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Cross-Border Insolvency

A Commentary on the UNCITRAL Model Law,
Third Edition

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Preface

Look Chan Ho
Freshfields Bruckhaus Deringer LLP

A curious inquirer might ask what the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency is all about. An innocent inquirer might ask whether the Model Law is the non-EU version of the EC Insolvency Regulation.

The answer is broadly twofold. First, unlike the EC Insolvency Regulation, which is primarily concerned with determining the jurisdiction to open insolvency proceedings, the Model Law does not determine the jurisdiction to open insolvency proceedings at all. The Model Law is in essence concerned with cross-border assistance in insolvency matters – the recognition of foreign insolvency proceedings, the coordination of proceedings in relation to the same debtor and cooperation between authorities in different states.

Second, the Model Law is a set of prescriptive guidelines to be given force through national enactment. National legislatures retain complete freedom when enacting the Model Law – to follow it verbatim or to depart from it in such manner as the local circumstances demand. As such, one cannot overemphasise the need to look at how the Model Law is implemented and applied in each jurisdiction. What is more, Article 8 of the Model Law provides that in the interpretation of the Model Law, "regard is to be had to its international origin and to the need to promote uniformity in its application", thereby making comparative legal analysis an imperative. It is primarily for these reasons that this book provides an article-by-article commentary on the local enactment of the Model Law. Indeed, the vibrant US and English case law since publication of the first edition of this book has borne out the comparative analysis required by Article 8 and has demonstrated that the Model Law truly works across borders.

The vibrancy of the Model Law has been fuelled by the recent synchronised downturn in the global economy, resulting in an upswing in cross-border insolvency cases. Notable examples include the US bankruptcy proceedings in respect of Lehman, Stanford and Madoff which have utilised the Model Law in a number of countries including England, Australia and Canada. In England, the Model Law is bound to develop rapidly alongside the common law, as exemplified in *Rubin v Eurofinance*.

Accordingly, this book seeks to show how the Model Law works in local jurisdictions and to facilitate comparative legal analysis with a view to achieving the Model Law's full potential.

I have the pleasure of thanking those who have helped bring this edition to

fruition. Above all, I am most grateful to all of the contributors for their commitment, patience and sterling efforts throughout.

Look Chan Ho
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Overview

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1. Introduction

On May 30 1997 the United Nations Commission on International Trade Law (UNCITRAL) adopted the Model Law on Cross-Border Insolvency with a view to helping states to manage transnational insolvency cases in an efficient, fair and cost-effective manner.[1] In its simplest form, a transnational insolvency involves an insolvency proceeding in one country, with creditors located in at least one other country. In the most complex cases, it involves multiple proceedings, subsidiaries, affiliated entities, assets, operations and creditors in dozens of nations.

The Model Law does not attempt to harmonise local insolvency law. The main issues addressed by it include:

- the recognition of foreign proceedings;
- the coordination of proceedings concerning the same debtor;
- the rights of foreign creditors;
- the rights and duties of foreign insolvency representatives; and
- cooperation between authorities in different states.

The Model Law provisions are directed towards admirable goals – international judicial cooperation and efficient administration of cross-border insolvencies, protection of the debtor's estate and creditors' interests, and facilitation of business rescue, among others. Whether these goals can be realised depends on the manner in which the Model Law is implemented and interpreted in the jurisdictions that have decided to adopt it. Thus far, about 20 jurisdictions have adopted the Model Law,[2] although in some cases the local enactments remain inoperative.

Article 8 of the Model Law provides that in interpreting the Model Law, "regard is to be had to its international origin and to the need to promote uniformity in its application". In all jurisdictions that have implemented the Model Law, the mandate embodied in Article 8 either has been implemented directly or is already part of the national legal culture. This makes it imperative for national courts to consider how

1 For a comprehensive treatment of the background to the Model Law, see Jenny Clift, "The UNCITRAL Model Law on Cross-Border Insolvency – A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency" (2004) 12 Tul J Int'l & Comp L 307; Andre J Berends, "The UNCITRAL Model Law On Cross-Border Insolvency: A Comprehensive Overview" (1998) 6 Tulane J Int Law 309.

