated with The Bear Stearns Companies, Inc. (“Bear Stearns”). PFPC Inc. (Delaware), a Massachusetts corporation, administered the Funds (the “Administrator”). Pursuant to an administrative services agreement, the Administrator served as administrator, registrar and transfer agent and provided day-to-day administrative services to the Funds, including accounting and clerical functions, processing the issuance, transfer and redemption of shares, maintaining all appropriate shareholder registers and ledgers, distributing annual reports and account statements to shareholders, responding to inquiries received from shareholders, prospective investors, and others, maintaining Funds’ principal administrative records, disbursing payment of expenses, responding to inquiries from the general public, and notifying investment manager of redemption requests. The books and records of the Funds were maintained and stored in Delaware by the Administrator. Bear Stearns Asset Management Inc. (“BSAM”), a corporation formed under the laws of the state of New York, acted as the investment manager for the Funds. The investor registers, however, were held in Dublin, Ireland by an affiliate of the Administrator.

In early 2007, the Funds’ investments performed poorly. Following the well-publicized volatility in the market related to United States sub-prime lending, by late May 2007 both Enhanced Fund and High-Grade Fund had begun to suffer a significant devaluation of their asset portfolios. The devaluation of those assets led to margin calls from many of their trade counterparties, which the Funds were ultimately unable to meet. This, in turn, resulted in the issuance of default notices by those counterparties and their exercise of rights under their respective agreements to seize and/or sell those assets of the Funds that had been the subject of repurchase agreements or over which they held security interests.

On or about June 20, 2007, Merrill Lynch, a United States creditor, issued a bid list to certain of its clients and thereafter sold off certain of these assets. This resulted in further downward pressure on the relevant asset classes and a revaluation of the Funds’ assets.

On July 30, 2007, the board of directors passed a resolution, authorizing each Fund to file a petition seeking an order that each Fund be wound up under the provisions of the Companies Law of the Cayman Islands and to apply for the appointment of the Petitioners to act as JPLs of the Funds, subject to the supervision of the Cayman Court.

Source: Verified petitions for recognition of Foreign Main Proceeding Pursuant to Sections 1515 and 1517 of the Bankruptcy Code filed by Fred S. Hodara on behalf of the High-Grade Fund and Enhanced Fund, respectively, dated July 31, 2007.

D. Procedural history

On July 31, 2007, the Cayman Court entered Orders (the “JPL Orders”) appointing Kristen Beighton and Simon Lovell Clayton Whicker as the JPLs of the Funds. The JPL Orders authorized the JPLs “to do any acts or things considered by them to be necessary or desirable” for the protection of the assets and property of the Funds in connection with the liquidation of the Funds and the winding up of their affairs.

On September 14, 2007, the Cayman Court entered orders converting the foreign proceedings from provisional to official liquidations and directing that the Funds be wound up under the Companies Law. Pursuant to these orders, the JPLs became the joint official liquidators (the “JOLs”).

On the day they initiated the foreign proceedings in the Cayman Islands, the foreign representatives filed petitions in the Bankruptcy Court seeking recognition of the foreign proceedings as foreign main proceedings, or, in the alternative, as foreign nonmain proceedings, under Chapter 15. The petitions were unopposed by any party to the bankruptcy. However, Merrill Lynch, Pierce, Fenner & Smith, Inc., Merrill Lynch International and Merrill Lynch Capital Services, Inc. (the “Merrill Lynch Entities”) filed a statement requesting that no choice of law determination be made regarding potential U.S. actions in conjunction with a conclusion as to the Funds’ center of main interests.

Pursuant to section 1519 of the Bankruptcy Code, the Funds requested entry of an order (i) staying execution against the Funds’ assets, (ii) prohibiting all persons from commencing or continuing any litigation or any other proceeding, including, without limitation, appeals, mediation or any judicial, quasi judicial, administrative or regulatory action, proceeding or process whatsoever, or taking any other actions against or involving the Foreign Representatives (with respect to the Funds), the Funds and their property in the United States, and (iii) entrusting the administration or realization of the Funds to the Foreign Representatives. On August 1, 2007, the Bankruptcy Court entered a temporary restraining order pending a hearing on a preliminary injunction.

On August 9, 2007, the Bankruptcy Court held a hearing on the applications for a preliminary injunction and granted a preliminary injunction pending the disposition of the Funds’ Chapter 15 petitions.

On September 5, 2007, the Bankruptcy Court filed a decision, dated August 30, 2007 and amended September 5, 2007 (the “Decision”), denying recognition of the foreign proceedings as foreign main proceedings or foreign nonmain proceedings.

