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Implementation of the UNCITRAL Model Law on Cross-Border Insolvency in Great Britain — The Impact for Chapter 11 Debtors

With the enactment of the Cross-Border Insolvency Regulations 2006 on 4 April 2006, the UK has given effect to the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency. The primary objectives of the Model Law are to harmonise the treatment of cross-border insolvencies and to facilitate cooperation between officeholders involved with the same debtor, without attempting to unify local insolvency laws or affect creditors' substantive rights.

Many articles have been written explaining the finer points of the regulations. This article will not attempt to do that. This article will instead outline the key aspects of the regulations particularly as they apply to Chapter 11 debtors with UK assets, and will address the manner in which the authors believe the regulations will alter the relationship between UK and US practitioners in Chapter 11 cross-border insolvency scenarios.

The historical political and cultural affinity between the US and the UK has not extended to the recognition by the UK of Chapter 11 proceedings. This fact usually came as a surprise to US practitioners, who expected the extra-territorial, world-wide effect of Chapter 11 orders to apply in Europe. US practitioners became accustomed to European creditors complying with the Chapter 11 procedure for fear of acting (or being perceived to act) in contempt of the US Bankruptcy court. One of the primary underlying difficulties is that the Chapter 11 procedure and the UK administration regime are fundamentally different restructuring and insolvency mechanisms.

The refusal by Mr Justice Hirst in the English High Court decision of *Felixstowe Dock & Railway Co v. United States Lines Inc* ([1989] 1 QB 360, [1988] 2 All ER 77) to discharge *Mareva* injunctions in the face of the restraining order of the New York Bankruptcy Court was the nadir and represented what Lord Millet later reflected "did great harm to the relations between the courts of the two countries, and seriously damaged the esteem in which the UK courts had previously been held by insolvency practitioners and judges abroad"(*Cross-Border Insolvency: The Judicial Approach* Int. Insolv. Rev., Vol 6: 99 – 113 at 108). In arriving at his decision, Mr Justice Hirst adopted the observation of Mr Justice Cons in *Mobil Sales and Supply Corporation v. The Owners of Pacific Bear* ([1979] HKLR 125 at 134), that the Chapter 11 process was "not a process of universal distribution but a process of deliberately preferential distribution"(quoted by Hirst J at [1989] QB 360, 387).

In the absence of a legal framework for cooperation, practitioners in a certain instances implemented court sanctioned insolvency protocols designed to provide a framework for cooperation in multinational insolvencies. The first time one was used was in 1992 in the insolvency of the *Maxwell Communication Corporation*, which was placed in administration in England and in Chapter 11 in New York, with administrators and an examiner appointed respectively. More recently in *Federal Mogul* a cross-border insolvency protocol was entered into with a view to co-ordinating the US and UK insolvency proceedings and assisting towards the development of a reorganisation plan for the group. While such protocols have had some success, they have been limited in number, largely because they are difficult to implement and, taking *Cenargo* as an example, are only possible where there is cooperation between the two courts and between the insolvency practitioners in each jurisdiction.

Typically, absent a protocol, insolvency practitioners appointed over UK companies whose US parent is subject to Chapter 11 proceedings have effectively ignored the existence and conduct of the Chapter 11. To the extent that a group's assets were held through UK subsidiaries, those subsidiaries were assessed as separate legal entities for solvency purposes, with rights and obligations independent to those of the US group parent. This often meant that upon Chapter 11 proceedings being instigated the directors of the local UK entity, possibly dependant on funding from their US parent, were duty bound to place the company into some form of UK insolvency proceeding, usually administration. A necessary and unavoidable result was that the US debtor lost any control over the UK subsidiary - it's only remaining interest being a claim as a creditor or equity holder.

During the 1990s, as the number of truly global corporate groups expanded and the number, magnitude and nature of corporate collapses increased, including *Maxwell* and *Barings*, so did the need for the implementation of an appropriately international cross-border insolvency recognition regime. From the efforts of the International Bar Association which developed the Cross-Border Insolvency Concordat, to the Group of Thirty/INSOL collaboration examining the issues that could arise in the cross-border insolvency of a financial institution, certain important mechanisms have emerged. In Europe of course it culminated with the introduction of the EC Regulation on Insolvency Proceedings in May 2006, and with the United Nations, the UNCITRAL Model Law.

First adopted by UNCITRAL in 1997, the purpose of the Model Law is to provide a mechanism for the mutual recognition of cross-border insolvencies and otherwise assist in the coordination of proceedings concerning the same debtor. The Model Law has already been enacted in the US, through Chapter 15 of the Bankruptcy Code, and nine other countries, with Australia, Canada and New Zealand destined to follow in the near future. Each jurisdiction has implemented the Model Law with slight, but in many instances important, modifications. In the UK, the Model Law is enacted through the Cross-Border Insolvency Regulations 2006.

