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Crossing Swords? Domestic Application of Foreign Law Under the UNCITRAL Model Law on Cross-Border Insolvency

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Contents

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Acknowledgement

INSOL International is pleased to present the 14th Technical Paper under its Technical Papers Series. The Paper is titled “Crossing Swords? Domestic Application of Foreign Law Under the UNCITRAL Model Law on Cross-Border Insolvency” and is written by Michael Quinlan and Hugh Boylan of Allens Arthur Robinson, Australia.

The UNCITRAL Working Group on Insolvency Law has stated that: 'A model law is a legislative text that is recommended to States for adoption as part of their national law. In incorporating the text of the Model Law in its system, a State may tailor the text of the law to its needs and, if appropriate, modify or leave out some of its provisions'.* Australia, United Kingdom and the USA the three main countries that are covered in this paper have all adopted a variant of the Model Law on Cross-Border Insolvency.

Recent case decisions in these countries dealing with issues under the new legislation have revealed that the application of foreign insolvency laws in domestic courts is a topic which is yet unresolved. This paper provides a very good overview of the recent international case law that has considered the issues surrounding the application of foreign law in domestic courts, and has drawn interesting conclusions in respect of each of these countries.

We would like to thank Michael Quinlan and Hugh Boylan for writing this excellent and informative paper that provides a good insight into the current judicial thinking.

September 2010

* UNCITRAL Working Group on Insolvency Law, 22nd Session, Vienna, 6-17 December 1999, A/CN.9/WG.V/WP.50, para 162.

Crossing Swords? Domestic Application of Foreign Law Under the UNCITRAL Model Law on Cross-border Insolvency

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1. Introduction

The multi-jurisdictional flavour of international business carries with it the risk of entangled international insolvencies with creditors spanning the globe. This risk was addressed by the United Nations Commission on International Trade Law (*UNCITRAL*) in 1997 when it produced the *Model Law on Cross-Border Insolvency* (*Model Law*). This article addresses one of the key problems faced by states that have enacted a variant of the UNCITRAL scheme: can foreign law be applied domestically pursuant to the local variants of the Model Law? Despite being acknowledged as an 'important issue',[1] little jurisprudence has addressed this question. This article attempts to fill that lacuna by reference to cases from the United States, the United Kingdom and Australia.

The central aim of the Model Law is to provide recourse to local courts to foreign creditors and insolvency practitioners. Under the Model Law, a representative of an insolvency proceeding (e.g. a liquidator) may act in a foreign state in the interests of the local proceeding as permitted by the law of the foreign state. Article 2 of the Model Law defines key terms. Two of the most important are 'foreign main proceeding' and 'foreign non-main proceeding' which determine whether or not a representative will be entitled to act beyond its domestic jurisdiction. A foreign main proceeding is a foreign proceeding opened in the jurisdiction where the debtor has its 'centre of main interests'[2], while a non-main proceeding is a foreign proceeding other than a foreign main proceeding, opened in a state where the debtor has an 'establishment'.[3] If a proceeding is recognized under the Model Law, articles 20 and 21 endow courts with the power to enforce mandatory and discretionary relief respectively.[4] The variant of the Model law in all three countries (see below) facilitates applications by foreign representatives for aid from foreign courts to recognize or enforce domestic decisions. The extent to which provision of such aid to uphold foreign orders or enforce foreign laws which are inconsistent with or non-existent in a country's domestic laws is outlined in varying degrees in the emerging decisions concerning the Model Law of each country.

The preamble to the General Assembly's Resolution (52/158 December 15 1997) states that the purpose of the Model Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

- Co-operation between the courts and other competent authorities of different states involved in cases of cross-border insolvency;

- Greater legal certainty for trade and investment;

[*] The views expressed in this article are the views of the authors, Michael Quinlan and Hugh Boylan of Allens Arthur Robinson, Australia and not of INSOL International, London.

[1] *Perpetual Trustee Co. Ltd. V BNY Corporate Trustee Services Ltd & Ors* [2009] EWHC 1912 (Ch), [62].

[2] This term is not defined in the Model Law or the *Cross-Border Insolvency Act 2008* (Cth). The Explanatory Memorandum notes that the 'centre of main interest' does not need to be defined because of the pre-existing body of common law in overseas jurisdictions. Explanatory Memorandum, Cross-Border Insolvency Bill 2008 (Cth).

[3] Maiden, S, *A Comparative Analysis of the use of the UNCITRAL Model Law on Cross-Border Insolvency in Australia*, *Great Britain and the United States*, (2010) 18 Insolv LJ 63, pp 65-66. Maiden outlines the differences between the Australian, UK and US definitions of 'establishment', but notes that the nuances are unlikely to result in any different application.

[4] Relief in respect of a foreign non-main proceeding is limited to assets that, according to local laws, should be administered in that proceeding or concerns information required in that proceeding.

- Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;

- Protection and maximization of the value of the debtor's assets; and

- Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

The variant of the Model Law in each of the three countries considered by this article is found in:

- Australia: The *Cross-Border Insolvency Act 2008* (Cth) (*Australian Act*)

- The United Kingdom: The *Cross-Border Insolvency Regulations 2006* (*UK Regulations*). UK cross-border insolvency law also incorporates the *EC Regulations on Insolvency Proceedings* (Commission Regulation No. 1346/2000 of 31 May 2002 on Insolvency Proceedings [2000] OJL 160/1).

- The United States: Chapter 15, Title 11 of the *United States Bankruptcy Code* (*US Code*), introduced by the *Bankruptcy Abuse Prevention and Consumer Protection Act 2005* (US).

In all three jurisdictions common law principles governing cross-border insolvencies are preserved.

