

CROSS-BORDER INSOLVENCY PROTOCOLS – DO THEY WORK?

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Introduction

1. The purpose of this Paper is to explore whether cross-border insolvency protocols work and will continue to work between the United Kingdom and the United States.
2. There are essentially 3 approaches that the courts can take to multinational insolvencies:-
 - (1) Different proceedings can be pursued in different jurisdictions each dealing with the assets and creditors in its own jurisdiction.
 - (2) Primary proceedings can be commenced in one jurisdiction with ancillary proceedings in others.
 - (3) Primary proceedings can be pursued in different jurisdictions with co-operation between the different jurisdictions.
3. The first scenario is what traditionally used to happen. As we shall see the second scenario is anticipated in both UK and US legislation. The third scenario is what has given rise to the increased use of Cross-Border Insolvency Protocols.
4. Their use is likely to increase further with the continuing globalisation of trade and industry, the growth of multinational trading corporation and the advances in information technology: all those factors mean that businesses today are truly international with assets and liabilities located in a large number of jurisdictions. Furthermore today there is a general recognition that the reorganisation or sale of an insolvent, but viable, business is the option which should first be explored so as to conserve the scarce resources. Creditors today are more likely to vote in favour of some kind

of reorganisation which enables the insolvent company to survive rather than pick over the bones of a dead carcass. If that reorganisation concerns assets and businesses in different jurisdictions it is important that matters are co-ordinated so far as possible between the different jurisdictions.

5. Those jurisdictions may well have differences of emphasis or opinion in relation to their internal insolvency laws. Different national insolvency rules have different creditor priorities and often incompatible rules concerning antecedent transactions (for example transactions at an undervalue, voidable preferences, and gratuitous alienations which are prejudicial to creditors). Those differences raise peculiar problems in cross-border insolvencies.
6. Before examining the development of cross-border insolvency protocols, it is worthwhile to take a brief look at the internal insolvency procedures of the UK and the US.

UK Insolvency Law

7. UK insolvency law developed in the eighteenth and nineteenth centuries when Britain was the foremost trading nation in the world. Insolvency law developed to reflect the needs of a mercantile community in which the assets of the trader might be situated in any part of the world.
8. English cross-border insolvency law is based on the principle of universality, so that the English insolvency extends to the company's assets in England and abroad. The courts of the Empire were all expected to assist and co-operate with the English court.
9. Bankruptcy was regarded as a disgrace. Debtors were put in prison. The suggestion that it could be an instrument of rehabilitation for the debtor is a relatively new development.
10. Corporate debt financing was provided by a Victorian invention – the floating charge. If the company became insolvent the most likely scenario

was the appointment of a receiver to take over the whole of the company's assets and run the entirety of the business. Those receivers traditionally were accountants and not lawyers and their primary duty was to realise the assets and goodwill of the company in the interests of the creditor who appointed them. Frequently that would result in little or no money being left over for the unsecured creditors.

11. However over time banks came to realise that more could be realised if the business is sold quickly as a going concern rather than broken up. The role of the receivers changed and rather than realising the assets in a piece-meal fashion over a period of time they became keen to sell the business or parts of the business as quickly as possible.
12. In 1986 a statutory rescue procedure called administration was introduced by the Insolvency Act 1986 to enable rescue to take place in cases in which there was no power to appoint a receiver or the creditor entitled to appoint a receiver did not want to do so. The administrator is appointed by a judge for one or more of 4 statutory purposes:-
 - (1) The survival of the company, and the whole or any part of its undertaking, as a going concern.
 - (2) The approval of a voluntary arrangement.
 - (3) The sanctioning of a compromise or scheme of arrangement.
 - (4) A more advantageous realisation of the company's assets than would be effected on a winding up.
13. The administrator has full power to do anything which may be necessary for the management of the affairs, business, and property of the company. He must within 3 months make proposals for how the statutory purpose is to be achieved and these are put to a creditors' meeting. If they are

successful, the administrator will be discharged. If not, he will report failure to the Court and will usually be appointed liquidator instead.

14. Administrators like the receivers before them tend to be accountants rather than lawyers. The judges are not regarded as having an important role to play and tend to allow the administrator a free hand regarding the administrator as the “businessman” who can understand the problems of a company in a way which lawyers cannot. Administrators tend to act very quickly since delay often results in further losses and a decline in the value of the business. When Barings Bank collapsed, the administrators were appointed on Sunday night and had sold the entirety of the bank nine days later.