2 Although the Cayman Islands has not expressly implemented the Model Law, its cross-border insolvency practice applies the Model Law principles in all but name, as demonstrated in *Re Straumur-Burduras Investment Bank hf*, 2010 (2) CILR 146.

the Model Law is implemented and interpreted in other jurisdictions. This book aims to provide some of the necessary materials for this endeavour.

Serving to complement the materials contained in the following chapters, this chapter seeks to provide an overview of the different implementing methods in different jurisdictions, highlighting some of the most important differences – in particular, between the enactments in the United Kingdom[3] and the United States, which have been the key users of the Model Law. Indeed, there is already a fair amount of US case law, not least because Chapter 15 of the US Bankruptcy Code is the only gateway to cross-border insolvency assistance under US law.[4]

2. Scope of application

While in principle the Model Law applies to insolvency proceedings in relation to all types of debtor, Article 1(2) contemplates the possibility of excluding certain types of entity from the scope of application, such as banks and insurance companies, as they are usually subject to special local insolvency regimes. The Guide to Enactment of the Model Law (paragraph 66) also contemplates the exclusion – in those jurisdictions that have not made provision for the insolvency of consumers or whose insolvency law provides special treatment for the insolvency of non-traders – of those insolvencies that relate to natural persons residing in the enacting state whose debts have been incurred predominantly for personal or household purposes.

Many jurisdictions have sought to take advantage of some of these permitted exclusions.

In the United Kingdom, the Model Law does not apply to certain entities that are already subject to special insolvency regimes, such as credit institutions and insurance undertakings.[5]

Similarly, in the United States, the Model Law does not apply to certain entities that are subject to specialised insolvency arrangements, such as banks and railroads, although it applies to foreign insurance companies.[6]

3. Reciprocity

Although reciprocity is not a requirement of the Model Law, the reciprocity requirement has been imposed *de jure* or *de facto* by a number of states – namely, the British Virgin Islands,[7] Mauritius,[8] Mexico,[9] Romania[10] and South Africa.[11]

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3 However, though the British legislation (the Cross-Border Insolvency Regulations 2006) dealt with in this book applies only to England, Scotland and Wales. Northern Ireland has its own equivalent legislation, namely the Cross-Border Insolvency Regulations (Northern Ireland) 2007. The British enactment is referred to as the 'British Model Law' in this chapter.

4 *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd*, 389 BR 325 (SDNY 2008). For detailed discussion, see the US chapter. See also Alesia Ranney-Marinelli, "Overview of Chapter 15 Ancillary and Other Cross-Border Cases" 82 Am Bankr LJ 269 (2008).

5 Article 1(2) of the British Model Law. See pp 142–143.

6 Section 1501 of the Bankruptcy Code. See p p 475–476.

7 See p 58.

8 See p 289.

9 See p 317.

10 See p 379.

11 See p 403.

4. Access of foreign representatives and creditors to local courts

Article 9 of the Model Law entitles a foreign representative to apply directly to a local court. The mandate embodied in this article is reflected in all jurisdictions that have adopted the Model Law, albeit with some local differences.

Article 9 appears almost verbatim in the British legislation.[12] However, in the United States, the legislation imposes recognition of the foreign proceeding as a condition to further rights and duties of the foreign representative.[13]

Article 11 of the Model Law entitles a foreign representative to commence a proceeding under the local insolvency laws if the conditions for commencing such a proceeding are otherwise met. Again, the mandate embodied in this article is reflected in all the jurisdictions that have adopted the Model Law, albeit with some local differences.

In the United Kingdom, it is made clear that foreign representatives of foreign main or non-main proceedings are given the right to apply to commence a British insolvency proceeding.[14] In the United States, however, the foreign representative's right to commence local bankruptcy proceedings is conditional upon the prior recognition of the foreign proceeding.[15]

Under Article 12 of the Model Law, upon recognition of a foreign proceeding, the foreign representative is entitled to participate in a local insolvency proceeding of the debtor. The intent in this article is reflected in all jurisdictions that have adopted the Model Law.