The Model Law facilitates the recognition of foreign proceedings, co-ordination of proceedings concerning the same debtor, rights of foreign creditors, rights and duties of foreign insolvency representatives, and co-operation between authorities in different states.[5] The complete fulfillment of the above objectives would require an impossible degree of jurisdictional harmonisation – and that is not the Model Law's purpose. To quote the UNCITRAL Working Group on Insolvency Law:

> 'A model law is a legislative text that is recommended to States for adoption as part of their national law. In incorporating the text of the Model Law in its system, a State may tailor the text of the law to its needs and, if appropriate, modify or leave out some of its provisions'[6]

The Model Law is not intended to supplant a state's existing cross-border insolvency regime or provide exhaustive governance– rather it provides a framework to be built into a state's domestic system for managing international insolvencies. However, the peculiarities of the legal systems of each state that has implemented a variant of the Model Law[7] may operate as a barrier to the total fulfillment of the UNCITRAL objectives (see above).

In the 13th session of the UNCITRAL Working Group it was noted:

> 'As to the possibility…that the court might issue measures pursuant to a foreign law, i.e., the law of the foreign proceeding, it was widely thought that such a possibility was unrealistic and that, therefore, the reference to foreign law should be deleted'.[8]

Despite this statement, there have been a number of instances in international jurisprudence permitting foreign law to tread, albeit lightly, into the domestic arena. In an article published in 2009, Look Chan Ho considered the situation in the United Kingdom and expressed the view that a jurisdiction to apply foreign law can be found in article 21 of the Model Law. Article 21(1)(g) permits the courts to order any appropriate relief that may be available to an insolvency officeholder under

5 Ho, (Gen. Ed.), *Cross-Border Insolvency: A Commentary on the UNCITRAL Model Law*, Globe Business Publishing Ltd, 2006, p 11.
6 UNCITRAL Working Group on Insolvency Law, 22nd Session, Vienna, 6-17 December 1999, A/CN.9/WG.V/WP.50, para 162.
7 Variants of the Model Law have been enacted in: Australia (2008), British Virgin Islands; overseas territory of the United Kingdom of Great Britain and Northern Ireland (2003), Canada (2009), Colombia (2006), Eritrea (1998), Great Britain (2006), Greece (2010), Japan (2000), Mauritius (2009), Mexico (2000), Montenegro (2002), New Zealand (2006), Poland (2003), Republic of Korea (2006), Romania (2003), Serbia (2004), Slovenia (2007), South Africa (2000), and the United States of America (2005).
8 UNCITRAL, 13th Session, 24 October 1996 A/CN.9/433 paragraph 133.

the laws of the enacting state. Article 2(q) of the English variant of the Model Law provides that references to the law of Great Britain include its rules of private international law. In Ho's view, the Model Law thereby 'leaves open these choice of law issues and the possibility of national courts applying foreign law to an avoidance action'.[9] Paragraph 166 of the Guide to the enactment of the Model law is referred to by Ho in support of this proposition:

> 'The Model Law expressly provides that a foreign representative has standing… to initiate actions to avoid or otherwise render ineffective legal acts detrimental to creditors. The provision is drafted narrowly in that it does not create any substantive right regarding such actions and also does not provide any solution involving conflict of laws'.[10]

The Model Law does not expressly confer jurisdiction to apply foreign law domestically. As noted above, that proposal was rejected by the Working Group.[11] It may be arguable in certain jurisdictions, as suggested by Ho's article, that a power exists under a nation's choice of law rules (provided the country's variant of the Model Law has a requisite link) to permit the application of foreign law domestically. There may be an implied or common law power to enforce foreign law in some jurisdictions. Another potential site for development is article 8, requiring courts to interpret the Model Law with regard to its 'international origin' and 'the need to promote uniformity', which may lead decision-makers to reach more liberal verdicts that reach beyond the scope of their nation's private international law. Decisions are being made on a case-by-case basis with clear regard to the public policy limitation in article 6 of each country's variant of the Model Law (the interaction between articles 6 and 8 may produce interesting decisions, see *Eurofinance*, below 3.2). As is evident in this article, transnational cross-border insolvency laws are resulting in the development of a body of precedent which will assist courts across jurisdictions in discerning the extent of their ability to apply foreign law in domestic disputes.

2. The United States

The US variant of the Model Law is found in Chapter 15 of the United States Code (*US Code*). A number of cases have applied foreign law in the United States. Any jurisdiction to apply foreign law conferred by the United States Code is limited by § 1506[12] (public policy) and § 1521 of Chapter 15. The latter section demands that the interests of US creditors are sufficiently protected and the court may exercise its power to entrust a debtor's assets to a foreign representative. In a 2007 article[13], Judith Wade noted that this may severely limit the assistance US courts will provide to foreign representatives as 'interests' are not defined in Chapter 15 and the United States House of Representatives Report[14] provides no guidance as to how it should be interpreted. Wade asserted that courts would be likely to continue to use case law decided under the repealed § 304 in their approach to the new Chapter 15 of the US Code. Wade noted that 'decisions under the previous § 304 could at times be quite protective of United States creditor interests'.[15] In Wade's view, such decisions would be likely to further narrow the opportunities for courts to apply foreign decisions or legislative provisions contrary to those of their domestic jurisdiction.

2.1 *Interpool Ltd v Certain Freights of M/V Venture Star* 102 B.R. 373 (1988)

This pre-Model Law case is an example of the problem identified by Wade. This case concerned an Australian liquidator's § 304 application which, if successful, would have recognized 'the rights of the liquidator to administer assets located in the United States under the umbrella of Australian

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[9] Ho, *Applying Foreign Law under the UNCITRAL Model Law on Cross-Border Insolvency*, Butterworths Journal of International Banking and Financial Law, Vol. 24, 2009, 671.

[10] UNCITRAL *Guide to the Enactment of the Model Law*, 72nd plenary meeting, 15 December 1997, paragraph 166.

[11] UNCITRAL, 13th Session, 24 October 1996 A/CN.9/433 paragraph 133

[12] *The United States Code,* Chapter 15, Title 11, § 1521. The Code is published every 6 years by the Office of the Law Revision Counsel. The current version can be viewed at http://uscode.house.gov/.

