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No Recognition of Solvent "Foreign Proceedings" in the UK

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The English court has held that solvent proceedings cannot be recognised under the Cross-Border Insolvency Regulations 2006 ("CBIR") (which implement the UNCITRAL Model Law for Cross-Border Insolvency in the UK), in the case of *Sturgeon Central Asia Balanced Fund Ltd*.

Impact

- The judgment restricts the nature of "foreign proceedings" capable of recognition under the CBIR — solvent debtors/proceedings intended to distribute a surplus to shareholders will not qualify.
- The judgment raises the question of whether the English court will have to make an investigation into insolvency when considering future applications for recognition of foreign proceedings. The judge in *Sturgeon* considered it would not, stating that the vast majority of cases will be obvious.
- However, care will be necessary in future cases where the company may not be obviously insolvent (or in financial distress). Of course, for certain international restructuring/insolvency regimes, most notably U.S. Chapter 11 cases, insolvency is not a prerequisite. For example, currently there are a number of high-profile U.S. Chapter 11 cases involving debtors that were solvent at the time of filing.
- This may also be problematic in the case of group proceedings where it may not be obvious that **all** debtors are insolvent.

Judgment and Comment

In essence, the court held that:

- It would be contrary to the stated purpose and object of the UNCITRAL Model Law to interpret "foreign proceedings" to include solvent debtors and, more particularly, to include proceedings that have the purpose of producing a return to members (rather than creditors); and
- For recognition to be ordered in England, the proceedings in respect of which recognition is sought must relate to the resolution of the debtor's insolvency or financial distress.

In *Sturgeon*, the foreign proceedings consisted of a Bermudan winding up on just and equitable grounds. The company was not in financial distress; it was "undoubtedly solvent". Accordingly, the court ordered that the existing recognition order be terminated.

This judgment contrasts with the approach in the U.S. under Chapter 15 of the U.S. Bankruptcy Code.[1] Indeed, this judgment marks the latest in a series of cases demonstrating the divergence of the U.K. and the U.S. on questions of cross-border recognition. Despite an apparent shared fidelity to the text of the UNCITRAL Model Law, there are significant differences between the U.S. and the U.K. approaches in practice. The most significant divergence concerns recognition of foreign restructuring plans: U.S. courts routinely recognise foreign restructuring plans, even endorsing features of foreign plans that would likely be unacceptable in Chapter 11 and including plans that modify/discharge obligations governed by New York law. In contrast, the English courts' approach is (in essence) that the relevant provisions of the UNCITRAL Model Law do not apply to the recognition and enforcement of foreign judgments against third parties.[2]

The court in *Sturgeon* noted that "consistency of approach, not uniformity, is the goal". Market participants should be aware that the consistency gap is widening.

Additional Background

Under the CBIR, a "foreign main proceeding" is defined as "a collective judicial or administrative proceeding in a foreign State … pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation". The issue in the present case was whether a just and equitable winding-up of a solvent company under the law of Bermuda fell within that definition.

The English court had recognised Sturgeon's solvent liquidation in May 2019 — the first order to recognise the liquidation of a solvent company as a foreign proceeding in this jurisdiction. The original recognition application had been made without notice and heard without the benefit of adversarial argument. A former director applied to terminate the recognition order, on the basis that the CBIR should not apply to demonstrably solvent companies.

The court conducted an extensive review of official guidance materials relating to the UNCITRAL Model Law (which, notably, does not attempt to define "insolvency", given the widely differing approaches taken in different jurisdictions). The court found that the relevant materials were focused on the need to recognise and provide relief upon recognition of foreign proceedings that concerned debtors that either could not pay their debts or were struggling to pay their debts and seeking to reorganise. It ultimately concluded that it was an essential element of "foreign proceedings" that the company itself be insolvent or in severe financial distress. Accordingly, Sturgeon's solvent winding up was not a "foreign proceeding" within the scope of the CBIR and therefore should not be recognised by the English court.

An appeal remains possible.

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1. In *re Betcorp* (2009), the U.S. court recognised the voluntary liquidation of an Australian company as a foreign main proceeding under Chapter 15 of the U.S. Bankruptcy Code. The court in *Sturgeon* held — following an extensive review of UNCITRAL papers and materials, many of which post-dated the U.S. decision in *Betcorp* — that *Betcorp* cannot be relied upon to support the proposition that a solvent company entering into liquidation on just and equitable grounds pursuant to insolvency legislation in a foreign jurisdiction is in and of itself sufficient to justify recognition. The court held that "a wrong turn was made in *Betcorp* as it was not an insolvent liquidation but a solvent liquidation. It was necessary to go one step further and ask whether the company was insolvent or in severe financial distress."↩

2. *Rubin v Eurofinance* (2012), Supreme Court; *International Bank of Azerbaijan* (2018), Court of Appeal.↩

Authors

David R. Seligman, P.C.

Partner / Chicago

Kate Stephenson

Partner / London

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