On September 10, 2007, the foreign representatives appealed the Bankruptcy Court’s Decision. Because the Petitions were uncontested, there are no appellees.

On September 21, 2007, the Foreign Representatives filed an unopposed motion for a stay pending appeal pursuant to Bankruptcy Rule 8005. The Bankruptcy Court held a hearing on September 24, 2007, at which the Foreign Representatives presented additional evidence from the Foreign Representatives’ continuing investigation.

On September 27, 2007, the Bankruptcy Court entered an order requiring that \$4 million be maintained in U.S. bank accounts established with respect to each Foreign Debtor and continuing the preliminary injunction pending final disposition of an appeal that was filed by the Foreign Representatives in the District Court for the Southern District of New York (the “District Court”).

On January 16, 2008, the appeal was heard before the Honorable Robert W. Sweet at the District Court. The order affirming the Bankruptcy Court's decision was issued on May 22, 2008 and entered on May 28, 2008. As no further appeals were taken, this order became final.

Source: Opinion of U.S. District Court Judge Robert W. Sweet denying Funds Liquidators' Appeal from Judge Lifland's Order.

E. Main parties involved

Petitioners: Kristen Beighton and Simon Lovell Clayton Whicker, as JPLs, and later JOLs

Petitioners' Counsel: Fred S. Hodara, Esq., Akin Gump Strauss Hauer & Feld LLP

Debtors: Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd. and Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd.

U.S. Trustee: Diana G. Adams, United States Trustee for Region 2

Party in Interest: Merrill Lynch, Pierce, Fenner & Smith, Inc., Merrill Lynch International and Merrill Lynch Capital Services, Inc. (collectively, the "Merrill Lynch Entities")

Counsel for the Merrill Lynch Entities: Madlyn Gleich Primoff and Jeffrey A. Fuisz, Kaye Scholer LLP

F. Chapter 15

Purpose

Chapter 15 of the United States Bankruptcy Code codifies a comprehensive framework through which representatives in corporate insolvency proceedings outside the United States have the ability to obtain access to the United States courts. Effective October 17, 2005, chapter 15 replaced Section 304 of the Bankruptcy Code. The purpose of Chapter 15 is to incorporate the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission for International Trade Law (UNCITRAL), and to provide effective mechanisms for dealing with cases of cross-border insolvency. Chapter 15 contains many similar definitions and concepts as those under the European Insolvency Regulation ("EIR"), which is hardly surprising given that both the EIR and Chapter 15 were produced as part of the same overall effort to unify the law. Since the EIR was adopted in 2002 by all members of the European Union, except Denmark, and has generated a fair amount of litigation, the experience to date under the EIR is relevant and illuminating to those attempting to interpret and apply the more recent provisions of chapter 15.

Chapter 15 of the Bankruptcy Code provides that in order to commence a proceeding for the recognition in the U.S. of a "foreign proceeding," a "foreign representative" must file a petition, accompanied by the decision of the foreign court authorizing the foreign proceeding and appointing the foreign representative, or other appropriate evidence of the status of the proceeding and representative. 11 U.S.C. § 1515. Chapter 15 is attractive to foreign corporations because a foreign representative in a foreign main case can enjoy many of the rights and exercise many of the powers of a trustee or debtor in possession under the Bankruptcy Code without filing a full case.

"Foreign proceedings" and "foreign representatives"

The definition of "foreign proceeding" under the Bankruptcy Code is "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or

liquidation.” 11 U.S.C. § 101(23). The definition of “foreign representative” under the Bankruptcy Code is “a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor’s assets or affairs or to act as a representative of such foreign proceeding.” 11 U.S.C. § 101(24). There is a presumption that the “foreign proceeding” and “foreign representative” named in the decision or certificate accompanying the petition are the authorized representatives of the foreign debtor. See 11 U.S.C. § 1516(a).

Moreover, a foreign representative may obtain recognition of a foreign proceeding as either a foreign main or nonmain proceeding. See 11 U.S.C. § 1517(a)(1). A foreign main proceeding is defined as a “foreign proceeding pending in the country where the debtor has the center of its main interests.” 11 U.S.C. § 1502(4). A foreign nonmain proceeding means any other proceeding “pending in a country where the debtor has an establishment,” 11 U.S.C. § 1502(5), with “establishment” defined as “any place of operations where the debtor carries out a nontransitory economic activity.” 11 U.S.C. § 1502(2). Section 1516(c) provides that “[i]n the absence of evidence to the contrary, the debtor’s registered office, or habitual residence in the case of an individual, is presumed to be the center of the debtor’s main interests.” 11 U.S.C. § 1516(c). However, this presumption may be rebutted with evidence to the contrary.