[13] Wade, J, *A New Era in United States Cooperation in International Insolvency Administrations?*, (2007) 15 Insolv LJ 35., p 48.

[14] *United States House of Representatives Report* 109-031 (I) as reprinted in 2005 U.S.C.C.A.N 88.

[15] Ibid. It is interesting on this point to note *In re Betcorp Limited (in Liq.), Petitioner* 400 B.R. 266, (51 Bankr 266) 2009, which the Bankruptcy Court (District of Nevada) ruled that an Australian voluntary liquidation classified as a 'proceeding' for the purposes of Chapter 15.

bankruptcy law'.[16] At the time of judgment, Australian insolvency laws did not provide either the procedural protections to creditors available under the United States bankruptcy law or the equitable subordination remedy.[17] The court denied assistance to the petitioner because 'protection of United States creditors is of utmost importance to this court. Actions taken by a foreign court in a foreign bankruptcy are to be given deference if, and only if, there would be no substantial violation of the law that would be applied in the United States'.[18]

Interpool was decided under the repealed § 304, and, despite Chapter 15's similar protection of US creditors, a number of recent cases, such as *Ephedra Products*[19] and *Metcalfe*[20] (below, 2.2 and 2.4 respectively) indicate that courts have given particular weight to the principles of comity. Whether or not this liberalism continues as more decisions emerge in the wake of the global financial crisis is yet to be seen. However, the concerns expressed by Wade in 2007 may not be being realized in practice. According to one United States judge, in US cross-border insolvency 'the purpose of comity is to co-ordinate efforts with a parallel foreign proceeding' and courts are aware that this 'may involve overriding domestic legal doctrines'.[21]

2.2 *In re Ephedra* Products Liability Litigation, 349 B.R. 333 (S.D.N.Y 2006)

(a) Can a foreign law be applied where that application would override a US citizen's rights under the Seventh Amendment to a jury trial?

As noted above the extent to which foreign law may apply is limited by a public policy exception in § 1506 of the US Code (article 6 of the Model Law). This case is an example of the limited extent to which § 1506 may operate to protect rights conferred on citizens by US law. In this case a Canadian order was enforced despite the fact that it overrode a party's constitutional right to a civil jury trial. Prior to the banning of Ephedra by the US Food and Drug Administration, Muscletech Research and Development Inc (a Canadian company) had sold products containing the ingredient in the United States. A large number of personal injury claims were brought against the company and in early 2006 when the company instigated an insolvency proceeding in Ontario, the Monitor sought recognition of the Canadian proceedings in US courts. A key argument brought by the opponents of recognition was that § 1506 prevented recognition of the Canadian proceedings because a mandatory mediation clause in Muscletech's Claims Resolution Procedure (which also governed the claims of US parties) denied them the right to a civil jury trial. The court disagreed.

Judge Rakoff cited *Hilton v Guyot*, 159 U.S. 113, S.Ct 139, 40 L.Ed 95 (1895), in which the Supreme Court held a foreign judgment should generally be accorded comity if 'its proceedings are according to the course of civilized jurisprudence', i.e. fair and impartial.[22] These concepts of fairness and impartiality appear to be a yardstick for determining whether or not a foreign judgment should be upheld (as evident in *Metcalfe* and *Qimonda*, below at 2.4 and 2.5 respectively). Pre-UNCITRAL dicta in Canada indicates that the same test may apply in that jurisdiction;

> 'respect should be accorded to the overall thrust of foreign bankruptcy and insolvency legislation in any analysis, unless in substance it is so different from the bankruptcy and insolvency law of Canada or perhaps because the legal process that generates the foreign order diverges radically from the process here in Canada'.[23]

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[16] *Interpool Ltd v Certain Freights of M/V Venture Star* 102 B.R. 373 (1988), [375].
[17] Wade, *A New Era in United States Cooperation in International Insolvency Administrations?* p 48.
[18] *Interpool Ltd*, [378].
[19] *In re Ephedra Products Liability. Litigation, 349 B.R. 333 (S.D.N.Y 2006).*
[20] *Metcalfe & Mansfield Alternative Investment s*, No. 09-16709 (MG) (Bankr. S.D.N.Y 2010).
[21] *In Re Atlas Shipping A/S* 404 B.R. 726 (Bankr. S.D.N.Y 2009), [16].
[22] *In re Ephedra Products Liability. Litigation,* [4], citing *Hilton v Guyot*, 159 U.S. 113, S.Ct 139, 40 L.Ed 95 (1895).
[23] *Babcock & Wilcox Canada Ltd* (2000), 18 CBR (4th) 157 (Ont SCJ), as cited by Golick and Wasserman in Ho, (Gen. Ed.), *Cross-Border Insolvency: A Commentary on the UNCITRAL Model Law*, Globe Business Publishing Ltd, 2006, p 43.

2.3 *In Re Atlas Shipping A/S* 404 B.R. 726 (Bankr S.D.N.Y 2009)

(a) Can principles of foreign law be used to extend existing domestic doctrines?

In this case, a Danish foreign representative of Atlas Shipping A/S and Atlas Bulk Shipping AS (debtor corporations in a Danish bankruptcy proceeding) sought to have nine maritime attachment liens obtained by foreign creditors vacated. The attachments had been issued in support of arbitrations commenced by Atlas' creditors in London pursuant to various provisions of applicable maritime charters.[24] The court was requested by the representative to apply provisions of the *Bankruptcy Act of the Kingdom of Denmark*. In breach of the Danish Act[25], seven of the attachments had been obtained after the Danish proceeding commenced.

