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Cross Border Insolvency – Aspects Of The Unctral Model Law

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CROSS BORDER INSOLVENCY – ASPECTS OF THE UNCTRAL MODEL LAW

address by
R I Barrett
A Judge of the Supreme Court of New South Wales

In beginning this session on cross border insolvency (and speaking only in the very broadest way to my written paper), I want to say something about the UNCITRAL Model Law and to look briefly at some of the things that may turn out differently because of it. To date, on the latest information I have, the Model Law has been adopted as part of the domestic law of Eritrea, Japan, Mexico, Poland, Romania, South Africa, Serbia, Montenegro, the British Virgin Islands and the United States, although in the case of the United States it will not come into operation until October of this year. That list makes it unsurprising that there is not yet any guidance to be gleaned from cases arising under the Model Law itself. But the European Community has since 31 May 2002 operated under quite similar provisions and there are some possible lessons there.

The relevance of all this to us is, of course, that the Australian Government is well advanced on plans to introduce into the Commonwealth Parliament legislation adopting the Model Law. The proposal has been around for quite some time now as CLERP 8. Perhaps an indication of the relative importance attached to the matter by legislators comes from the fact that CLERP 9 is well and truly implemented and in force while CLERP 8 remains unlegislated, although it does appear to be in the final stages of legislative preparation.

I thought I would approach the subject by reference to some cross border insolvency cases that have crossed my horizon in the last six months and offering some thoughts on how they might have turned out under the Model Law.

Before doing that, I should just outline what the Model Law aims to do. It sets out in its preamble its purpose of providing effective mechanisms for dealing with cases of cross border insolvency so as to promote five objectives –

> first, co-operation between the courts and other competent authorities of the enacting country and reciprocating foreign countries in cases of cross border insolvency;
> second, the objective of greater legal certainty for trade and investment;
> third, the objective of fair and efficient administration of cross border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
> fourth, the objective of protecting and maximising the value of the debtor's assets; and
> fifth, the objective of facilitating the rescue of financially troubled businesses thereby protecting investment and preserving employment.

How does it do this? Chapter II of the Model Law is entitled "Access of Foreign Representatives and Creditors to Courts in this State". Its basic principle is that what is called a "foreign representative" – let us say a foreign liquidator or trustee in bankruptcy – is entitled, by virtue of that status, to apply directly to the local court. Foreign creditors can do likewise. As a matter of domestic law, therefore, a liquidator from another country has a right of access to the domestic court, regardless of whether his country also subscribes to the Model Law. So too, creditors from elsewhere are unambiguously entitled to come in under the local administration. There is thus a rejection of the old idea that domestic courts administer insolvent estates with the assistance of local liquidators or trustees and for the benefit of domestic creditors or creditors having some logical connection with the local jurisdiction. The old idea of a territorially confined administration – and the possibility of several of them in different places – is modified. The right of a foreign representative or foreign creditor to sue in our courts is not confined to any particular type of action. A foreign liquidator, for example might ask for the appointment of a receiver of the local property.

Chapter III is entitled "Recognition of a Foreign Proceeding and Relief". The basic message there is that a foreign representative (say, liquidator or trustee in bankruptcy) may apply to the local court for recognition of the insolvency proceeding in the foreign country in which the representative was appointed. The foreign proceeding will be recognised in the local jurisdiction if it falls within a

broad definition of insolvency proceedings, if proper particulars of it are filed and if the application is made to the proper local court. Once a foreign proceeding is seen to meet the criteria, it will be recognised in the local jurisdiction as either a foreign main proceeding or a foreign non-main proceeding. The distinction between the two turns upon the concept of "centre of its main interests" or "COMI" – on which I concentrate in the written paper. It is a foreign main proceeding if it originates from the jurisdiction where the debtor has its COMI. It is a foreign non-main proceeding if the debtor does not have its COMI in the relevant foreign jurisdiction but has an "establishment" there. It follows that a foreign proceeding qualifies for recognition only if its origin is the debtor's COMI (in which event it is a foreign main proceeding) or a place where the debtor has an "establishment" (so that it is a foreign non-main proceeding). If the foreign proceeding comes from somewhere with which the debtor has neither of these connections, it is not recognisable under the Model Law. In the case of corporate insolvency, the place of incorporation plays no part in any of this.

