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Gas attack?—Cross-border insolvency and the perils of non-submission

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Abstract

This article looks at the long-arm reach of cross-border insolvency in the light of the recent decisions of the Privy Council in *Cambridge Gas Corporation* and the Court of Appeal in *Rubin v Eurofinance SA* and, in particular, how orders made in foreign bankruptcies and liquidations in relation to transaction avoidance may be given effect to in England and Wales against third parties, such as trustees, notwithstanding that those third parties had not submitted to, or been present in, the jurisdictions in which such orders were pronounced.

It is perhaps a trite proposition that at common law, a foreign judgment *in personam* will only be enforceable if the court which made it had jurisdiction over the defendant. Jurisdiction for these purposes means the competence of the foreign court to summon the defendant before it. Absent any submission to the jurisdiction of the foreign court, such competence depends upon the physical presence of the defendant in the country concerned at the time of the suit.[1]

Accordingly, provided that the defendant has no assets, and is not present, in the foreign jurisdiction, and there has been no actual submission (whether by contract or appearance in the action), it might be thought that, absent statutory intervention (eg within the EU, the Judgments Regulation), foreign proceedings against him could be safely ignored. But that is to overlook another consideration, namely the potential impact of foreign insolvency proceedings, where such general principles have no application.

This article looks at the long-arm reach of cross-border insolvency and how decisions made in foreign bankruptcies and liquidations affecting third parties may be given effect to in England and Wales, notwithstanding that those third parties had not submitted to, or been present in, the jurisdictions in which such decisions were given.

International co-operation between courts in relation to cross-border insolvency has a long history. However, it was only recently that its importance was brought into sharp focus by the Privy Council decision of *Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508.

In that case, a group of Isle of Man shipping companies, which had borrowed US$300 m on the New York bond market, had become insolvent and had petitioned the court in New York under Chapter 11 of the US Bankruptcy Code. The creditors proposed a scheme of arrangement under which they would take control of the group's assets by acquiring the shares of the intermediate holding company, Navigator. The court approved the creditors'

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1. See *Adams v Cape Industries Plc* [1990] 1 Ch 433.

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scheme and sent a letter of request to the court in the Isle of Man, asking for assistance in giving effect to it.

The ultimate holding company, a Cayman company which owned the Navigator shares, protested that it had never submitted to the jurisdiction of the New York court and that therefore that court had had no jurisdiction to appropriate its assets, namely the shares, which were situated in the Isle of Man.

Lord Hoffman (who delivered the judgment of the Privy Council) held that while those submissions would have been entirely correct had the general principles (outlined above) applied, those principles had no application to insolvency proceedings.

As he saw it, judgments are judicial determinations of the existence of rights. Where a judgment is recognized by a foreign court, it is accepted as establishing the right which it purports to have determined, without further enquiry by the foreign court as to the grounds on which it did so. The judgment itself is treated as the source of the right.

Conversely, the purpose of insolvency proceedings is not to determine or establish the existence of rights but to provide a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established. It might be necessary in the course of the insolvency proceedings to establish rights which are challenged, but this could be achieved utilizing procedures within those proceedings to enable this to be done summarily or, if necessary, by ordinary action; it did not detract from the underlying purpose of the proceedings.

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Moreover, the touchstone in insolvency proceedings is universalism. Ideally, there should be a single insolvency in which all creditors are required and entitled to prove. No one should have an advantage because he happens to live in a jurisdiction which has more of the assets or less of the creditors.

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Applying this approach, Lord Hoffman held that at common law the court has the jurisdiction to give assistance by doing whatever it could have done in the case of a domestic insolvency, to enable the foreign office holder or creditors to avoid having to start parallel insolvency proceedings and to give them the remedies to which they would have been entitled if the equivalent proceedings that had taken place in the domestic forum. Thus, the Isle of Man court could, and should, assist the New York court by giving effect to the scheme. The assistance required was the appropriation of the Navigator shares. The Privy Council felt able to do this by treating the shares as a bundle of rights, which, as between company and shareholder, could be varied or extinguished by the mechanisms provided by the company's articles or by legislation. One such mechanism was a scheme of arrangement under the Isle of Man Companies Act, which could properly provide that a shareholder's shares be transferred into the name of another.

Shortly after *Cambridge Gas* was decided, Lord Hoffman found a further opportunity to consider the doctrine of universalism in the House of Lords' decision of *Re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852. There, four Australian insurance companies had gone into liquidation in Australia. They had assets in England, so the Australian bankruptcy court issued a letter of request to the English court to appoint provisional liquidators over those companies in England. A further letter of request followed asking that the English court direct the provisional liquidators to remit the English assets to the Australian liquidators, to be dealt with as assets of the Australian liquidations. Under Australian law insurance creditors were given a priority that had no equivalent under English law. The effect of the remittance was thus to prejudice creditors who might

have claimed in the English liquidation. The letters of request had been issued under section 426 Insolvency Act 1986. This provision requires courts having jurisdiction in relation to insolvency law in any part of the UK to assist the courts having corresponding jurisdiction in any country designated as 'relevant' by the Secretary of State (currently a limited number of Commonwealth countries, including Australia). Whilst Lord Scott and Lord Neuberger considered that s. 426 alone governed the position Lord Hoffman (with whom Lord Walker agreed) viewed the application as essentially an invocation of the principle of universalism. The primary liquidations of the companies were taking place in Australia. The English liquidations were ancillary. Universalism required the English court to remit the assets to Australia so that all creditors and all assets were subject to the same insolvency regime. While universalism was a principle rather than a rule, and was qualified by pragmatic considerations, the English courts should, so far as is consistent with justice and UK public policy, co-operate with the courts in the country of the principal liquidation (likely to be the centre of a debtor's main interests) to ensure that all the company's assets are distributed to its creditors under a single system of distribution.