US Insolvency Law

15. There is not the same stigma attached to insolvency in the US. Indeed it has been said that “Americans regard it as, at worst a misfortune and, at best, a necessary precondition to commercial success”.¹
16. Traditionally the US Courts had favoured the territorial approach. This has been described as “a self-serving approach to an international free-for-all, with each country claiming plenary power over assets located within its borders and paying no attention to what other countries may say”² Territoriality has earned the nickname “the grab rule”.
17. Towards the end of the last century the body of case law that emerged under section 304 of the US Bankruptcy Code suggested a departure from the territorial approach and an increasing recognition of the need for co-operation and respect between different jurisdictions.
18. There are fundamental differences between Chapter 11 proceedings in the US and administration proceedings in the UK. The debtor company

¹ Per Lord Millett, *Int. Insolv. Rev.*, Vol 6: 99 – 113.

² J. L. Westbrook: “The Lessons of Maxwell Communication”, *Fordham Law Review*, Vol 64, p 2531.

remains in possession unless removed on account of fraud, dishonesty or gross mismanagement. Chapter 11 proceedings involve the appointment of an examiner. The examiner is responsible to a judge, who in turn has to have regard to the various interest groups, who are themselves jockeying for position. The insolvency is in effect handled by lawyers who prefer to negotiate deals between competing interests and leave the business to be run by the existing management: in the UK, however, insolvency is dealt with by accountants, who share the creditors' contempt for the existing management whose incompetence has ruined the business and who prefer to take over the management and leave the competing interests to be dealt with according to fixed legal rules.

Recognition of foreign insolvency proceedings

19. Section 426 Insolvency Act 1986 provides that:-
 - (1) The courts having jurisdiction in relation to insolvency law in any part of the UK shall assist the courts having the corresponding jurisdiction in any other part of the UK or any other relevant country or territory (section 426(4)).
 - (2) A request made to a court in any part of the UK by a court in any part of the UK or in a relevant country or territory is authority for the court to which the request is made to apply, in relation to any matters specified in the request, the insolvency law which is applicable by either court in relation to comparable matters falling within its jurisdiction. In exercising its discretion, a court shall have regard in particular to the rules of private international law.
20. However whilst the Bahamas, Bermuda, Cayman islands, British Virgin Islands are all relevant countries, the United States is not.
21. Section 304 of the US Bankruptcy Code sets out guidelines to be followed when a US Bankruptcy Court is asked to give assistance to foreign bankruptcy proceedings:-

- (1) It provides that on an application by a debtor's foreign representative, the US Court may prevent proceedings against a debtor or a debtor's property in the US or order such property to be handed over to the foreign representative.
- (2) It sets out 6 guidelines to be followed in determining whether or not to make any order requested by the foreign representative, namely:-
 - (a) just treatment of all holders of claims against or interests in the debtor's estate;
 - (b) protection of claim holders in the US against prejudice and inconvenience in the processing of claims in such foreign proceeding;
 - (c) prevention of preferential or fraudulent dispositions of property of such estate;
 - (d) distribution of proceeds of such estate substantially in accordance with the order prescribed in the US rules;
 - (e) comity; and
 - (f) if appropriate, the provision of an opportunity for a fresh start for the debtor.

Further section 305 permits the US Court to dismiss or suspend any pending US bankruptcy proceedings where there are current foreign insolvency proceedings and the facts referred to above justify such a course.

22. Section 304 is designed to function in aid of a foreign proceeding. It invokes the jurisdiction and powers of US Bankruptcy only in limited

ways. Accordingly there is no automatic stay in section 304 ancillary cases. Section 304 proceedings also do not confer authority to appoint trustees or creditors' committees nor do they provide a mechanism for the filing and adjudication of claims. Further a foreign representative cannot utilise US avoidance law to challenge preferential and/or fraudulent transfers.

23. Both sections 426 and 304 are concerned with giving co-operation to foreign insolvency proceedings. They anticipate primary insolvency proceedings in another jurisdiction with the UK and US Courts giving assistance to those proceedings. They are not concerned with primary insolvency proceedings taking place concurrently in different jurisdictions.
24. There is, however, a significant difference between the 2 sections. Section 426 creates a mandatory obligation to render assistance in respect of a limited number of countries and leaves other cases to the common law. Section 304 applies without restriction to all countries but is by no means mandatory.
25. Co-operation is, however, not always the name of the game. In Felixstowe Dock & Railway Co v United States Lines Inc [1989] 1 QB 360, the defendants were a US company carrying on a worldwide shipping business. They operated in England and were registered under the Companies Act 1985. The defendants petitioned the US bankruptcy court for reorganisation under Chapter 11. The US Court made a restraining order (pursuant to the automatic stay) staying all claims against the defendant within and outside the US. Under the proposed plan of reorganisation the defendants intended to close down their English and European operations and to concentrate their activities in North America. The plaintiffs, who were English and European trade creditors of the defendants, commenced proceedings in the English court seeking payment for services they had provided and obtained a freezing order restraining the defendants from removing their English assets from the jurisdiction. The defendants applied to set aside that freezing order, inter alia, on the ground

that the English Court should recognise the US restraining order and allow the US Court to govern the disposition of the English assets.