Among many arguments raised by the objecting creditors was the submission that the attachments had to remain in force because of a decision of the Second Circuit in *Aqua Stoli Shipping Ltd v Gardner Smith Pty Ltd, 460 F.3d*, (at [436]) which laid down principles for when an attachment could be vacated. Comity was not one of the grounds. Citing *Ephedra Products* (above, 2.2), the Court dismissed this argument, noting that 'the purpose of comity is to co-ordinate efforts with a parallel foreign proceeding: that may involve overriding domestic legal doctrines'.[26] The Court found that 'in such circumstances, the attachments would be dissolved and the funds returned to the foreign forum'.[27] Glenn J held that as application of Danish law would result in all nine attachments being dissolved, the court would grant comity to the Danish proceeding and dissolve them.[28]

It would be difficult to argue that this case is authority for the proposition that foreign law may be applied despite contrary domestic decisions, but the case does form part of the body of precedent used in coming to decisions like *Qimonda* (below, 2.5), and accordingly is important in understanding the impact of Chapter 15 on intrusions of foreign principles into domestic common law.

2.4 *Metcalfe & Mansfield Alternative Investments* No. 09-16709 (MG) (Bankr. S.D.N.Y 2010)

(a) Can a Canadian Order be upheld in the United States despite contradicting the Unites States Bankruptcy Code?

The *Metcalfe* proceedings arose as a result of a restructuring in the Canadian Asset Backed Commercial Paper market.[29] In *Metcalfe*, the Ontario Superior Court of Justice (*Ontario Court*) supported a Sanction Order and Plan agreed to by the court-appointed Monitor, the Investors Committee and other key participants in the market. The plan included a global third-party non-debtor release. The Ontario Court's orders also provided injunctive relief to the aforementioned market participants. The petitioners successfully asserted that the Canadian Orders preserving the release should be upheld in the United States irrespective of the possibility that the release may not have been recognized in a Chapter 11 bankruptcy proceeding.

It was argued that the Ontario Court's orders were inconsistent with the US Law because they would not pass the stringent tests applied to such releases laid down in other Chapter 11 cases. The US Court had regard to obiter in *In re Metromedia Fiber Network, In*c., 416 F. 3d 136 (2d Cir. 2005) in which it was said 'a non-debtor [sic] release is a device that lends itself to abuse…the potential for abuse is heightened when releases afford blanket immunity'' (at [142]) and 'a non-debtor release in a plan of reorganization should not be approved absent the

[24] *In Re Atlas Shipping*, [2].
[25] *Bankruptcy Act of the Kingdom of Denmark*, s 31(1).
[26] *In Re Atlas Shipping,* [16].
[27] Ibid, [13].
[28] Ibid. Two of the nine attachments were pre-bankruptcy, but evidence also supported their dissolution.
[29] The ABCP market froze during the week of August 13 2007. The crisis was largely triggered by market sentiment, as news spread on defaults of U.S. sub-prime mortgages. *Metcalfe & Mansfield Alternative Investment s*, [6].

finding that truly unusual circumstances render the release terms important to the success of the plan' (at [143]).

Judge Glenn emphasized the importance of comity (relevantly expressed in Chapter 15 at § 1509 and § 1507) in determining whether or not to enforce the Canadian orders; and noted:

> 'principles of enforcement of foreign judgments and comity in chapter 11 cases strongly counsel approval of enforcement in the United States of the third-party non-debtor release and injunction provisions included in Canadian Orders, even if those provisions could not be entered in a plenary chapter 11 case'.[30]

Judge Glenn cited a line of authority confirming that, once a case has been recognized as a foreign main proceeding, 'chapter 15 specifically contemplates that the court will exercise its discretion consistent with the principles of comity'.[31] Judge Glenn also noted that 'the relief granted in the foreign proceeding and the relief available in a US proceeding need not be identical'[32] in order for the court to recognize foreign authority, and reasoned that 'the key determination required by this Court is whether the procedures used in Canada meet our fundamental standards of fairness'.[33] The looseness of this test is immediately apparent, but a degree of flexibility is paramount in enforcing variants of the Model Law if it is to impact on cross-border insolvency adjudications at all. Judge Glenn also had regard to the relationship between the American and Canadian legal systems, citing *Cornfeld v Investors Overseas Servs*., Ltd 471 F. Supp 1255 (S.D.N.Y 1979) 'Canada is a sister common law jurisdiction with procedures akin to our own'.

2.5 *In Re Qimonda AG 2009 WL 4060083 (Bankr. E.D.Va., July 2 2010)*

(a) Can a provision of the German Insolvency Code operate to the exclusion of a contrary provision in the US Bankruptcy Code?

In Re Qimonda is the most recent and instructive case on point. This case concerns the fate of patent cross-licensing agreements between several US companies and a German company upon the insolvency of the latter. The relevant aspect of the dispute is whether or not the German company was permitted to elect non-performance of the cross-licensing agreements – representing a conflict of laws between § 365(n) of the US Code and § 103 of the German Insolvency Code (*German Code*). This conflict arose because the German Code permits non-performance of executory contracts, and under the US Code, while trustees in bankruptcy have the option of rejecting executory contracts, certain rights of parties remain. To paraphrase § 365(n), if a trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee may elect to either treat the contract as terminated by the rejection and sue, or elect to retain its rights under the contract (an election with which the trustee must comply). These rights are inconsistent with the German Code.

In November 2009, the Bankruptcy Court ruled that:

> 'the application of § 365 to Qimonda's patent portfolio would substantially undermine German Insolvency Code § 103, which permits an administrator to elect nonperformance of an executory contract'[34]; and section 365 must give way to the German Insolvency Code because '[a]ncillary proceedings such as the chapter 15 proceeding pending in this court should supplement, but not supplant, the German proceeding'.[35]

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[30] .*Metcalfe & Mansfield Alternative Investments*, [18].
[31] Ibid, [19], citing *In Re Atlas Shipping.*
[32] Ibid, [20].
[33] Ibid.
[34] *In re Qimonda AG*, 2009 Bankr. LEXIS 3786 (Bankr. E.D. Va. July 2, 2010), (though the court conditioned the applicability of s 365(n) on the formal rejection of an executory contract under the Bankruptcy Code).
[35] Ibid, [6].

