

A SPECIAL RELATIONSHIP? US / UK Cross-border Insolvency

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1. INTRODUCTION

In 1997, Lord Millet of the Court of Appeal wrote,
“...some consistency in the approach of the English judiciary to cross-border insolvency can be detected. Its watchwords are flexibility, cooperation and judicial restraint.”¹

There is no doubt that the development of a philosophical, legislative and regulatory framework to facilitate the efficient resolution of cross-border insolvencies is critical to the continued development of sophisticated global markets and the encouragement of cross-border investment. As business itself becomes more globally interdependent, so too will business failure. A universal approach to cross-border insolvencies is critical, as is cooperation between national courts, authorities and practitioners.

Despite the real difficulties posed by cross-border insolvencies, there is no uniform code for practitioners to follow. Failure to properly manage a complicated cross-border insolvency can result in lost assets for the estate that would otherwise be distributed to stakeholders. In some cases, it may even mean that a business that might have survived a restructuring might end up in liquidation at the expense of shareholders, employees and local economies.

Both public and private bodies in many jurisdictions have made attempts to address the problem. In the remainder of this paper we explore and examine the success or otherwise of some of the major attempts at cooperation in cross-border insolvencies, with particular emphasis on how these are relevant to US / UK insolvencies.

Against the background of Lord Millet’s remark and similar efforts in other jurisdictions, we examine:

- the scope of the EC Regulation on Insolvency proceedings, including some of its unintended consequences;
- attempts at unilateral harmonisation (Section 304 of the US Bankruptcy Code and section 426 of the UK Insolvency Act 1986 (“IA 1986”));
- global harmonisation through the Uncitral Model Law;
- the principles of comity as applied in protocols in the UK and in the US;

and consider what real progress has been made towards achieving cross-border harmony.

An overview of insolvency procedures in the UK is included for your convenience at Appendix 1.

¹ *Cross-border Insolvency: The Judicial Approach* (1997) 6 IIR 99 at 103.

2. EC REGULATION ON INSOLVENCY PROCEEDINGS (1346/2000): DOES IT HAVE EXTRA-TERRITORIAL EFFECT?

EC Regulation 1346/2000 (the “Regulation”) came into force on 31 May 2002, with the purpose of harmonising and simplifying the rules governing the recognition and enforcement of insolvency proceedings among the Member States of the European Union (“EU”). With the accession of new EU states in May 2004, the Regulation now applies as directly applicable and overriding law in 24 of the 25 Member States – Denmark having opted out.

The Regulation seeks to achieve its purpose by ensuring that the affairs of insolvent companies are administered in the jurisdiction with which they have the closest connection. A perhaps unintended consequence of the Regulation is that it has been applied to companies that are not registered in EU Member States, including to companies registered in the US.

Overview of the Regulation

The Regulation applies to “collective insolvency proceedings”, proceedings which are conducted for the majority of the creditors. In the UK and with respect to companies, these are: winding-up by or subject to supervision by the court; creditors or voluntary winding-up which has been confirmed by the court; administration and Company Voluntary Arrangements (“CVA”). Receivership is excluded as it is not a collective proceeding.

The principal rule is that insolvency proceedings should be opened in the Member State where the debtor has its Centre of Main Interest (“COMI”). This is presumed to be the place where the debtor has its registered office. This presumption is capable of being rebutted – as we will discuss below in relation to companies registered in the US. The proceedings opened in the COMI are known as “main proceedings”.

“Secondary proceedings”, which (controversially) must be winding-up proceedings, may subsequently be opened in another Member State if the debtor has an “establishment” there². The regulation defines an “establishment” as “any place of operations where a debtor carries out a non-transitory activity with human means and goods”. The Regulation also allows insolvency proceedings, known as “territorial proceedings” to be opened prior to the opening of main proceedings in a Member State where the debtor has an establishment and: (i) the creditor has its registered office; (ii) the claim arises in relation to the debtor’s operations in that Member State; or (iii) domestic law does not allow main proceedings to be opened in the debtor’s COMI³. While these need not be winding-up proceedings, they may be converted to winding-up proceedings on the application of the liquidator in the main proceedings if this is proved to be in the interests of the creditors in the main proceedings.

While main proceedings take effect throughout the Member States, territorial and secondary proceedings are confined to dealing with assets in the jurisdiction in which they are opened.

² Article 3.2.

³ Article 3.4.

The Regulation provides that the domestic law of the Member States will govern proceedings opened in that Member State and any insolvency proceedings opened in a Member State must be recognised in other Member States.

Two simple illustrations

The first case on the new Regulation was *Re Enron Directo*⁴, in which Justice Lightman made an order placing an Enron company, incorporated in Spain whose headquarters were in London, in administration in the UK on the basis that the company's COMI was in the UK.

In *Re A Company*⁵, a Swedish company applied to restrain the presentation of a winding-up petition in England. The petition was threatened on the basis that, although the company was incorporated in Sweden, it had a subsidiary with a place of business in England. It was argued that this constituted an "establishment" within the meaning of the Regulation, which entitled the creditor to open insolvency proceedings in England. The court held that the Swedish company was entitled to the injunction. The fact that the Swedish company had a subsidiary with business premises in England did not justify the opening of territorial proceedings against it in England as it did not constitute an establishment of the company itself.