Upon recognition of a foreign main proceeding, several provisions of the Bankruptcy Code automatically apply with respect to the foreign debtor’s property within the territorial jurisdiction of the U.S. Based on the foregoing, the result of chapter 15 in ancillary cases is that: (i) the ability of a foreign representative to gain recognition for a foreign main proceeding in the U.S. has been streamlined and simplified; and (ii) the foreign representative can obtain powerful relief in the U.S. courts (however, the foreign representative’s ability to remit assets abroad for distribution in the foreign case is still always subject to the requirement that “the interests of creditors in the United States are sufficiently protected.” 11 U.S.C. § 1521(b)).

G. Issues in dispute

The issue for the Bankruptcy Court was whether the “foreign proceedings were eligible for relief as main or nonmain proceedings under chapter 15 of the Bankruptcy Code.

The issue for the District Court on appeal was whether the Bankruptcy Court erred in determining that the foreign proceedings were neither main nor nonmain proceedings under chapter 15 of the Bankruptcy Code.

H. Court ruling and analysis

The Bankruptcy Court held that the foreign proceedings were neither main nor nonmain proceedings under chapter 15 of the Bankruptcy Code.

Bankruptcy court’s analysis of COMI for “main proceeding” eligibility

In order to qualify under section 1502(4) as a foreign “main proceeding,” the Funds had to establish that the foreign proceeding was pending in the country where the Funds had their “center of main interests” or COMI. The Funds were not able to meet this burden. The Bankruptcy Court noted in its decision that the Petitioners’ own pleadings provide the evidence to establish that the Funds’ COMI was in the United States, not the Cayman Islands. Although the Funds were registered in Cayman Islands, this was not sufficient. Section 1516(c) presumes that COMI is the place of the debtor’s registered office but only “[i]n the absence of evidence to the contrary.” See 11 U.S.C. § 1516(c). However, in this case, there was evidence to the contrary: there were no employees or managers in the Cayman Islands, the investment manager for the Funds was located in New York, the Administrator that ran the back office operations of the Funds was in the United States along with the Funds’ books and records, and prior to the

commencement of the foreign proceeding, all of the Funds' liquid assets were located in United States. Furthermore, (i) the investor registries were maintained and located in the Republic of Ireland; (ii) accounts receivables were located throughout Europe and the United States; (iii) counterparties to master repurchase and swap agreements were based both inside and outside the United States but none were claimed to be in the Cayman Islands. Therefore, the Bankruptcy Court concluded that the COMI for the Funds was in the United States, the place where the Funds conducted the administration of their interests on a regular basis and was therefore ascertainable by third parties.

Bankruptcy court's analysis of qualification for "nonmain proceeding" eligibility

In order to qualify under section 1502(5) as a foreign "nonmain proceeding," the Funds had to establish that the foreign proceeding was pending in the country where the Funds had an "establishment" for the conduct of nontransitory economic activity, i.e., a local place of business. The Bankruptcy Court noted that the burden to meet this requirement is rather high, especially in view of the Cayman Islands' statutory prohibition against "exempted companies" engaging in business in the Cayman Islands except in furtherance of their business otherwise carried on *outside* of the Cayman Islands. See Companies Law (2004 Revision) of the Cayman Islands § 193. As discussed above, there was no significant nontransitory economic activity conducted locally in the Cayman Islands by the Funds; only those activities necessary to operate their offshore "business." Therefore, the Court found that the Funds did not have an "establishment" in Cayman Islands for purpose of section 1502(5), and the foreign proceedings did not qualify as foreign nonmain proceedings.

Because the foreign proceedings were not pending in a country where the Funds had their COMI or where they had an establishment, the Bankruptcy court held that the foreign proceedings were not eligible for relief as either main or nonmain proceedings under chapter 15.

The Court ordered that the preliminary injunction order of August 9, 2007 remain in effect for 30 days to give parties in interest an opportunity to file a petition for relief under chapters 7 or 11 of the Bankruptcy Code in the district where the seat of the Funds' management functions are located.