The Court also had regard to the practical consequences of making a contrary order, noting that if each license was dealt with according to the jurisdiction in which the licensees or licensors were operating, a large number of inconsistent rulings would ensue.

An appeal was launched in January 2010 and the helpful decision of Judge Ellis of the United States District Court, Alexandria, Virginia was handed down on 2 July 2010. One of the issues raised on appeal was whether the Bankruptcy Court erred in deferring to the application of the German Code under comity principles. The appellants submitted that application of § 103 of the German Code would inequitably permit the foreign representative to terminate their cross-licensing agreements with Qimonda, and then demand that they pay new licensing or royalty fees. There was also a dispute as to whether § 1521 (article 21 of the Model Law) permitted § 365(n) to be applied on a discretionary basis, or whether § 1520 (article 20 of the Model Law, conferring mandatory imposition of sections 361, 362, 363, 549 and 552 upon recognition of a foreign main proceeding) required its mandatory application. The court found that the application of § 365 was discretionary.

Having failed to make out their argument against the discretionary use of § 365(n), the appellants contended that application of the German Code fell afoul of the public policy exception in § 1506 of the US Code, which states that: 'nothing in [chapter 15] prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States'. The courts interpret the limitation narrowly and the exception will only apply to 'the most fundamental policies of the United States'.[36] The interaction of the narrow interpretation of § 1506 and the directive that a United States court '*shall* grant comity or cooperation to the foreign representative' in § 1509 is interesting and has yet to be fully tested. Ellis J summarizes that two factors are determinative of whether § 1506 will apply: whether the foreign proceeding was procedurally fair, and whether the application of a foreign proceeding would 'severely impinge the value and import' of a US statutory or constitutional right, such that granting comity would 'severely hinder United States bankruptcy courts' abilities to carry out… the most fundamental policies and purposes of these rights'.[37] This question was remanded to the Bankruptcy Court for it to state its reasons why the exception should not apply. Ellis J highlighted that all four decisions[38] regarding § 1506 concur on the 'fact that application of foreign law leads to a different result than the application of US. Law, is, without more, insufficient to support § 1506 protection'.[39] The key consequence of this case is the recognition by the court that it is possible for German legislation to be applied to the exclusion of a contrary provision in US law.

2.6 Conclusions on the US approach

Whilst it may be too early to identify a 'trend' in US jurisprudence, a number of judges have shown a willingness to apply principles of comity to permit relief and orders which are provided for by foreign laws but which would not be awarded by US domestic law.

3. The United Kingdom

The English common law has traditionally aspired to provide universal fairness to creditors. As Lord Hoffman put it:

> 'Fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and

[36] *United States House of Representatives Report* 109-031 (I) as reprinted in 2005 U.S.C.C.A.N 88. , p 172, as cited in *In re Ephedra Products Liability Litigation*. This is also reflected in paragraph 87 of The UNCITRAL Guide to Enactment of the Model Law.

[37] *In re Qimonda AG*, [32], citing *In Re Gold & Honey Ltd*, 410 B.R. 357 (Bankr E.D.N.Y 2009), [372]. *In Re Gold & Honey* is one of the four cases addressing § 1506, and the only one in which the exception was found to apply.

[38] *In Re Metcalfe & Mansfield Alternative Investments*, *In re Ernst & Young Inc*., 383 B.R. 773 (Bankr. D. Col. 2008), *In re Ephedra Products*, *In Re Gold & Honey Ltd*, 410 B.R. 357 (Bankr E.D.N.Y 2009).

[39] *In re Qimonda AG*, [31].

required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated'.[40]

This tradition reflects the philosophy of the Model Law and the relevant cases provide an interesting perspective on the manner in which the aspiration is upheld under the *Cross-Border Insolvency Regulations 2006* (UK) (*The Regulations*). Before considering the impact of the Regulations[41], we will briefly examine a non-Model Law case.

3.1 *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings plc & Ors [2009] UKPC 26*

This case was decided prior to the enactment of the Regulations. The Privy Council considered whether or not a plan of reorganisation approved by a US Bankruptcy Court could be enforced in its jurisdiction. The court noted, citing *Re African Farms* 1906 TS 373, that 'recognition carries with it the assistance of the court'. However, such assistance, in the absence of statutory guidance, is limited. The Privy Council ruled that the common law will not apply the provisions of foreign insolvency law which form no part of the domestic system. In this case, the Privy Council remained pragmatic and had regard to the principles of international judicial co-operation and the need to minimize the risk of parallel proceedings. Accordingly, despite the Court's refusal to embrace the proposal that it could apply foreign law, it held that the plan should be recognized.

3.2 *David Rubin and Henry Lan v Eurofinance SA & Ors* [2009] EWHC 2129 Ch 31

(a) Will an English court submit to the American determination that a trust may be a debtor?

In the United States a trust is treated as a separate legal entity. In the United Kingdom it is not. In order to access insolvency remedies in the UK, there must be a debtor with a legal personality, and in this case it was submitted that the insolvent trust was not such a debtor and, accordingly, the case could not be administered by English cross-border insolvency law. The point of interest in this case is the flexibility with which courts can interpret the Model Law to facilitate its full effect. While a trust would not fall within the traditional classification of a debtor in English law, in this case Nicholas Strauss QC (sitting as a deputy judge in the High Court) found that: 'the drafting origins of the relevant definitions are international, not domestic'…'it would be in my view perverse in that context to given the word "debtor" any other meaning than that given to it by the foreign court in the foreign main proceeding'.[42] He was also swayed by article 8, informing judicial officers of their role interpreting their nation's variant of the Model law in the interests of uniformity and with regard to its international origin. This is an important decision. Nicholas Strauss QC provides authority for later consideration that words in the Model Law should be given the meaning ascribed to them by the foreign jurisdiction asserting their relevance. It will be interesting, however, to see the degree to which the ambit of article 8 is limited by article 6: would the English public policy exception arise in relation to a semantic dispute? Presumably a grossly narrow interpretation of the word 'creditor' by a country asserting a foreign proceeding would trigger article 6 if the definition would operate to strip British creditors of their rights to recover. The *bona fide* requirement in article 8 is not likely to stretch too far beyond pragmatism (evident in this case) where national interests are at stake, particularly in a case where the fundamental principles of English insolvency law (equality amongst creditors) would be threatened or undermined.[43]