What does that have to do with you? – Extra-territorial effect and the US

Although the Regulation was ostensibly intended to merely harmonise insolvency proceedings among the EU Member States, two cases – *Re BRAC Rent-a-Car International Inc*⁶ and *Cenargo*⁷, raised the possibility that the Regulations might have extra-territorial effect where the company in question is incorporated outside the EU, but whose COMI might be established within a Member State.

In *Re BRAC Rent-a-Car International Inc*, the question at issue was whether the Regulation applied to a company incorporated in Delaware for the purposes of making an administration order in England. It was established that the company (which was in Chapter 11 in the US), had never traded in the US, its operations were conducted almost entirely in England and it traded from an address in England. It was registered as an overseas company in England, all of its employees worked in England and its trading activities were carried out by way of contract with subsidiaries and franchisees governed by English law.

It was contended that, as the company was incorporated outside the EU, the English courts should not have jurisdiction as the Regulation only dealt with the position between Member States and not as between Member States and the rest of the world. However, the court decided it had jurisdiction to make the order sought as, on its true construction, the Regulation gave jurisdiction to the court of a Member State to open insolvency proceedings in relation to a company incorporated outside the EU if the COMI was in the Member State.

⁴ Lightman J, 5 July 2002.

⁵ [2002] 2 All ER 223.

⁶ [2003] 2 All ER 201.

⁷ *Re Cenargo International plc* (unreported, 14 February 2003, SD NY, United States)

It reached this conclusion based on section 8(7) of the IA86, added as a result of the Regulation. That section, which deals with the court's ability to make an administration order, includes a reference to a company in relation to which an administration order may be made by virtue of Article 3 of the Regulation, which provides that, "The courts of a Member State within the territory of which the centre of a debtor's main interests in situated shall have jurisdiction to open insolvency proceedings...".

The judge concluded that those provisions gave the court power to open insolvency proceedings against an overseas incorporated debtor provided it had its COMI in England; his reasoning being that if it had been intended to exclude such overseas companies then it would have been easy to say so in Article 3.

The impact of this case is far reaching. It demonstrates that the English courts are prepared to bring within their ambit companies whose business are genuinely centred in England, notwithstanding that they are incorporated in a non-EU jurisdiction. Previously, the English courts would probably have considered that they did not have power to make an administration order or were restricted to winding the company up as a foreign company under section 225 of the IA86.

BRAC Rent-a-Car International Inc was an easy test case for the principle that the Regulation might have extra-territorial effect, but where a company's COMI is not as obviously in England as was BRAC Rent-a-Car's, the approach of the court remains to be seen.

Determining COMI – a balancing exercise

We have some indication of the approach the court might take from its decision in *Daisytek-ISA Limited*⁸. Daisytek-ISA Limited was an English subsidiary of a US parent, Daisytek International Corp, which filed for Chapter 11 proceedings in the US. The group had a European network of dormant companies (who had guaranteed the liabilities of other companies in the group) and trading companies. The trading companies had suffered cash flow difficulties as a result of suppliers reducing their credit terms. The activities of the European network were coordinated by the English company's head office in Bradford. As a result of their financial difficulties, the English company, three German subsidiaries and one French subsidiary filed for administration in England in order to achieve a better realisation of assets.

Mr Justice McGoigal sitting in the High Court in Leeds, UK, held that the companies satisfied the test of insolvency necessary to obtain an administration order and the need to demonstrate that there would be a better realisation of assets than on a winding-up. The real question was whether there was jurisdiction to put the French and German companies into administration. The COMI of a company is presumed to be in the Member State where it has its registered office. However, this presumption is rebuttable and, in this case, the court decided that it had been rebutted. In coming to this conclusion, the court weighed up the sale of the companies' interests in England compared to its place of incorporation. The court reached the view that the COMIs of the English, French and German companies were in England since their administrative functions were run from Bradford. In addition, the majority of the large

⁸ [2003] BCC 562.

and important suppliers knew this and it was only the small local suppliers who dealt with the European subsidiaries in their local jurisdictions.

The French court of first instance, the Commercial Court of Pontoise, ruled that the COMI of the French incorporated subsidiary was located in France and opened main proceedings there. When the Court of Appeal of Versailles heard the appeal, it ruled that: (i) the English Court had opened main proceedings in England in accordance with Article 3 of the Regulation; (ii) Articles 16 and 17 of the Regulation required recognition of the English decision in France without any further formality and (iii) the French Commercial Court of Pontoise had, consequently, no jurisdiction to open main insolvency proceedings.⁹ This decision illustrates how important it is to be the first jurisdiction to open main proceedings and could spark off a race to open proceedings, perhaps accelerating the pace at which distressed companies are moved into official insolvency procedures by creditors who fear being pipped to the post by creditors in other jurisdictions.

Daisytek-ISA Limited demonstrates that the court's determination of a company's COMI is a balancing exercise and is as much art as science. Whilst there was a very strong argument that BRAC Rent-a-Car had its COMI in England, in more debatable cases the court is likely to look at administrative, management and trading operations to determine where, on balance, the company's COMI is located. This means that US companies could be subject to English insolvency proceedings, even where they have significant operations in the US, if the court determines that overall, the company's centre of gravity is in England.