Once an application is made for recognition of foreign proceedings, the local court has jurisdiction to grant what is called "relief of a provisional nature" – we would call it interlocutory relief. The orders that may be made under that heading are of a general preservation kind pending determination of the substantive application.

It is at the point of the final determination that substantive provisions come into play – assuming, of course, that the decision is to recognise the foreign proceeding. Specifically, the statutory consequence of local recognition of a foreign main proceeding is that there arises, as a matter of domestic law, a statutory stay upon commencement or continuation of actions against and involving the debtor or its property. In addition, the right to transfer assets of the debtor is suspended. Where the proceeding is a foreign non-main proceeding, the same results can be achieved by court order, but whether on a case-by-case basis or a blanket basis is not stated. In both cases, recognition of the foreign proceeding puts the local court in a position where it can order examinations, provide for the administration of local assets and grant any other relief available under local law.

Another consequence of recognition of the foreign proceeding is that the local court may entrust to the foreign representative distribution of the debtor's local property – but only if it is satisfied that the interests of local creditors are "adequately protected". This is the effect of articles 21(2) and 22. So there is the first potential brake on the cross-border roller-coaster. The second follows it: the court is not to grant any of the discretionary relief that recognition of a non-main foreign proceeding enables it to grant unless it is satisfied that "the relief relates to assets that, under the law of this State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding". So, in all cases of recognition – both main and non-main – entrusting of local property to the foreign administration depends on it being seen that the interests of local creditors are adequately protected. And in a case of non-main recognition, the grant of further relief is dependent on a view that the local assets should, as it were, be dealt with in what is itself something conceptually in the nature of an ancillary administration.

Chapter IV of the Model Law is headed "Co-operation with Foreign Courts and Foreign Representatives". It says that, where either the assistance of the local court is sought by a foreign court in connection with a foreign proceeding or a foreign proceeding and a proceeding in the local court co-exist in relation to the same debtor, the local court "shall co-operate to the maximum extent possible" with foreign courts or foreign representatives. This part of the Model Law goes on to say:

> "The court is entitled to communicate directly with, or to request information or assistance directly from, foreign courts or foreign representatives."

Particular forms of co-operation are referred to – appointment of a person or body to act at the direction of the court; communication of information by any means considered appropriate by the court; co-ordination of the administration and supervision of the debtor's assets and affairs; approval or implementation by courts of agreements concerning the co-ordination of proceedings; co-ordination of concurrent proceedings regarding the same debtor.

It will be interesting to see where this leads. Under some of the protocols developed between the US and Canada, as I understand it, two courts may effectively sit together and decide some matter of common interest. The words of the Model Law here – "communicate directly with foreign courts or foreign representatives" – leave open the possibility of a judge in Sydney or Melbourne or Brisbane phoning a judge of the US Bankruptcy Court for a chat about what order should be made in the case of X. Deeply rooted principle would, of course, be against this. Judges do nothing that might affect the position of X without giving X an opportunity to be heard. And judges do nothing in the absence of the public except in exceptional circumstances where the public interest in open justice is outweighed by some other public interest. The new concepts are going to have to accommodate the old ways in this area – and I do not think anyone should have in mind an image of cosy judicial fireside chats sorting out Enron or Parmalat or HIH.

Chapter V of the Model Law is entitled "Concurrent Proceedings". Its principal message is that,

after recognition of a foreign main proceeding, a local proceeding may be commenced only if the debtor has assets in the jurisdiction; and the effects of that proceeding must be restricted to those assets and any others that under the local law should be administered in the proceeding. There is also a provision in this part saying that, in the absence of evidence to the contrary, recognition of a foreign main proceeding is, for the purpose of commencing a proceeding under the local law, proof that the debtor is insolvent.

The Model Law is quite a slim document. The copy I have been working from which is an annexure to the resolution of the United Nations General Assembly of 15 December 1997 runs to just over eleven pages, not at all closely typed. But it is packed with possibilities.

As I said, I would like to spend a few minutes thinking aloud about how the Model Law might have affected some cases that arose in the last six months. I know that some of them are likely to be dealt with later in the session; but I do not think I will be stealing any thunder.