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[40] *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings plc & Ors* [2009] UKPC 26, [834]. Similar statements appear in American jurisprudence, 'American courts have long recognized the need to extend comity to foreign bankruptcy proceedings [because] the equitable and orderly distribution of a debtor's property requires assembling all claims against the limited assets in a single proceeding: if all creditors could not be bound, a plan of reorganization would fail', *Victrix S.S. Co., S.A. V Salen Dry Cargo A.B.*, 825 F. 2d 709, 713-714, as cited in *In Re Atlas Shipping,* [8].

[41] For an overview of case law concerning the Model Law to date, see Frazer, *The Limits of English Law in the English Courts*, 3-4 Digest, 3-4 South Square Barristers, November 2009, 2-4.

[42] *David Rubin and Henry Lan v Eurofinance SA & Ors* [2009] EWHC 2129 Ch 31 July 2009, [39].

[43] This case was appealed to the High Court, *Rubin and Lan (Joint Receivers and Managers of The Consumers Trust) v Eurofinance SA & Ors* [2010] EWCA Civ 895, but the relevant issue was not pursued.

3.3 *Swissair Schweizerische Luftverkehr-Aktiengesellschaft* [2009] EWHC 2099 (Ch)

(a) Can English courts remit assets to Swiss liquidators despite Swiss legislative violation of England's *pari passu* distribution rule?

In this case, Swiss-appointed liquidators applied to English courts, under both the court's inherent jurisdiction to remit assets to foreign liquidators and article 21 of the Model Law, to have English assets of Swissair remitted to them for distribution under Swiss law. The relevant Swiss insolvency law granted preferential status to certain creditors – but in this case sufficient assets had been realized in Switzerland to pay out the preferential liabilities in full. All remaining claims were to be paid out *pari passu*. David Richards J was able to avoid the foreign law question because the English assets to be remitted to the Swiss liquidator were to be applied solely in the general *pari passu* distribution in Switzerland.[44] His Honour cited a line of authority establishing the jurisdiction of the courts to direct a liquidator in an ancillary English liquidation to remit the assets to a foreign liquidator.[45] David Richards J found in favour of the remittal both under the court's power to give directions to liquidators and under article 21 of the Model Law.

3.4 Conflicting decisions and the Lehman matrix: *Perpetual Trustee Co. Ltd. v BNY Corporate Trustee Services Ltd & Ors [2009] EWHC 1912 (Ch)*

(a) Can an English court apply US Bankruptcy law to strike down the subordination of a party in a priority dispute?

The decisions of US and UK courts in this case highlights the need for international judicial co-operation. While the Model Law only arises in relation to the requested stay (below), the facts of the case and key submissions require canvassing. This situation is interesting because the cases considered the same set of facts but yielded different results.

A subsidiary of Lehman Brothers Holdings International, Lehman Brothers Special Financing Inc. (*LBSF*), entered into various agreements which were secured by assets held on trust by BNY Corporate Trustee Services (*BNY*). Essentially, note-holders subscribed to notes issued by a special purpose vehicle (*SPV 1*). The proceeds of the purchase of the notes went to purchasing notes issued by a different special purpose vehicle (*SPV 2*). SPV 2 purchased bonds and other secured investments (the collateral) which were held on trust by BNY. LBSF entered into a swap agreement with SPV 2 under which LBSF paid SPV 2 the amounts due by SPV 2 to the note-holders in exchange for sums equal to the yield on collateral. SPV 2 charged the collateral to BNY to secure its obligations to the investors and LBSF. While SPV 2's obligations to the note-holders and LSBF were secured by the same assets, LBSF had priority unless an event of default occurred – in which case a flip clause would be triggered and the note-holder would take priority. On 3 October 2008 LBSF filed for Chapter 11 bankruptcy, constituting a default event which triggered the flip clause and, prima facie, gave note-holders the first bite of the apple.

The cases turned on the validity of the flip clause. In the UK, and in Australia, the common law anti-deprivation principle[46] operates to prevent parties from contracting out of the obligation to have their assets distributed *pari passu* on bankruptcy. In other words, it is impermissible for contracting parties to arrange for property to move to one specific party in the event of another's insolvency. A similar principle is exists in the U.S. Code. When it considered these facts, the US Bankruptcy court found that the flip clauses were invalid under US law. When the

[44] A related discussion is provided in *Re HIH Casualty and General Insurance Ltd and Ors; McMahon & Ors v McGrath & Anor* [2008] UKHL 21, in which assets were remitted to Australian liquidators despite the preferential status of insurance company creditors under Australian insolvency law contracting the pari passu rule. Unfortunately this was not a Model Law case, and the House of Lords permitted remitter on s 426 of the *Insolvency Act 1986* (UK) which contains the UK letters of request procedure.

[45] See *Re Matheson Bros Ltd* ([1884] 27 Ch D 225, Re BCCI (No 10) [1997] Ch 213.

[46] See, for example, *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758, more recently *Mayhew v King & Ors* [2010] EWHC 1121 (Ch).

same facts were considered in the UK, the Court of Appeal ruled that the clauses did not violate the anti-deprivation principle.