In addition to providing direct access for foreign representatives, Article 13(1) requires that foreign creditors have access to the courts of the enacting state for the purpose of commencing or participating in a local insolvency proceeding. While making clear that this principle of creditor access does not affect the ranking of claims in local insolvency proceedings, Article 13(2) requires that, at a minimum, foreign creditors receive the same treatment as general unsecured creditors, unless they are in a class of creditors in which domestic creditors would also be subordinated. The Model Law also allows for an exception to the principle of non-discrimination as to foreign revenue and other public law claims.

The intent in Article 13 is broadly reflected in all of the jurisdictions that have adopted the Model Law, albeit with some local differences.[16] The British Model Law has in fact gone further than Article 13 by abrogating the common law rule that foreign revenue and public law claims are unenforceable.[17] On the other hand, the US Bankruptcy Code leaves this common law position undisturbed.[18]

5. Centre of main interests and establishment

The operation of most of the Model Law's provisions depends on whether one is

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12 Article 9 of the British Model Law.
13 Section 1509 of the Bankruptcy Code.
14 Article 11 of the British Model Law.
15 Section 1511 of the Bankruptcy Code.
16 Korea has not implemented Article 13(2). See p 429.
17 Article 13(3) of the British Model Law.
18 Section 1513.

concerned with a foreign main or non-main proceeding.[19] A 'foreign main proceeding' is a foreign proceeding taking place in the state where the debtor has its centre of main interests;[20] a 'foreign non-main proceeding' is a foreign proceeding, other than a foreign main proceeding, taking place in a state where the debtor has an establishment – that is, any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.[21] Although 'centre of main interests' is not defined, there is a presumption that the debtor's registered office, or habitual residence in the case of an individual, is the debtor's centre of main interests.[22]

These concepts have been enacted in all jurisdictions, with some local variations.[23] Given that the concepts of centre of main interests and establishment have their origin in the EU Convention on Insolvency Proceedings, which was subsequently reproduced as Council Regulation (EC) 1346/2000 on insolvency proceedings, case law[24] on the meaning of 'centre of main interests' and establishment under the EC Insolvency Regulation has been treated as influential in this respect.[25] Case law under the EC Insolvency Regulation should not be treated as decisive. Also, the weight of the presumption in favour of the debtor's registered office or habitual residence should carry less weight in the Model Law.[26]

6. Recognition of a foreign proceeding and relief

The provisions dealing with recognition of foreign proceedings represent the core of the Model Law. They set out the recognition requirements, mandate recognition once the requirements are satisfied and provide for the effects of recognition.

6.1 Recognition process

Articles 15 and 16 of the Model Law set out the paperwork that should accompany a foreign representative's application for recognition and the presumption of authenticity of the application papers. The idea behind Articles 15 and 16, a simplified application procedure, is enacted in all of the jurisdictions.

Article 17 mandates that, once the necessary criteria have been satisfied, a foreign proceeding shall be recognised as a foreign main proceeding or non-main proceeding. The local court is obliged to determine the recognition application promptly. The requirements of Article 17 have been implemented in all jurisdictions.

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19 In the United States, the existence of a foreign main or non-main proceeding represents the new 'entry visa' for foreign debtors seeking assistance from the US court. For criticisms of the US position, see Alesia Ranney-Marinelli, "Overview of Chapter 15 Ancillary and Other Cross-Border Cases" 82 Am Bankr LJ 269 (2008).

20 Article 2(b).

21 Articles 2(c) and (f). Note that the mere presence of assets is insufficient to meet the definition of 'establishment'.

22 Article 16(3).

23 For example, the Canadian legislation contains no definition of the term 'establishment' in order to allow the Canadian courts to recognise in appropriate circumstances a foreign proceeding from a jurisdiction where the debtor does not even have an establishment. See p 78.

24 For example, *Re Eurofood IFSC* [2006] 1 Ch 508.

25 Sometimes leading to mistakes, for example, *Re Stanford International Bank* [2010] EWCA Civ 137; [2011] Ch 33. See pp 191–206.

26 For further discussion, see pp 191 and 206.

6.2 Interim relief

Article 19 of the Model Law allows the court, at the foreign representative's request, to grant interim relief when this is urgently needed to protect the debtor's assets or the creditor's interests. This includes staying execution against the debtor's assets and entrusting the administration or realisation of all or part of the debtor's assets to the foreign representative or another person designated by the court. Any such relief will terminate when the application for recognition is decided upon.