Parmalat SpA

It is worth noting that in the Parmalat collapse the issue of jurisdiction has been so fiercely fought under the Regulation that on 26 July 2004 the Supreme Court of Ireland referred specific matters relating to the opening of main proceedings and the COMI of one of the Parmalat subsidiaries, Eurofoods IFSC Ltd., to the European Court of Justice¹⁰. The principle point of conflict is whether the COMI of the subsidiary, which was registered in Ireland, is in Ireland or Italy. The Italian appellants argue that the subsidiary was a "mere financial vehicle for Parmalat, that it had only a formal office in Ireland and that its exclusive point of reference was the interests of the parent". So although the company was registered in Ireland, held its board meetings in Ireland, had Irish directors and was subject to Irish tax, customs and financial regulation, the Italian appellants contend that its COMI is in Italy because it was beholden to its Italian parent.

The Supreme Court of Ireland, in referring the issue to the European Court of Justice observed that should the Italian appellants' argument succeed, that it would have a very profound effect indeed on the principles of corporate structures. Fennelly J wrote:

"It seems to this Court to be deeply inimical to the need for respect for corporate identity and respect for the rules of law (including Community law rules) relating to companies that the separate existence of such companies should be ignored.... It

⁹ [2003] B.C.C. 984

¹⁰ *Re. Eurofoods IFSC Ltd* [2004] IESC 47 (27 July 2004).

would have very serious implications for the future of international corporate structures if it were accepted that the test for centre of main interests were to be the ultimate financial control by a parent company rather than legal and corporate existence.”¹¹

Given these examples, it is clear that although the Regulation was intended to harmonise and simplify insolvency proceedings, it has turned out that the Regulation has created a new level of uncertainty – at least with respect to non-EU companies. The conflict that can result from this uncertainty is well-demonstrated by the clash of the English and US courts in the Cenargo case.

Public conflict – Private solutions

Cenargo International plc was a UK ferry operator, working primarily out of the Irish Sea with other operations throughout Europe. None of its operations were conducted in the US and virtually all its subsidiaries were incorporated in England. There was really only one set of US creditors – a group of note holders holding approximately £125 million of notes secured by certain ship mortgages and represented by an indenture trustee in the US. Cenargo was concerned that another English creditor, Lombard Initial Leasing Limited (“Lombard”) would terminate critical shipping leases. For that reason, it commenced Chapter 11 proceedings in the US, as Chapter 11 carries an automatic worldwide stay and is available to foreign entities, requiring nothing more than a deposit into a US bank account to found jurisdiction.

Lombard obtained an order for the provisional liquidation of Cenargo in England, which does not automatically recognise the worldwide stay under Chapter 11 proceedings. The English judge made the order on the basis that Cenargo had no connection with the US and the important connection was with England.

There was a clash of two competing jurisdictions and the two parties were locked in battle on either side of the Atlantic. Cenargo immediately responded by filing for an injunction in the US to enforce and implement the stay and a claim for damages against Lombard and the joint provisional liquidators from taking any action in relation to Cenargo in the English courts. There was stalemate. It was resolved by Lombard agreeing to support a financial restructuring and not to terminate the shipping leases and Cenargo agreeing to make the payments under the leases. In consultation with the English courts, the US courts surrendered jurisdiction and the US courts stayed the Chapter 11 proceedings. Resolution of a seemingly insoluble dispute was facilitated greatly by the willingness of the US and UK judges to confer directly on the telephone.

What would have happened if there had not been an accommodation reached or if the US courts had had not been prepared to surrender jurisdiction to the English courts remains to be seen.

The scuffle highlights three emerging themes in the management of cross-border insolvencies – (i) the lack of certainty provided by the existing legislative and regulatory structures; (ii) the importance of cooperation and communication between the courts and their judges and (iii) the power of the parties to create efficient

¹¹ *ibid.*

solutions through extra-judicial negotiation and cooperation. These themes will continue to be developed throughout the rest of this paper.

3. UNILATERAL ATTEMPTS AT HARMONISATION

In recognition of the need to provide structural certainty, a number of states have enacted provisions that instruct their domestic courts to assist foreign courts in insolvency proceedings. The two most relevant examples of these provisions are section 426 of IA86 and section 304 of the US Bankruptcy Code (“USBC”).

Section 426 of IA86 requires the courts of England and Wales to assist the courts of a “relevant country or territory”, if requested to do so¹². The relevant countries and territories are specified by order by the Secretary of State made for this purpose. This is the first limitation of the usefulness of the section. Thus far, the only countries that have been designated by the Secretary of State for the purposes of this section are former or current Commonwealth countries¹³. Additional countries could be added, but this is entirely at the discretion of the Secretary of State, so uncertainty remains.

The second limitation of the application of section 426 is that the English courts retain their inherent discretion in choosing whether and how to assist the courts of other jurisdictions. The Court of Appeal in *Hughes v Hannover Rucksversicherungs AG*¹⁴ confirmed that the court has discretion in the application of section 426 and may reject a request for assistance. Indeed, Moritt LJ observes that in all of the cases in which assistance has been sought, “the judge concerned has recognised that the requesting court was not entitled to assistance as of right but that there was some discretion in the courts here to determine whether and if so on what terms assistance should be given.”¹⁵

However, judicial comity is the starting point of any request for assistance under section 426¹⁶ and courts should grant a request for assistance unless there is some “extraordinary” reason not to do so¹⁷.