The English Court also had to consider whether or not it should grant a stay in order for the US Bankruptcy Court (at the time hearing its own application) to formulate a request to the courts for assistance under either the Model or common law. The claimants (Perpetual and Belmont) argued that there was no point in ordering a stay because even if one were imposed there was no assistance the US Court could apply for which the English court could render and the *Insolvency Act* 1986 (UK) (*Insolvency Act*) did not apply, and nothing in the common law nor the Model law permitted the court to apply foreign law in England. The Chancellor determined that it would be 'premature and academic'[47] to use these facts to test the ambit of the court's powers under A\articles 21 and 25 of the Model Law. The Court ordered an adjournment to allow the U.S. Bankruptcy Court time to formulate a request.

3.5 *D/S Norden A/S v Samsun Logix Corporation [2009] EWHC 2304 (Ch)*

(a) Can a British court apply Korean insolvency law to set aside a lien?

D/S Norden A/S (*Norden*) applied to the court for permission to bring proceedings against an insolvent company, Samsun Logix Corporation (*Samsun*), notwithstanding a previous stay granted under the UK Regulations pending the resolution of a proceeding in a Korean court (Seoul Central District Court (3rd Bankruptcy Division)). Samsun applied to the High Court for Norden's claim to be struck-out. Norden was the owner of a vessel (the Port Moresby) which it chartered to Samsun, who in turn sub-chartered it to Carbofer. Samsun failed to make payments under the charter agreement and accordingly Norden served four notices of lien on Carbofer. Some of the payments were then made (both by Samsun and Carbofer). Carbofer agreed that it was liable to Samsun for $1 million under the sub-charter agreements. The dispute concerns $500,000 allegedly owed to Norden by Samsun.

On application by Samsun's receiver, the Korean court imposed a preservation order preventing Samsun from repaying its debts or providing security. Norden's security was challenged under the Korean bankruptcy legislation. When proceedings were brought in England, the court at first instance ruled that the Korean proceeding be recognized as a foreign main proceeding under the Model Law, ordering a stay of the kind expressed in article 20. The matter was then heard by Newey QC (acting as a deputy judge in the High Court). Counsel for Norden submitted that under paragraph 43 of Schedule B1 to the *Insolvency Act* a creditor would normally be given leave to exercise a proprietary right unless doing so would impede the achievement of the purpose of the administration. Counsel for Samsun submitted that it the court should not pre-empt a decision by the Korean court that Norden's security could not be enforced. It was further argued by Samsun that if the Korean court did find in the receiver's favour it was likely that an English court would uphold that decision.

The contract governing the parties' relationship established that matters arising under it were to be determined in accordance with English law. In these circumstances, counsel for Norden asserted that there 'was no prospect of an English Court granting relief to give effect to a Korean decision invalidating Norden's security in circumstances where…the security would not be vulnerable to challenge under English domestic law'.[48] While admitting that this argument had 'considerable force' Newey QC determined that 'the extent, if any, to which a Korean decision in the receiver's favour could be enforced in England, would, in my judgment, be best addressed if and when the Korean court has so ruled'.[49]

[47] *Perpetual Trustee Co. Ltd*, [62].
[48] *D/S Norden A/S v Samsun Logix Corporation* [2009] EWHC 2304 (Ch), [14].
[49] Ibid, [15].

Newey QC adopted the 'wait and see' approach paralleled in the Lehman Bros. case (above 3.4) ruling that the stay should be continued on the proviso that Norden's acceptance of the Korean jurisdiction would not cause it to be estopped from later making a claim in the English courts. It is likely that the Model Law will not permit English courts to apply foreign law to matters which should be decided according to principles of English contract. This is consistent with the approach taken by courts prior to the Model Law. Cases like *Cambridge Gas Transport Corp*, (above, 3.1) which was decided after the enactment of the Regulations but not under the auspices of the Model Law, make it clear that some common law rules will not be ousted.

3.6 Conclusions on the UK approach

The position in the UK regarding the application of foreign law is complicated by its four layers of insolvency regulation: the *Insolvency Act 1986*, the Model Law, the *EC Regulations on Insolvency Proceedings (EC Regulations)* and the common law. For example, the extent to which a court may grant 'any appropriate relief' under article 21 of the Model Law may be subject to interpretation in light of the common law ancillary liquidation doctrine, or private international law, which could limit the court's power to application of choice of law rules (possibly restricting article 21 to questions of forum non conveniens). Further, countries (e.g. Australia) attracting s 426 of the *Insolvency Act*[50] (the letters of request procedure which continues to be available in addition to the Model Law) – potentially have rights to apply to English courts for relief under the common law, the *Insolvency Act*, and the Model Law. Similarly, EU countries (save Denmark) that are not provided for in s 426 of the *Insolvency Act* may have rights under the common law, Model Law and *EC Regulations*.

It could, however, be said that the emerging authorities discussed in this article indicate that because certain common law rules are changing in light of the Regulations (for example, an automatic stay on recognition is not provided for at common law, but is codified in article 20), the Model Law confers a limited power to apply foreign law – possibly without excessive private international or common law intervention. These laws are interwoven through the relevant jurisprudence making single lines of authority difficult to discern. It is clear that the multi-layered regulation of foreign insolvencies in the UK has thus far resulted in more conservative decisions than those of United States judges. Movement may be seen in this area should English judges refer more often to US decisions. Increasing reliance on or references to article 8 (as in *Eurofinance*, above 3.2) may also provide a basis for further development. As yet no case has arisen in the UK offering courts the opportunity to fully test the extent of the jurisdiction conferred by the Model Law, but in our opinion it is possible that emerging US jurisprudence and factual scenarios attracting article 8 may provide impetus for change in this area.

4. Australia

The *Cross-Border Insolvency Act 2008* (Cth) (*Australian Act*) is the variant of the UNCITRAL Model Law. Very few relevant decisions have been handed down, and the most relevant case was decided under Australia's letter of request procedure (through which a 'prescribed' country[51] for the purposes of the legislation may apply to Australian courts for assistance in cross-border insolvencies where the insolvent company or group has interests in both Australia and the requesting country).