Universalism has been given statutory expression, not only in the form of section 426 Insolvency Act 1986 (mentioned above) but also with the implementation of the UNCITRAL Model Law on Cross-Border Insolvency (see Cross-Border Insolvency Regulations 2006 (CBIR) Reg. 2). The Model Law in essence allows foreign insolvency office holders to apply for recognition and, once recognized, allows them to be granted any appropriate relief that might be granted to a British insolvency office holder. Article 25 provides that the English court:

> may co-operate to the maximum extent possible with foreign courts of foreign representatives

albeit that it falls short of stating expressly that it should (or might) enforce judgments of foreign insolvency courts (see Article 27).

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In view of the wide-ranging impact of universalism, exemplified by *Cambridge Gas* and *HIH*, it is important to understand the parameters of insolvency proceedings. In *Halford v Gillow* (1842) 13 Sim 44, Shadwell V.C. stated:

> ... the jurisdiction in bankruptcy has authority to deal only with that which is the bankrupt's estate; but has no power to determine what is the bankrupt's estate. [emphasis in the original]

This passage finds echo in Lord Hoffman's observation in *Cambridge Gas* that insolvency proceedings are collective proceedings to enforce rights, and not establish them. However, this statement is not as straightforward as it might seem, as the defendants in *Rubin v Eurofinance SA* [2010] EWCA Civ 895 found to their cost.

Rubin concerned a sales promotion scheme operated in the United States under which, as an incentive to purchase goods or services, members of the public were offered a cash voucher promising a rebate of 100% of the price 3 years later, provided certain conditions were met. The conditions were almost impossible to meet. The scheme, which was operated through a trust, was financed by merchants who paid 15% of the value of the voucher. Of that 15%, less than half was retained to fund redemptions, the balance being paid out to the scheme's promoters and those associated with them. The scheme attracted the attention of the Attorney-General for Missouri, who brought proceedings under consumer protection legislation. While those proceedings were settled, other proceedings in other states were likely. In consequence, the promoters decided to obtain the appointment of receivers over the trust assets (in England), with the aim of those receivers then seeking relief under Chapter 11 of the US Bankruptcy Code in

New York (where, unlike in England, the trust was recognized as a legal entity). A plan of liquidation was subsequently approved by the New York court under which the receivers were appointed as legal representatives of the trust, with the power to commence and prosecute proceedings against potential defendants, including the promoters. An action (known as Adversary Proceedings) was subsequently commenced seeking *inter alia* the recovery of money paid to the promoters from the trust. The promoters were personally served with the proceedings in UK. They took advice as to the enforcement of orders made in New York in England, and, in the light of that advice, deliberately decided not to submit to the jurisdiction of the New York courts or to defend the proceedings against them. In consequence, a default judgment was obtained against them in relation to claims of unjust enrichment and claims under various statutory provisions dealing with fraudulent conveyances, fraudulent transfers and the liability of transferees of avoided transfers. The receivers then applied in England as foreign representatives under the CBIR, seeking recognition of the New York proceedings and enforcement of the judgment.

The judge at first instance, Nicholas Strauss QC, while granting recognition, held that what the New York court had done was to establish the debtor's rights as against third parties in a judgment *in personam*: at common law, the English court could not accede to a request by a foreign insolvency court to enforce a judgment *in personam* contrary to the rules of English private international law. All that could be done was to authorize the receivers to bring an action on the judgment (which would engage the common law principles) or commence fresh proceedings in England. Further, while the CIBR permits the English court to co-operate with the foreign court, such co-operation did not extend to enforcing a judgment. The receivers appealed.