Section 426 of the Insolvency Act may be compared with section 304 of the USBC. Section 304 allows a US bankruptcy court to commence ancillary proceedings brought by foreign representatives. Unlike section 426, this measure has universal application in that every country may receive assistance of the US court, but again, whether assistance is provided is subject to the discretion of the individual court.¹⁸ The legislation helpfully provides criteria that will be applied in determining whether

¹² Section 426(4),(5).

¹³ Anguilla, Australia, the Bahamas, Bermuda, Botswana, Canada, Cayman Islands, Falkland Islands, Gibraltar, Hong Kong, the Republic of Ireland, Montserrat, New Zealand, St Helena, Tucks and Caicos Islands, Tuvalu and the Virgin Islands (all by SI 1986/2123), Malaysia and South Africa (by SI 1996/253). Brunei was added by SI 1998/2766.

¹⁴ [1997] BCC 921.

¹⁵ at 937B.

¹⁶ *England v Smith (Re Southern Equities Corp)* [2001] Ch 419.

¹⁷ *Duke Group Ltd v Carver* [2001] BPIR 459.

¹⁸ Indeed, in *Disconto Gesellschaft v Umbrett* 208 US 570 at 582 the US court explicitly stated, referring approvingly to the decision of Mr. Justice McLean in *Oakey v Bennett*, (11 How. 33, 44, 13 L. ed. 593, 597) that a country had the right to favour its own citizens in the realisation of their rights over the claims of creditors outside the jurisdiction. Such a notion would not find favour in the UK.

the court will provide assistance, which provides more certainty and is generally a more helpful model than section 426 of the Insolvency Act. Indeed, for US parties seeking assistance from the UK courts, section 426 is no help at all.

In order to receive section 304 relief, the application must concern a “foreign proceeding”. It is interesting to note that it is a possibility (although not very likely) that the out-of-court administration procedure recently introduced by the Enterprise Act 2002 might not qualify as a foreign proceeding and could limit the ability of UK administrators to seek relief under section 304.¹⁹

4. UNCITRAL MODEL LAW – GLOBAL HARMONISATION?

Given the dissonance among the insolvency procedures in different jurisdictions, and the mixed results from unilateral attempts for jurisdictions to assist one another, an attempt to achieve global harmonisation of the various insolvency regimes through international treaty is tempting.

The United Nations Commission on International Trade Law (“UNCITRAL”) was established in 1966 in order to reduce obstacles to the flow of trade. One of these obstacles is the conflict of laws between different jurisdictions with regard to insolvency proceedings, which can result in the dissipation of assets and the loss of an opportunity to save a viable business. The UNCITRAL Model Law on Cross-Border Insolvency is that body’s attempt to promote modern and fair legislation for cases where the insolvent debtor has assets in more than one state.

Briefly, the UNCITRAL Model Law entitles a foreign representative to apply directly to the courts of the signatory state to commence proceedings under the laws of the signatory state²⁰ and to participate in such a proceeding once commenced²¹. The foreign representative also has the same rights as a creditor in a signatory state to participate in and be notified with regard to any proceeding commenced in that state²². The signatory states also have an obligation to recognise foreign proceedings on application for recognition. Proceedings will be recognised as main proceedings or as non-main proceedings depending on where the debtor has its COMI.

At this point, legislation based on the UNCITRAL Model Law on Cross-border Insolvency has been adopted in Eritrea, Japan, Mexico, Poland, Romania, South Africa, and within Serbia and Montenegro, Montenegro. In incorporating the Model Law into its own legislative framework, each signatory is free to modify or omit provisions in the Model Law, although it is hoped that the signatories will leave the law relatively intact in order to achieve the goal of providing a truly international framework for the management of cross-border insolvencies.

¹⁹ Cogan, Brian M. “Recent Developments in European Insolvency Law and the ‘Foreign Proceeding’ Requirement of Bankruptcy Code Section 304 – Potential Consequences for United Kingdom Collective Administration Proceedings”. *IBA Section on Business Law Insolvency and Creditors’ Rights*. Vol XIV, No 1, April 2004.

²⁰ Article 11.

²¹ Article 12.

²² Article 13 and 14.

Section 14 of the Insolvency Act 2000 permits the Secretary of State to make regulations to give effect to the Model Law and to make any appropriate amendments to section 426 of the Insolvency Act. This way, the limited requirement to cooperate which presently exists in section 426 might be expanded to all those countries who have adopted the UNCITRAL Model Law. The Insolvency Service Policy Unit has reported that the Secretary of State intends to adopt the Model Law in September 2005, but that there is still a formal consultation process to go through²³. In the US, it seems that the Model Law has been incorporated into a new Chapter 15, but that the adoption of Chapter 15 has been delayed because it is appended to bankruptcy reform legislation still pending in the US²⁴.

Once UNCITRAL is more widely adopted, it will provide much-needed assistance in the development of harmonised cross-border insolvencies, but until that day, companies, courts and practitioners must look to non-legislative ways to increase cooperation in cross-border insolvencies.

5. NON-LEGISLATIVE COOPERATION – PUBLIC AND PRIVATE

There are two types of cooperation to which to appeal – public cooperation, in the principles of comity and mutual assistance; and private cooperation, in the form of contractual relations between parties in a cross-border insolvency.

Public cooperation - the principles of comity and mutual assistance

In the absence of comprehensive legislative solutions to the challenges posed by complicated international insolvencies, courts, companies and practitioners must try to find other ways to facilitate cooperation. Millet LJ, in his decision in *Credit Suisse Fides Trust SA v Cuogh*²⁵, described the task.