[50] It should be noted that the s 426 of the *Insolvency Act* has been held to be largely consistent with the common law ancillary liquidation doctrine, which would imply that the power to apply the law of a foreign jurisdiction conferred by the Act is simply a reflection of the choice of law rules to ensure a proceeding is heard in the appropriate forum. See generally *Re HIH Casualty and General Insurance Ltd* and the discussion in Moss, *The Secret Code of Insolvency Law*, 3-4 Digest, 3-4 South Square Barristers, November 2009, 16-19

[51] The prescribed countries are listed in reg 5.6.74 of the *Corporations Regulations 2001* (Cth) as Jersey, Canada, Papua New Guinea, Malaysia, New Zealand, Singapore, Switzerland, the United Kingdom and the United States.

4.1 *Independent Insurance Company Ltd* [2005] NSWSC 587

(a) Can a 'blanket injunction' in the United States in related proceedings be applied in Australia?

Section 581 of the *Corporations Act 2001* (Cth) confers a special jurisdiction on Australian courts to act in aid of foreign courts in prescribed countries following receipt of a letter of request from a court of appropriate jurisdiction in those countries to so act. The jurisdiction conferred on Australian courts by s 581 of the *Corporations Act* is not as broad as that conferred by s 426 of the UK *Insolvency Act*, under which it has been held that the task of an English court in receipt of a letter of request is 'to apply either its own insolvency law or the insolvency law of the requesting country'.[52] In *Independent Insurance*, Barrett J, considering a letter of request from the High Court of Justice of England and Wales, noted of s 581 that 'the Australian court is not expressly permitted nor required by the Australian legislation to exercise statutory powers that the English court itself may exercise, nor, of course, can the United Kingdom legislation be the source of any direct power of the Australian court to do so'.[53] The discretion conferred by s 581(3) is 'for the court to exercise such powers with respect to the matter as it could exercise if the matter had arisen in its own jurisdiction'.[54]

The relevant intersection of the Australian Act and the *Corporations Act* arises in s 22 of the former, which grants it overriding jurisdiction in the case of inconsistency. In *Independent Insurance* one of the questions faced by Barrett J was whether or not an Australian court could impose an injunction expressed in indefinite terms regarding the identity of the persons to be bound. Such blanket injunctions had been issued in the US and in Ireland, and the court was asked, in the interests of comity, to make such an order. Barrett J refused, citing *BP Australia Ltd v Brown* [2003] NSWCA 216 'the obligation to comply with procedural fairness…requires… that a person likely to be adversely affected by an order of the court is given an opportunity of making submissions to the court before any such order is made'.[55] Barrett J further noted 'while in the United States, there is apparently acceptance of the notion that a prohibitory order against persons with no notice of it is unobjectionable because those persons may apply to be exempt from it, the clear emphasis in our courts is the other way'.[56]

4.2 Conclusions on the Australian approach

Such judgments give rise to the same concern highlighted by Wade in her discussion of the American situation; the Australian common law principles of international insolvency still apply, and it is likely that such decisions will be used to interpret the Australian Act. *Independent Insurance* was decided three years before the introduction of the Australian Act and, given the inconsistency provision in s 22 and the developments in US and UK jurisprudence in the area since then, it is possible that Barrett J may have reached a different conclusion had the Model Law been in force and had the case been brought as an application under the Australian Act. It is interesting to note that the passage from *BP Australia* cited by Barrett J concerns procedural fairness, and it is likely that His Honour would have faced the same balancing of priorities faced in the UK and US in determining the extent to which Australian law will sacrifice its notions of procedural fairness in the interests of transnational judicial co-operation. Unlike the United States, Australia does not yet have the benefit of many domestic decisions made under its variant of the Model Law, making it difficult to determine whether or not the principles of comity embodied in it will be interpreted so liberally as to enable a departure from principles established in cases like *Independent Insurance*. However, as is the case for the United Kingdom, it is possible that, should a case be brought requiring the court to apply article 8, further development may be seen. Article 8 provides a solid footing for the argument that Australian courts must have regard to, for example, US authority, and consulting

[52] *Independent Insurance Company Ltd [2005] NSWSC 587*, [15], citing *England v Smith* [2001] 1 Ch 419 and *Hughes v Hannover Ruckversicherungs* AG [1997] 1 BCLC 497, see also footnote 49, above.
[53] *Independent Insurance Company Ltd* , [15].
[54] Ibid, [13].
[55] Ibid, [46] citing *BP Australia Lt v Brown* [2003] NSWCA 216.
[56] Ibid, [52].citing *BP Australia Lt v Brown*.

cases like *Qimonda* (above, 2.5) may have significant impact on the outcome of future Australian decisions under the Model Law.

5. Conclusion

The changing pace of international business raises complex problems. These problems have been magnified by the global financial crisis and the strength of national variants of the Model Law will be vigorously tested as courts grapple with the many legal challenges the crisis has produced. Judge Peck of the U.S. Bankruptcy Court commented that the collapse of Lehman brothers was 'undoubtedly the most massive cross-border insolvency in the history of the world',[57] and it is in the wake of this and similar collapses that courts must interpret and re-interpret the provisions of the Model Law. The importance of pragmatism continues to be highlighted by the fall of gargantuan corporate groups with interests in multiple jurisdictions. While the drafters of the Model Law did not intend it to result in broad spectrum application of foreign law, it is clear that some judges are open to the possibility of gradual development. Some decisions are likely to represent an amalgam of international and domestic principles. Whilst we expect that this is likely to be a trickle not a flood, there are some positive signs indicating that courts will use the Model Law to develop a more pragmatic and internationalist approach to resolving cross-border insolvencies.

[57] Reuters, Update 2: Lehman hopes for bankruptcy exit within two years, http://www.reuters.com/article/idUSN1447094220090114