The first case I have in mind is the case of *ABC Containerline NV* decided in February [(2005) 52 ACSR 750] which was a case in which a Belgian company had been adjudicated bankrupt by a Belgian court under the law of Belgium in, I think, 1997 and, a couple of years later, the Belgian trustees in bankruptcy had applied for and been granted a winding up order under the *Corporations Law*, as it then was. The sole purpose in doing this was to conduct some examinations of persons in Australia they thought might be able to throw light on the viability of a possible claim against an Australian company with which the bankrupt company had had business dealings. The local liquidator conducted the examinations and reported back to the Belgian trustees. They decided, on the basis of Australian legal advice, that the possible claim could not usefully be pursued. The Australian liquidator then asked to be discharged. He never collected any assets. He never called for proofs of debt. In fact, he did nothing beyond conducting the examinations. The evidence showed that a significant number of Australian creditors had proved directly in the Belgian administration.

Had the Model Law applied as part of the law of Australia, it would have been clear in that case that the COMI of the company was in Belgium so that, from the perspective of an Australia in which the Model Law was in force, the Belgian proceeding would have been a foreign main proceeding. The way for the Belgian trustees to proceed under the Australian Model Law, it seems to me, would have been very simple. They could have applied for recognition of the Belgian proceeding in Australia, which recognition the Australian court would have been bound to give. The Belgian trustees would then have made use of their right direct access to the Australian court, obtained some orders of the kind referred to in article 21(1)(d) – dealing with examination of witnesses - completed their examinations and returned to Belgium. I do not think they could have obtained access to the examination processes under Part 5.9 of the *Corporations Act* that they in fact used, but they could have got the same result under the Model Law in a simpler way.

I think next of the case of *Independent Insurance Limited* decided in June [[2005] NSWSC 587] which was a case in which provisional liquidators appointed in England applied to the Australian court for an injunction restraining all persons from initiating or proceeding with any proceedings against the company or concerning its property. The aim was thus to obtain, in the form of a court order in Australia, embargos equivalent to those which applied legislatively as part of the *UK Insolvency Act* which, in that respect, is very much the same as our *Corporations Act*. In the result, the orders were refused but if the Model Law had been in force, they would never have been sought. The UK proceedings in which the provisional liquidators were appointed would have been categorised as a foreign main proceeding. The Australian court would have been asked to make an order recognising that UK proceeding and, on the face of things, it would readily have done so. Thereafter, Article 20 of the Model Law would have operated as part of the law of Australia to impose the very stay the foreign provisional liquidators were, under the old system, forced to seek by court order as a matter of general jurisdiction. The objective sought in that case would thus have come wholly and solely from an Australian order recognising the foreign main proceeding.

The third case is *Gebo Investments (Labuan) Limited*, also decided in June [(2005) 54 ACSR 111]. That was a case where the Australian court had made an order appointing a provisional liquidator of a company incorporated in Malaysia on the basis that it was a Part 5.7 body – basically, that it was incorporated in another country but carried on business here. There was a subsequent application by contributories to have the order set aside (it was made in the absence of the defendant), the contention being that the Malaysian company had not carried on business in Australia and was therefore not a Part 5.7 body.

This case raises somewhat different considerations. The CLERP 8 paper has something to say about the future of Part 5.7 in the context of the Model Law. The paper says that it is arguable that Part 5.7 should be retained “as it is necessary to provide for the administration of a foreign company where the Model Law cannot or has not been invoked, for example, where no foreign proceeding has been commenced or the foreign company has been dissolved in its place of origin”. That was exactly the position in *Gebo*. There had been no proceeding in Malaysia or, for that matter, anywhere else apart from Australia where there was a winding up application by contributories on a combination of the insolvency ground and the just and equitable ground. It was in Australia alone that moves towards winding up were initiated and, had it not been for Part 5.7, that would not have been possible –

something that the Model Law itself will not change. The Model Law does not attempt to diminish the jurisdiction of any individual country as regards insolvency. Separate countries are able to claim jurisdiction as they wish (and validly can).