“In areas of law, such as cross-border insolvency, commercial necessity has encouraged national courts to provide assistance to each other without waiting for such cooperation to be sanctioned by international convention.”

Comity is, loosely speaking, that recognition which one nation extends within its own territory to the legislative, executive and judicial acts of another. In the US Supreme Court case *Hilton v Guyot*²⁶, widely cited as the starting point of any discussion of comity, the concept is described as “neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens...”. Thus understood, comity is a philosophy or a judicial “approach” to cross-border disputes. Its invocation can lead to flexible and novel accommodation and resolutions to complex disputes between parties in different jurisdictions where the law patently conflicts.

²³ Muhunthan Vaithianathar, UK Insolvency Service, 20 July 2004.

²⁴ Melnik, Selina. “International Insolvency – Country Debt, Company Debt & Cross-Border Cases: Preventing pileups at the Global intersection – Harmonizing the harmonizing efforts. From a seminar on Recognition and Enforcement of Foreign Insolvency Proceedings”, 10 May 2004.

²⁵ [1997] All ER 724 at 730.

²⁶ 159 US 113, 163-64, 16 S.Ct. 139,143, 40 L.Ed. 95 (1895).

An example of the application of the principles of comity is encouragement of direct communication between courts in order to facilitate the efficient resolution of the insolvency. In *Stonington Partners Inc v Lernout & Hauspie Speech Products*²⁷, a conflict between American and Belgian law meant that honouring a request made to the American court would mean effectively enjoining Belgian proceedings²⁸. The Third Judicial Circuit of the US Court of Appeals was frustrated by the difficulty of managing a complex and fast moving cross-border insolvency. Rendall, Circuit Judge, commented, “We note at the outset that the task facing a court in this factual and legal setting is, to say the least, difficult. In fact, it has been called a ‘Herculean task’ to do what is required here – namely, to ‘accommodate conflicting, mutually inconsistent national regulatory policies while minimizing the amount of interference with the judicial processes of other nations.’”²⁹

The court affirmed the importance of comity in an insolvency situation. “The principles of comity are particularly appropriately applied in the bankruptcy context because of the challenges posed by transnational insolvencies...”. The court went on to suggest that direct communication between the courts could help facilitate resolutions to these dilemmas:

*“We strongly recommend, in a situation such as this, that an actual dialog occur or be attempted, between the courts of the different jurisdictions in an effort to reach an agreement as to how to proceed, or at the very least, an understanding as to the policy considerations underpinning salient aspects of the foreign laws. ...we urge that, in a situation such as this, communication from one court to the other regarding cooperation or the draft of a protocol could be advantageous to the orderly administration of justice.”*³⁰

A development of the call for direct cooperation between courts came in the form of the Transnational Insolvency Project of the American Law Institute – Guidelines for Court-to-Court Communications in Cross-border Cases, adopted 16 May 2000 and approved by the International Insolvency Institute in June 2001. Although originally adopted to apply to North American Free Trade Agreement (NAFTA) countries, the guidelines are intended to be applicable to courts in any jurisdiction that might find them a helpful way to guide communications between courts.

In recognising that court-to-court communications, while expedient, may cause concerns for the litigants in an insolvency, the Guidelines seek to “encourage communications while channelling them through transparent procedures,” and are meant to “permit rapid cooperation in a developing insolvency case while ensuring due process to all concerned”.

The 17 Guidelines are intended to provide a framework for orderly discussion between courts and officials of the courts. Guideline 1 recommends that the Guidelines be adopted formally before they are used and the rest of the Guidelines set out the procedure by which the courts should conduct their communications. Notably,

²⁷ NV, 310 F 3d.

²⁸ Raslavich, Stephen. “When Courts Collide: Judicial Cooperation in ‘Duelling’ Insolvency Proceedings”, *IBA Section on Business Law: Insolvency and Creditors’ Rights*, April 2004.

²⁹ Rendall, quoting *Laker Airways Ltd. v Sabena* 731 F.2d 909, 214 (D.C. Circuit 1984).

³⁰ *Stonington Partners Inc v Lernout & Hauspie Speech Products*, as at footnote 24.

although the courts are encouraged to communicate via telephone, video conferencing or other electronic means, unless otherwise directed, the “counsel for all affected parties should be entitled to participate in person during the communication.”³¹ Guideline 9 provides that the courts may conduct joint hearings, sharing evidentiary and other written materials. These, as well as the other Guidelines, establish a mechanism whereby it is envisaged that the organisation and administration of complicated cross-border insolvencies³² could be co-ordinated in real time, resolving conflicts cooperatively as they arise and providing an invaluable interrogative tool whereby courts can discuss and debate the best way to proceed in the presence and with the participation of the parties involved.

Private cooperation – Protocols

In addition to the courts’ application of the principle of comity, the parties in the insolvency themselves can play an important part in establishing a private framework for cooperation across jurisdictions.

The most successful example of a protocol between the US and the UK courts was that established in the Maxwell Communication case³³. On 16 December 1991, Maxwell Communication Corporation plc (“Maxwell”), filed a Chapter 11 petition in the US Bankruptcy Court. The next day, the UK High Court of Justice appointed PricewaterhouseCoopers as joint administrators.