All jurisdictions that have adopted the Model Law provide for the possibility of such interim relief. The Japanese legislation even allows the application for interim relief to be made by any interested party.[27]

6.3 Effect of recognition

The effect of recognition depends on whether the foreign proceeding is a foreign main or non-main proceeding.

Article 20 provides that, upon recognition of a foreign main proceeding, certain automatic relief ensues, including:

- a stay of actions of individual creditors against the debtor;
- a stay of execution against the debtor's assets; and
- suspension of the debtor's right to transfer or encumber its assets.

The enacting state is given plenty of freedom to define and modify the automatic relief.

Apart from Japan[28] and Korea,[29] all other jurisdictions provide for certain automatic relief upon the recognition of a foreign main proceeding. However, the scope of the automatic relief is far from uniform. For example, in the United States, the automatic relief includes a stay on the enforcement of security interests,[30] while in the United Kingdom, secured creditors are free to enforce their security.[31]

Article 21 allows the court to grant discretionary relief upon the recognition of a foreign main proceeding and non-main proceeding to protect the debtor's assets or the creditors' interests. The scope of the discretionary relief includes matters already covered by the interim relief under Article 19 and automatic relief under Article 20. All jurisdictions have implemented Article 21, albeit with some local differences. In Poland, there is an argument that the recognition of a foreign non-main proceeding will attract automatic relief.[32]

7. Protection of creditors and other interested parties

The Model Law contains provisions (in particular, Articles 6 and 22) intended to protect the interests of all interested parties and to allay concerns that the Model Law is not based on the principle of reciprocity.

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27 See p 283.
28 See pp 283–284.
29 See p 428.
30 Section 1521 of the Bankruptcy Code.
31 Article 20 of the British Model Law.
32 See pp 362–363.

Article 22 requires the court to be satisfied that the interests of creditors and other interested persons are adequately protected when granting or denying relief under Article 19 or 21. The court may subject the relief granted to conditions it considers appropriate,[33] and may modify or terminate such relief if requested by any person affected.

Article 22 has been implemented in all jurisdictions, apart from Japan and Korea.[34]

Moreover, Article 6 allows the court to refuse to take an action governed by the Model Law if the action would be manifestly contrary to the public policy of the enacting state. This article is meant to be interpreted in the most restrictive manner so that it is confined to the fundamental principles of law.

In the context of the public policy exception under the EC Insolvency Regulation, the European Court of Justice in *Re Eurofood IFSC* confirmed that such exception is reserved for exceptional cases which include the fundamental right to be heard:

> *Concerning more particularly the right to be notified of procedural documents and, more generally, the right to be heard ... these rights occupy an eminent position in the organisation and conduct of a fair legal process. In the context of insolvency proceedings, the right of creditors or their representatives to participate in accordance with the equality of arms principle is of particular importance. Though the specific detailed rules concerning the right to be heard may vary according to the urgency for a ruling to be given, any restriction on the exercise of that right must be duly justified and surrounded by procedural guarantees ensuring that persons concerned by such proceedings actually have the opportunity to challenge the measures adopted in urgency.*[35]

US Chapter 15 cases continue to provide guidance on the operation of this public policy exception.[36]

Article 6 has been implemented in all of the jurisdictions.

8. Communication and cooperation

Cross-border cooperation is indispensable to achieving the Model Law's objectives. Accordingly, the Model Law mandates local courts and insolvency representatives to "cooperate to the maximum extent possible with foreign courts or foreign representatives".[37] Local courts and insolvency representatives are authorised to communicate directly with foreign courts and foreign representatives.[38] Article 27 of the Model Law contains a non-exclusive list of types of cooperation, which may be especially helpful to states where cross-border judicial cooperation has traditionally been limited.