If the *Gebo* case had arisen after the Model Law had come into force in Australia, the Australian winding up order would not have been affected by it. But there is a question of how that order would have been regarded in other places had the liquidator wished, for example, to have it recognised in Malaysia, the jurisdiction of incorporation (assuming the Model Law was in force there). This is a case in which arguments would have developed about the location of the COMI. The registered office, which, under article 16(3), is the main determinative COMI in the absence of proof to the contrary, was, of course, in Malaysia. But as the evidence showed, all, or all but one, of the de facto directors resided in Australia. The formally appointed directors were Malaysian entities. The evidence did not paint any exhaustive or conclusive picture of the extent and location of the business operations, although it did show enough to justify the only finding that was relevant in the case itself, namely, that business was carried on in Australia. It may well have been carried on elsewhere as well, perhaps in a more substantial way. So Malaysia would have had the prima facie claim to COMI but with Australia as a countervailing claimant on the limited evidence I had before me.

The fourth case is the *HIH Insurance* case in which there were judgments in March and June [(2005) 215 ALR 562 and [2005] NSWSC 536]. There are significant cross border elements there, in particular because, although winding up proceedings were first initiated here in Australia as the place of incorporation, there have also been proceedings in the United Kingdom (where provisional liquidators have been appointed) and in the United States (where certain orders of the United States Bankruptcy Court are in place to maintain the status quo).

The *HIH* windings up have highlighted some significant cross border issues in the context of an application in Australia by the liquidators for orders convening scheme meetings under Part 5.1 of the *Corporations Act*. Well to the fore was the fact that certain aspects of Australian law give preference or priority of a kind that favours Australian creditors. We are here, of course, in the realms of insurance which, like banking, is traditionally singled out for special kinds of creditor protection. This is not the time or place for me to say too much about this matter, although it is clear that a major issue is whether realisations received by the provisional liquidators in England may or will be remitted to Australia for incorporation into the general pot to be dealt with under Australian law or whether they will be administered as a separate fund in the United Kingdom according to United Kingdom law which, of course, does not contain the provisions protective of Australian creditors. There is a possibility too that the separate fund in the UK might be administered there on the basis of the Australian rules. Also at stake is the operation of a peculiarly Australian provision about the application of reinsurance proceeds. There are currently proceedings in progress in London with a view to finding answers to this from the perspective of English law so that the liquidators can factor that into their formulation of a creditors' scheme of arrangement.

Introduction of the Model law as part of the law of Australia would not affect that aspect of *HIH*, as I see it. The COMI is clearly Australia. The UK proceeding is accordingly, from an Australian perspective, a foreign non-main proceeding. But it is difficult to see what the English provisional liquidators would achieve by seeking to take advantage of the Model Law in Australia.

Things would be different if the United Kingdom had adopted the Model Law. The Australian liquidators could then obtain recognition there of the Australian proceeding as a foreign main proceeding. But the Model Law itself contemplates that it may, as adopted in a particular country, not apply to banks or insurance companies, among other kinds of sensitive industries. A UK Model Law Act might have such exclusions, although logically this might only be for locally based sensitive industries. But the UK Model Law Act would contain articles 21(2) and 22, which require the United Kingdom court, in dealing with applications for post-recognition relief, to be satisfied that the interests of the creditors are adequately protected. The extent to which Australian law perpetrated discrimination against United Kingdom creditors and other non-Australian creditors would no doubt be relevant here.

Let me finish with one question which I am sure John Martin has in his line of vision: is a voluntary administration under Part 5.3A of the *Corporations Act*, viewed from the perspective of, say, the post-Model Law USA, "a collective judicial or administrative proceeding in a foreign State" in which "the assets and affairs of the debtor are subject to control or supervision by a foreign court" as referred to in the Model Law's definition of "foreign proceeding"? European cases mentioned in the written paper all involved judicially imposed administrations, with one possible exception, which was the *Parmalat* case. Although an Italian court played a part there, it seems from the brief description of the Italian background in the Irish judgment that it was a Government Ministry that imposed the administration and appointed the administrator. Part 5.3A administration is not an administrative proceeding in the sense that, for example, a case in the Administrative Appeals Tribunal is an administrative proceeding – with "administrative" being distinguished from "judicial". But the definition of "foreign proceeding", one might think, has a flavour that includes Part 5.3A administration, particularly when one has regard to the court's role under Part 5.3A: administrators may be removed by the court, can seek directions from the court and sometimes need the leave of the court for certain

things. The “control or supervision” aspect, vis-à-vis the court, may be present. A full consideration of that will no doubt become the lot of a non-Australian court in due course – perhaps in Eritrea or Serbia.