An examiner may be appointed by virtue of the USBC section 1104 and although his role is usually investigative, he may have any role and powers that the court designates. In the Maxwell Case, Judge Tina Brozman appointed an examiner and required him to act to harmonise the US Chapter 11 case and the UK administration for the benefit of all Maxwell’s creditors, shareholders and other interested parties and in order to maximise the prospects for rehabilitation and reorganisation.³⁴

To that end, Judge Brozman in the US and Justice Hoffman in the UK empowered the examiner and joint administrators to enter into a protocol, which governed their relationship. The protocol required the joint administrators to notify, consult or obtain consent from the examiner before taking specific actions. For instance, the joint administrators had the power to commence insolvency proceedings in respect of intermediate companies between the debtor and the ultimate parent company, but was required to notify the examiner and to cause the debtor to consult with the examiner before doing so. Other actions that required consultation or consent of the examiner included, amongst others: borrowing money; selling or charging assets; converting a Chapter 11 bankruptcy to Chapter 7; commencing insolvency proceedings with respect to any group companies; and filing a plan of reorganisation.

³¹ Guidelines 7 and 8.

³² As well as other cross-border litigation. The Guidelines, though conceived to assist with insolvencies, are not limited to insolvencies and the framers foresaw that they could be applicable in a variety of cross-border disputes.

³³ *In re Maxwell Communications Corp* (93 F 3d 1036 2d Cir (1996)). As discussed in the helpful article by Flaschen, Evan D and Silverman, Ronald J. “The role of the examiner as facilitator and harmoniser in the Maxwell Communication Corporation plc insolvency.” *Insolvency Law and Practice*, Vol 9, No 3 (1993), pp53-69 as well as by Lobello, Edward and Damast, Craig in their article “Examiners in Pivotal Evolving Roles,” *The New York Law Journal*, 26 August 2002.

³⁴ at 1042.

It is important to note that most of the obligations were not absolute. They imposed a duty to consult or notify and attempt to obtain consent in good faith. The degree to which the protocol effectively governed the relationship between the parties depended entirely on the attitude of the respective parties and the degree to which the parties were able to align their interests such that cooperation was always more advantageous than taking an adversarial approach to the process.

The collaborative approach was successful. In *re Maxwell Communication*, Judge Homan commented,

*“These parallel proceedings in the English and American courts have resulted in a high level of international cooperation and a significant degree of harmonization of the laws of the two countries. The affected parties agreed to the plan and the scheme despite differences in the two nations’ bankruptcy laws. The distribution mechanism established by them – beyond addressing some of the most obvious substantive and procedural incongruities – allowed Maxwell’s assets to be pooled together and sold as going concerns, maximizing the return to creditors...these accomplishments – which, we think, are attributable in large measure to the cooperation between the two courts overseeing the dual proceedings – are well worth preserving and advancing. This collaborative effort exemplifies the ‘spirit of cooperation’ with which tribunals, guided by comity, should approach cases touching the laws and interests of more than one country.”*³⁵

In light of the success of Maxwell Communications and the importance that the protocol played in formalising the cooperative approach the parties intended to take, it seemed reasonable that a similar approach would be adopted in one of the largest US/UK cross-border insolvencies in history – that of Federal Mogul Corporation.

Federal Mogul Corporation and its subsidiaries (“Federal Mogul”), a global supplier of automotive components and subsystems, filed for Chapter 11 restructuring in the US and administration in the UK on 1 October 2001. Federal Mogul had been plagued by asbestos liabilities before filing for reorganisation and paid approximately \$834 million in asbestos-related litigation and liability between 1998 and 31 September 2001³⁶.

Most of the asbestos-related liability was related to the acquisition of T&N plc, a UK company. Although Federal Mogul knew of the asbestos liability at the time of the acquisition in 1998, the company came to believe that the reserves of \$2.1 billion would not be adequate to cover all the anticipated asbestos litigation and liability.

A cooperative approach between the US and the UK was desired in order to give Federal Mogul the best possible chance to emerge from the restructuring as a viable business. To that end, a Cross-border Insolvency Protocol was adopted by the UK administrators, the cross-border companies and the US companies. The parties to the protocol adopted it in order to:

- Promote the orderly and efficient administration of the insolvency proceedings to, amongst other things, maximise the efficiency of the insolvency

³⁵ at 3d.

³⁶ www.federal-mogul.com

proceedings, reduce the costs associated therewith, and avoid duplication of effort;

- Harmonise and co-ordinate activities undertaken in the insolvency proceedings;
- Implement a framework of general principles to address certain business, administrative and management issues arising by virtue of the international nature of the insolvency proceedings; and
- Facilitate the fair, open and efficient administration of the insolvency proceedings for the benefit of all the debtors, creditors and other interested parties.

The parties intended for parallel schemes of administration and a Chapter 11 plan to be adopted and the administrators agreed that the US management would have primary responsibility for the development, implementation and confirmation of the plan of reorganisation. The administrators also consented to allow the boards of directors of each of the cross-border companies to continue to manage the affairs of the companies, subject to the supervision of the administrators. All parties agreed to consult with one another before taking any material actions with regard to the management of the companies or the insolvency process, whether in the US or the UK.