On a practical level, the Regulations provide a familiar mechanism for a US debtor in Chapter 11 proceedings with UK assets to seek direct access and relief from the UK courts without having to bear the full cost of an UK insolvency procedure or lose control of its UK assets.

The impact of the Regulations on a particular debtor in Chapter 11 proceedings depends on two factors. First, whether the proceedings are "main" or "non-main", and second the timing of the application for recognition.

As to the first issue, the regulations operate by recognising a "foreign proceeding" as either main or non-main. The definition of foreign proceeding in this context applies to collective insolvency proceedings (receivership or a foreign equivalent will not be recognised) which differs from the scope of the definition in Chapter 15 which also includes "adjustment of debt" proceedings. Accordingly the regulations exclude out-of-court restructuring processes. On this basis, whether the Regulations apply to restructuring procedures executed within insolvency processes (such as a plan of reorganisation) can only be said to be arguable at this early stage. However on the basis of the recent decision of the Privy Council in *Cambridge Gas Transport Corporation v. The Official Committee of Unsecured Creditors* (Privy Council Appeal No 46 of 2005), we believe it is likely that a plan of reorganiation would in any event be enforceable in an English court.

Upon the recognition of a "foreign main proceeding" (being one which is taking place in the State where the debtor has the centre of its main interests, (COMI)), an automatic moratorium applies. The moratorium is broad but does not affect any right to take steps to enforce security over the debtor's property and does not prohibit local creditors from initiating or continuing insolvency proceedings in the UK in relation to the debtor when a foreign proceeding has already been recognised.

The recognition of the foreign proceeding as "foreign non-main proceeding", being where the debtor has an "establishment" in the foreign State ("a place of operations where the debtor carries out a non-transitory economic activity with human means and assets or services"), does not lead to automatic relief, but certain specified relief is available upon application. The relief available includes the

examination of witnesses and injunctive relief which are also available to a foreign representative in a foreign main proceeding where it is necessary to protect the assets of the debtor or the interests of creditors.

As to the second issue of timing, the regulations differentiate the treatment of concurrent proceedings depending on the timing and nature of the proceedings. This will have an impact on the strategy employed by the foreign representative depending on the precise aims of the recognition proceedings. Where a UK proceeding is taking place prior to the filing of an application for recognition of a foreign proceeding (whether main or non-main), relief granted under the regulation must be consistent with the existing UK proceeding. Further, in the case where a foreign proceeding is recognised as a foreign *main* proceeding after the commencement of a UK proceeding, the automatic moratorium will not be available to the foreign proceeding. If however UK proceedings are commenced after the filing of an application for recognition of a foreign proceeding (whether main or non-main), the relief given to, or proceedings brought by, the foreign representative will be reviewed, and if such relief or proceedings are inconsistent with the later UK proceedings, the relief shall be terminated or directions regarding continuance of proceedings shall be given by the UK court.

Where a UK proceeding and a recognised foreign non-main proceeding run concurrently, any modification or continuance of relief is subject to the UK court's satisfaction that the relief granted to that non-main foreign proceeding is appropriate to such proceeding under UK law.

Given the moratorium that automatically applies upon recognition of a foreign proceeding as a foreign main proceeding, we see an emerging practice in which a debtor in Chapter 11 proceedings files for recognition as a foreign main proceeding in the UK to take control of its local assets, and subsequently places the local entity into administration under UK law. The administration would then be conducted in a soft manner with the debtor-in-possession able to effectively retain control of the local assets as part of a coordinated international realisation strategy. The office holder would also be able to apply for ancillary relief such as the appointment of individuals to act in certain roles, and for the implementation of insolvency protocols, if appropriate. Adding teeth to the recognition, the regulation also provides the foreign officeholder with rights to apply to the UK courts under UK anti-avoidance provisions (for example, transactions at an undervalue and preferences under sections 238 and 239 of the Insolvency Act 1986).

This is clearly a very different situation to that which existed prior to the enactment of the regulations. However there are uncertainties in the scope of the regulations.

A key uncertainty which we understand UNCITRAL is examining is how the interpretation of the regulations will impact upon multinational groups of companies. Given that the COMI of the group may not be the same as that of its individual component companies, the question arises as to whether the COMI should be in respect of each company or for the group as a whole. Whether the courts should interpret the issue in accordance with current European case law (for example *Eurofoods*) remains to be seen.

The enactment of the Cross-Border Insolvency Regulations 2006 is a welcome development, particularly given the tortured history of the recognition of Chapter 11 proceedings in the UK. There are real practical benefits to be obtained immediately for debtors in Chapter 11 proceedings, notwithstanding the practical differences between the regulations and Chapter 15, and the uncertainties that will invariably be the subject of judicial clarification. There are clearly very real opportunities available for distressed debtors with insolvency advisors who have relevant expertise on both sides of the Atlantic, particularly with large scale insolvencies.

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