Although the Model Law restricts its recognition regime to foreign proceedings opened in a state where the debtor has either its centre of main interests or an establishment, the cooperation provisions in Articles 25, 26 and 27 extend to foreign

33 Article 22 is not meant to qualify the mandatory recognition under Article 17.
34 See pp 284 and 428.
35 *Re Eurofood IFSC* [2006] 1 Ch 508.
36 See pp 178–181.
37 Articles 25 and 26.
38 An example of the central role of court-to-court communication is *In re Cenargo Int'l, PLC*, 294 BR 571, 594 (Bankr SDNY 2003).

proceedings opened on the sole basis of the presence of assets within that state. Nor is the court's ability to cooperate conditional on prior recognition of the foreign proceeding.

To the extent not already reflected in existing national law, these cooperation provisions have been implemented in all jurisdictions.[39]

9. Concurrent proceedings

The Model Law also deals with the possibility of concurrent local and foreign insolvency proceedings.

Article 28 deals with the commencement of a local insolvency proceeding subsequent to the recognition of a foreign main proceeding. Article 28 permits such a commencement if the debtor has assets in the state.[40] The effect of the local proceeding will be limited to the local assets and, to the extent necessary to implement the cooperation provisions in Articles 25, 26 and 27, to other assets that under local law should be administered in the foreign main proceeding.

Where there are concurrent local and foreign proceedings, Article 29 requires the court to cooperate under Articles 25, 26 and 27, and mandates the coordination of relief.

Article 30 addresses the circumstances of multiple concurrent foreign proceedings. The court is enjoined to seek cooperation and coordination among the proceedings under Articles 25, 26 and 27.

These provisions have been largely reflected in all jurisdictions, apart from Japan. The Japanese legislation adheres to the 'one proceeding per debtor' principle, which dictates that where one proceeding is taking place in relation to a debtor, all other proceedings must be stayed and then terminated when the former proceeding is completed.[41]

Article 32 establishes the 'hotchpot rule', which requires that before a creditor can lodge a proof and receive dividends in a local insolvency proceeding, it must account for what has been obtained abroad.[42] It does not affect the ranking of claims as established by the law of the enacting state and is intended solely to establish the equal treatment of creditors of the same class. For example, when an unsecured creditor has received 5% of its claim in a foreign insolvency proceeding and then participates in the insolvency proceeding in the enacting state where the rate of distribution is 15%, the creditor will receive 10% of its claim in the enacting state in order to put it in a position equal to other creditors in the enacting state.[43]

Although the hotchpot rule in Article 32 does not apply to secured claims, its implementation in Canada,[44] Japan,[45] and Korea[46] may also apply to secured claims.

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39 Note that court-to-court communication still may not be the custom in civil law jurisdictions, such as Korea (see p 434).

40 In other words, Article 28 permits the commencement of a local proceeding, even if the debtor does not have a local establishment.

41 See p 285.

42 See generally Look Chan Ho, "On *Pari Passu*, Equality and Hotchpot in Cross-Border Insolvency" [2003] LMCLQ 95.

43 Guide to Enactment of the Model Law, para 198.

10. Conclusion

The Model Law is an important, though modest,[47] stride towards the fair and efficient management of cross-border insolvencies. It is to be hoped that it will be widely adopted and consistently applied.

Beyond the Model Law, there remain a number of important areas which require further harmonisation, such as the choice of law issues left open by the Model Law, the recognition of foreign discharges,[48] the determination of the centre of main interests of a corporate group and procedural due process.[49] However, a successful application of the Model Law will no doubt go a long way towards resolving these issues.

Note: the conventions followed with regard to capitalisation, punctuation and similar throughout this guide are the publisher's own house style.

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44 See p 98.
45 See p 286.
46 See p 434.
47 "A journey of a 1000 miles begins with a single step": Jay Lawrence Westbrook, "Chapter 15 At Last" (2005) 79 Am Bankr LJ 713, fn 23. Cf Lynn LoPucki, "Global and Out of Control?" (2005) 79 Am Bankr LJ 79; Jay Lawrence Westbrook, "Multinational Financial Distress: The Last Hurrah of Territorialism" 41 Tex Int'l LJ 321 (2006).
48 Jay Lawrence Westbrook, "Chapter 15 and Discharge" (2005) 13 Am Bankr Inst L Rev 503.
49 Honorable Samuel L Bufford, "Global Venue Controls Are Coming: A Reply to Professor LoPucki" (2005) 79 Am Bankr LJ 105.