However, as in the Maxwell protocol, the Federal Mogul protocol does not contain absolute obligations and the success of the protocol is totally dependant on the parties adhering to the spirit, as much as to the letter, of the protocol. Indeed, the accommodations each of the parties afford one another are always expressly subject to their obligations under the laws of their respective countries. Thus, if the parties do not agree that cooperation is the most advantageous strategy to pursue for their constituencies, the good intentions embodied in the protocol can easily be subverted.

In the Federal Mogul case, it seems that the protocol may be unable to facilitate a cooperative exit from insolvency proceedings for Federal Mogul and its subsidiaries. Despite ongoing efforts to negotiate, the administrators believe that the plan of reorganisation is unfair to UK asbestos claimants and to pensions stakeholders and find themselves unable to support it. It now seems unlikely that parallel schemes of arrangement and the US plan of reorganisation will be pursued. The UK companies are likely to proceed down a controlled realisation path instead.

6. CONCLUSIONS

This paper has sought to review the various mechanisms by which international insolvencies might be managed. From international law in the form of UNCITRAL or the European regulations, to private treaty in the form of protocols, efforts to coordinate the process in cross-border insolvencies are developing.

No one piece of legislation, regulation, set of guidelines, philosophy or agreement can make a cross-border insolvency a cooperative experience that results in the most advantageous outcome for a company and its stakeholders. Only through a flexible application of all the tools available can individual solutions be tailored to each

company and its particular matrix of challenges. More importantly, though, only through a commitment to cooperation by the individuals involved in each cross-border insolvency can the best outcomes be achieved, as the pursuit of one constituency's interests to the exclusion of the interests of all the stakeholders, taken together, can result in unnecessary loss of time, assets and perhaps an opportunity to recover for vulnerable companies.

Courts, practitioners and those charged with the management of distressed companies should be alive to the various tools at their disposal to manage a cross-border insolvency and should be committed, from the start, to the coordination of their insolvency strategy.

Appendix 1

OVERVIEW OF UK INSOLVENCY PROCEDURES

Until the insolvency reforms, which are now incorporated in the Insolvency Act 1986, (“IA86”), liquidation and receivership were the two principal corporate insolvency procedures in the UK. There was only one means of compromising claims with creditors, through the formal and sometimes cumbersome scheme of arrangement. To these, IA86 added a third insolvency procedure, administration and the less formal company voluntary arrangement (“CVA”). Ironically, it was the success of administrative receivership which encouraged the creation of the administration procedure. Sir Kenneth Cork in his report in 1982³⁷, noted that what is now known as administrative receivership had been a great success, but was only available to the holders of floating charges. He proposed that an administrator be appointed whenever the circumstances justify it,

“with all the powers normally conferred upon a receiver and manager appointed under a floating charge, including power to carry on the business of the company and to borrow for that purpose.”

Hence, administration was born and, as it grew in popularity, the concept of extending its use as a rescue procedure gathered pace.

This was the goal of the corporate provisions of the Enterprise Act 2002 (“EA02”), which came into force on 15 September 2003. EA02, which amended IA86, was intended to emphasise and create the appropriate mechanisms to promote a more developed culture of corporate rescue. It drew much of its inspiration from insolvency procedures in Australia and the United States. EA02 prohibited the appointment of an administrative receiver by a floating charge holder, except in limited circumstances. The administrative receiver was almost invariably appointed by a bank who would be able to manage the assets of a company to enforce the security of the bank. In the deliberations surrounding the EA02, it was finally decided that this was an unhelpful way to manage the affairs of a distressed company, for both the company and its other creditors, and the use of administrative receivers was sharply curtailed.

However, administrative receivership was not wholly abolished. It remains an option for any holder of a floating charge which was created prior to 15 September 2003, and to those holders of floating charges created after that date who have been specifically exempted on the basis that their transactions could be jeopardised if they did not retain the right to appoint an administrative receiver (e.g. capital markets transactions and project finance transactions).

There are, following EA02, four major insolvency procedures which a distressed company may avail itself of; receivership; winding-up (or liquidation);

³⁷ Report of the Review Committee: Cmnd 8558.

administration; and company voluntary arrangements. Schemes of arrangement under the Companies Act 1985 are also frequently used by both solvent and insolvent companies in order to reach a compromise with creditors. A brief outline of each of these procedures follows.

Liquidation

Liquidation, or winding-up, applies to companies or partnerships. It involves the realisation and distribution of the assets and, usually, the closing down of the business. Insolvent liquidation rarely results in a restoration of the company as a trading entity. There are three types of liquidation – compulsory, creditors’ voluntary and members’ voluntary.

A compulsory liquidation is generally instigated by a creditor who is owed £750 or more, on the basis that the company is unable to pay its debts, although directors and members of the company can also apply. The process is commenced by a petition to the court to wind up the company. The Official Receiver is normally appointed liquidator when the winding-up order is made, unless or until replaced by a (private) licensed insolvency practitioner.

Voluntary liquidations are commenced out-of-court, with a resolution of the Board of Directors to call a meeting of the members of the company to wind it up. Because these are out of court procedures, the process is faster and more cost-effective. In a members’ voluntary liquidation there is no requirement for a meeting of creditors, as the directors will have sworn a declaration that the company is solvent and will be able to pay its creditors in full within 12 months. If that subsequently proves not to be the case, the company will have to go into creditors’ voluntary liquidation. In a creditors’ voluntary liquidation, the company is insolvent and it is necessary to call a creditors’ meeting following the members’ meeting, at which the directors will present a statement of affairs of the company and the creditors will nominate a liquidator. Where the creditors’ choice of liquidator is different to that of the members, the creditors’ choice takes priority.