The ruling by the District Court on Appeal

The District Court upheld the Bankruptcy Court's denial of recognition of the Cayman Islands liquidation proceedings of the Bear Stearns Funds as either main or nonmain proceedings. First, the District Court rejected the comity argument made by the JPLs that recognition should be liberally granted, and ruled that the objective criteria outlined in the statute (and discussed above) must be met before principles of comity come into play. Second, the District Court held that the Bankruptcy Court did not err in concluding that COMI for the Funds was in the United States, and not in the Cayman Islands, and the statutory presumption that COMI is where the registered offices are located could be and was correctly rebutted in this case with evidence to the contrary. Third, the District Court ruled that there were sufficient facts to deny recognition of the foreign proceedings as nonmain proceedings because the JPLs failed to prove that the Funds carried out "nontransitory economic activity" in the Cayman Islands. The Funds did not have any assets in the Cayman Islands, and the mere facts that third parties had conducted auditing activities and prepared corporate papers for the Funds did not amount to "operations" or "economic activity" by the Funds. No appeal was taken from the District Court's decision.

I. Commentary on cross-border relevance

Prior to the Bear Stearns decision, petitioners seeking relief under chapter 15 of the U.S. Bankruptcy Code, expected that if no objections were filed, chapter 15 relief would be available to them almost as a matter of right. The Bankruptcy Court in this case made it clear that it will not rubber stamp petitions for recognition under chapter 15, thereby calling into doubt earlier decisions on this issue, including *In re SphinX, Ltd.*, 351 B.R. 103 (Bankr. S.D.N.Y. 2006), and petitioners must affirmatively meet their burden of establishing that the foreign proceeding qualifies under either section 1502(4) as a “main” proceeding or under section 1502(5) as a “nonmain” proceeding by meeting the specific requirements of the applicable section. This decision significantly changed the landscape for off-shore companies facing insolvency concerns, that may be tempted to file under chapter 15 and thereby obtain the benefits and protections of the U.S. bankruptcy laws without the need and related burdens and costs of filing for bankruptcy protection under chapter 7 or chapter 11 of the Bankruptcy Code.

Although this area of the law is still developing and it remains unclear what combination of local activities would provide sufficient basis for invoking chapter 15 relief, the off-shore entities that maintain at least some credible business activity and operations in their home jurisdiction would find themselves in a much better position to argue that they should qualify for the protections of chapter 15 in the event such application is sought.

J. Useful information

Petition and related documents – Appendix A

1. Chapter 15 Petitions for Recognition of Foreign Proceeding filed on July 31, 2007 by Fred S. Hodara, Esq., of Akin, Gump, Strauss, Hauer & Feld, LLP on behalf of High-Grade Fund and Enhanced Fund, respectively.

[\[Annexure - 1\]](#)

2. Verified petitions for recognition of Foreign Main Proceeding Pursuant to Sections 1515 and 1517 of the Bankruptcy Code filed on July 31, 2007 by Fred S. Hodara on behalf of High-Grade Fund and Enhanced Fund, respectively.

[\[Annexure - 2\]](#)

3. Declaration of Sandra Corbett to support verified petition for recognition of Foreign Main Proceeding, filed on July 31, 2007.

[\[Annexure - 3\]](#)

4. Declaration of Kristen Beighton as Foreign Representative of Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., filed on July 31, 2007.

[\[Annexure - 4\]](#)

5. Petition to the Grand Court of the Cayman Islands, filed on July 31, 2007.

[\[Annexure - 5\]](#)

6. Memorandum of Law in Support of Recognition of Foreign proceedings as Foreign Main Proceeding dated August 24, 2007.

[\[Annexure - 6\]](#)

Docketed orders – Appendix B

1. Order of the Grand Court of the Cayman Islands for appointment of Joint Provisional Liquidators, entered on July 31, 2007.

[\[Annexure - 1\]](#)

2. Judge Lifland's Written Opinion and Order Denying Recognition of Bear Stearns Funds' Foreign Proceeding, dated August 30, 2007.

[\[Annexure - 2\]](#)

3. Judge Lifland's Amended Decision and Order Denying Recognition of Foreign Proceeding, dated September 5, 2007.

[\[Annexure - 3\]](#)

4. Order Granting the Motion of the Foreign Representatives for Stay Pending Appeal Pursuant to Bankruptcy Rule 8005, entered on September 26, 2007.

[\[Annexure - 4\]](#)

5. Opinion of U.S. District Court Judge Robert W. Sweet denying Funds Liquidators' Appeal from Judge Lifland's Order, dated May 22, 2008 and entered on May 28, 2008.

[\[Annexure - 5\]](#)

Links to U.S. Bankruptcy Court website

www.nysb.uscourts.gov