In the Court of Appeal, the argument turned on the question of whether the Adversary Proceedings could properly be characterized as part and parcel of the insolvency proceedings. Central to the debate was the distinction drawn by Lord Hoffman in *Cambridge Gas* between proceedings to enforce rights and proceedings to establish rights. Ward LJ, who gave the only reasoned judgment, saw a clear distinction between ordinary claims brought by the insolvent debtor against third parties and claims which arose only by virtue of the fact that insolvency proceedings had been commenced and could only be brought by an office holder. Under English law, the most prominent of such claims, in corporate insolvency, are transactions at an undervalue (section 238 Insolvency Act 1986) and preferences (section 239 Insolvency Act 1986). It was conceded by the promoters that those parts of the judgment in the Adversary Proceedings which the receivers sought to enforce in England were in relation to New York claims which were broadly equivalent to those that could be brought under section 238-9 Insolvency Act 1986. Such claims are in essence restitutionary: the office holder is collecting in assets that should have belonged, but no longer belong, to the insolvent estate. In the absence of any authority as to whether this feature was sufficient to bring the Adversary Proceedings within the ambit of insolvency proceedings, Ward LJ looked to published guidance on the Model Law, academic commentary, and some *obiter* comments of Rimer J in *UBS AG v Omni Holdings AG (in liquidation)* [2000] 1 WLR 916 and Lloyd LJ in *Re Ultra Motorhomes International Ltd* [2006] BCC 57 (dealing with the superficially analogous question of the exclusion of insolvency proceedings from the EU Judgments Regulation). He considered that this material supported his conclusion that proceedings under sections 238 and 239 Insolvency Act 1986, and the equivalent provisions in the US, were integral, and central, to the collective nature of bankruptcy and were not merely incidental procedural matters. Accordingly, albeit that the Adversary Proceedings had the indicia of judgments *in personam*, they were in fact part of the collective enforcement regime of bankruptcy and thus were subject to the laws relating bankruptcy rather than the general common law rules relating to the enforcement of judgments. Those laws required the application of the common law doctrine of universalism and the rendering of juridical

assistance to the New York court, which should extend to enforcing against the promoters the orders that court had made; in particular, so as to avoid the need for the office holder to commence parallel proceedings in England. As for the application made under the CBIR, Ward LJ decided to express no view as to whether co-operation with the New York court under those Regulations would produce a similar result. It is perhaps worth noting that *Rubin* is currently on appeal to the Supreme Court so Ward LJ's judgment will not be the last word.

So what is the relevance of these cases for trustees? The starting point is that a settlor settles assets on trust gratuitously. If he becomes bankrupt, then his trustee in bankruptcy may seek to set aside the transfer of assets into the trust as a transaction at an undervalue. The defendant to the application will be the trustee.

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In England, such an application is made under section 339 Insolvency Act 1986. Under section 339(2), the court makes such order as it thinks fit to restore the position to that which it would have been in if the bankrupt had not entered into the transaction. Such orders might include requiring the property transferred, or any property representing that property, to be vested in the trustee in bankruptcy and requiring the recipient to pay to the trustee, in respect of benefits received by him, such sum as the court might direct (see section 342(1)). The 'reachback' period for section 339 is the 5 years preceding the adjudication of bankruptcy.

Other jurisdictions of course have different insolvency provisions, with different time limits and different requirements. There may, or may not, be any recognition of a change of position defence, which may be of particular relevance if the trustees have distributed some or all of the trust estate before the claim is made.

In England and Wales, a bankruptcy petition can be presented against a debtor if he is domiciled in the jurisdiction, is present within the jurisdiction when the petition is presented, is ordinarily resident, or has a place of residence in the jurisdiction, or has carried on business within the jurisdiction. Other common law jurisdictions have similar requirements (see eg the Bankruptcy Law of the Cayman Islands (1997 revision)). Such requirements are unlikely to be met in the offshore jurisdiction in which the trustees are likely to reside. Accordingly, the bankruptcy of a settlor is likely to take place in another jurisdiction. That being the case, the ability of the foreign trustee in bankruptcy to export an order made in the foreign bankruptcy into the jurisdiction in which the trustees reside becomes all important. The doctrine of universalism provides the mechanism for the trustee in bankruptcy to do just that. As both *Cambridge Gas* and *Rubin* show, the fact that the trustees have taken no part in the foreign proceedings is irrelevant.

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Accordingly, if trustees are served with an application in foreign bankruptcy proceedings seeking to set aside the dispositions made by the settlor into the trust they will need to think long and hard about the merits of allowing the application to proceed by default. It is perhaps worth noting in this context that in *Rubin* the Court of Appeal expressed no sympathy for the defendants, who had deliberately decided not to submit to the jurisdiction of the New York courts.

One of the important considerations may be whether the mechanism to set aside transactions in the foreign bankruptcy regime plays the same integral part as section 339 Insolvency Act 1986 does in the

English insolvency regime. In *Rubin*, one of the things that particularly impressed Ward LJ about applications under sections 238 and 239 Insolvency Act 1986 and (as it appears to have been assumed) their US equivalents was that they could only be made by office holders. Even if *Rubin* is upheld in the Supreme Court, it may well remain a moot point whether avoidance applications made under other provisions (eg in England under section 423 Insolvency Act 1986), which can also be brought by others, should be treated in the same way.

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Another issue may be whether the court in which the foreign bankruptcy proceedings have commenced is in fact to be regarded, under the doctrine of universalism, as the court of the principal jurisdiction of the settlor, which the trustees' local court is required to assist. For example, different considerations might apply if the settlor were made bankrupt in an obscure jurisdiction only as a result of his fleeting presence there.

While there will still be cases where the best course is not to submit to the foreign jurisdiction, the position is no longer as clear as it might once have appeared. If nothing else, *Cambridge Gas* and *Rubin* have provided salutary reminders that foreign insolvency proceedings in a jurisdiction to which the trustees have not submitted cannot simply be ignored.

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