Once the liquidator is appointed, he will collect in the assets and distribute them in accordance with the order of priority set out in IA86. In all types of liquidation, once the assets have been distributed, the company will be dissolved.

Administration

Prior to the coming in to force of EA02 the only route into administration was by court order. Floating charge holders were generally more likely to appoint an administrative receiver than petition the court for an administrator. EA02 made significant changes to the administration regime in the UK. Most notably, floating charge holders may no longer appoint an administrative receiver to enforce their security, except in a few very limited circumstances which have been discussed above. The *quid pro quo* for this concession is that such a creditor may appoint an administrator directly, without the need for court order. Thus, the secured creditor can still have significant influence over the process of administration and the choice of administrator. One of the stated objectives of the new administration procedure is to realise the property for the benefit of the secured or preferential creditor. However, that objective will always be subordinated to the primary goal of saving the company

(not just the business) as a going concern, or realising the assets for the benefit of the creditors as a whole.³⁸

Administration takes place in a moratorium, under the control of licensed insolvency practitioners who will act as administrators. This allows the administrators, and the company, time to seek to achieve the objective of the administration process without threat from individual creditors.

The administrator has very broad powers to achieve these objectives, including power to dispose of assets (including secured assets but protecting the secured creditors in respect of the proceeds of realisation), borrow money, appoint agents, and any other power the administrator might need in order to effectively manage the company's affairs, business and property³⁹. However, unlike Chapter 11 in the US, and after a long debate, there is no debtor in possession financing, which limits the value of the administration as a rescue procedure.

Following EA02, there are now two routes into administration: the court route and the out-of-court route. Appointment by the out-of-court route is available to floating charge holders and the company and its directors. The court route is the only way a creditor, except a floating charge holder or a supervisor under a CVA, may put a company into administration. Directors must also use the court route if, in general, the company is already in some kind of insolvency proceeding⁴⁰.

Once an administration has been completed, exit may be effected by CVA, liquidation or dissolution. If the administration produces a solvent company, control can revert back to the directors.

Receivership

There are three types of receivership:

- An administrative receiver who is appointed by a debenture holder under a charge which as created was a floating charge, over the whole or substantially the whole of the assets of the company;
- A Law of Property Act (or fixed charge) receiver who is appointed over specific assets; and
- A receiver appointed by the court (a rare procedure, occasionally to be used where management is deadlocked or abusing a dominant position).

As stated above, the appointment of administrative receivers has been severely curtailed, going forward, by the provisions of EA02. However, the power to appoint fixed charge receivers remains intact.

The duty of the administrative receiver is primarily to his debenture holder, unlike the administrator (whose duty is to all creditors and the company) and, generally speaking, once he has realised the assets subject to the charge the administrative receiver will resign.

³⁸ *ibid*, Schedule B1, para 3.

³⁹ *ibid*, Schedule 1.

⁴⁰ *ibid*, Schedule B1, para 23-25.

Company voluntary arrangements

A CVA is a contract between a company and its creditors. In most cases, it allows a company to enter into a binding arrangement with its creditors for the composition of its debt by a simple, out-of-court procedure. It is not merely a standalone procedure and may be used as an exit route by companies that are in administration or liquidation.

In the case where a company is not in administration or being wound up, a CVA is proposed to both the company and its creditors by the directors, administrators or liquidators of the company⁴¹. The proposal will provide for a nominee (an insolvency practitioner) to be appointed to supervise the implementation of the proposal and, in most cases, to act as a trustee for the benefit of the company's creditors. Where a company is in administration or liquidation, the administrator or liquidator, respectively, may propose a CVA and will usually act, in each case, as nominee and supervisor of the CVA.

If the proposal is approved by the requisite majorities at meetings of the shareholders of the company and its creditors, the arrangement will become binding on all of those entitled to vote at those meetings.

The CVA procedure is of limited use for two reasons. First, except in the case of eligible small companies, there is no moratorium available to restrain proceedings against the company whilst the CVA proposal is being considered and implemented. Second, the CVA may not be enforced against a secured or a preferential creditor without his consent⁴². For these reasons, companies that might have been good candidates for a CVA are more likely to enter into administration.

Schemes of Arrangement

A scheme of arrangement is a compromise or arrangement between a company and its members or creditors (or any class of them) under section 425 of the Companies Act 1985. A scheme can be either a solvent or an insolvent procedure. A company can effect almost any kind of internal reorganisation (for example a merger, de-merger or restructuring) through a scheme of arrangement.

In order to be approved, a meeting to approve the scheme, convened by the court, requires approval by a majority in number representing three-quarters in value of the members or creditors (or class of members or creditors) who vote at the meeting in person or by proxy. It must then be sanctioned by the court and once this happens the scheme of arrangement is binding on all members or creditors (or class of members or creditors) of the company.

Although the UK's insolvency procedures may sound familiar to insolvency practitioners in the US and other jurisdictions, the differences are critical enough that cross-border insolvencies require both structural and attitudinal cooperation in order to achieve the most desirable and efficient outcomes in cross-border insolvencies.

⁴¹ IA86, section 1(1).

⁴² IA86, section 4(3), 4(4).

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