26. In his judgment Hirst J said that he was assisted by what he describes as “a most helpful opinion of Judge Bushman [the US bankruptcy judge] ... and directed by him to be furnished to this Court.” But he then ignored it!
27. Hirst J dismissed the application for the following reasons:-
 - (1) The US restraining order was an order in personam which did not have to be recognised by the English Court.
 - (2) Although comity demanded that the English Court should co-operate with the US Court the nature and degree of that cooperation had to depend on English bankruptcy practice which did not favour an order which removed an overseas company's assets entirely outside the control of the English courts.
 - (3) The continuation of the freezing orders would not unjustly impede the Chapter 11 proceedings nor would it cause any prejudice to the defendants since the English assets could not be distributed in England without the intervention of ancillary winding up proceedings.
 - (4) If the freezing orders were discharged the English assets would be removed from the jurisdiction and used to keep the defendants as a going concern in North America, which although it would benefit the creditors there, would cause the plaintiffs in England irreparable prejudice.
28. That case has been described as the low-water mark in cooperation between the bankruptcy courts of the UK and the US. It shows the English Court adopting a territorial approach rather than a universal approach. Hirst J would probably disagree since he cited and agreed with the following description of the Chapter 11 process:

*“not a process of universal distribution but a process of deliberately preferential distribution.”*³

29. Lord Hoffman has defended the decision of Hirst J⁴. He considers it was a very special case on its facts which was decided correctly and would have been decided in the same way in the US if the situation had been reversed.
30. In contrast, Lord Millet thinks that an English Judge should not have decided the matter at all⁵. He has said:-

“The decision did great harm to the relations between the courts of the two countries, and seriously damaged the esteem in which the UK courts had previously been held by insolvency practitioners and judges abroad. There was clearly a very difficult issue to resolve – the relative weight to be given to competing claims of the creditors outside the United States and the survival of the company and its business in the United States – but, with great respect to Hirst J, it was not for him to resolve. The English and European creditors had dealt with a US corporation (ie a corporation that was amenable to Chapter 11) and had to take the consequences. The creditors had a case because they were entirely excluded from the scope of the proposed reconstruction; but, in my view, it was a case which should have been presented to the New York court.”

Maxwell

31. When Robert Maxwell disappeared from his yacht it sparked the collapse of a global empire of publishing and other interests and a number of allegations of financial irregularities. The business was located in London where it was administered and nearly all of its financial affairs managed.

³ Per Cons J in Mobil Sales and Supply Corporation v Owners of Pacific Bear [1979] HKLR 125 at p 134.

⁴ “Cross-Border Insolvency: a British Perspective” (1996) 64 Fordham Law Review 2507.

⁵ “Cross-Border Insolvency: The Judicial Approach” Int. Insolv. Rev., Vol 6: 99 – 113.

However 80% of the assets (being various large operating companies) were located in the US.

32. After a period of unsuccessful negotiation with its banks, the company petitioned for an administration order in England. The order was made but there was dispute between the company and the banks over who should be appointed administrator. The English court (Hoffman J, as he then was) ruled in favour of the banks' choice. The company management then went off to New York to petition under Chapter 11. They invited the New York Judge (Judge Brozman) to appoint an examiner. They hoped that this would block the attempts of the English administrators to gain control of the US assets. Judge Brozman appointed an examiner for the different and perfectly proper reason that she needed someone independent to advise her how to run the Chapter 11 proceedings.
33. Both Judges sensed that the information they were receiving in their respective courts was incomplete. They independently raised with their respective counsel the concept of a protocol between the two administrations as a way of resolving any impasse and facilitating better and more timely exchanges of information.
34. Hoffman J, took about 20 minutes to approve the Protocol and has commented⁶:-

“I certainly did not think of myself as giving effect to some unusual form of cross-border insolvency cooperation ... I had appointed administrators in respect of the whole company and it was their duty to take charge of the business and collect the assets according to their professional judgment ... in general the attitude of the court is that if the administrator's business judgment is that doing something would be in the best interests of the creditors, the court will accept that judgment.”

⁶ “Cross-Border Insolvency: a British Perspective” (1996) 64 Fordham Law Review 2507

35. Once the protocol was agreed the case effectively disappeared from the Courts. The UK administrators got to run the company on a day to day basis but an examiner was appointed by the US Court to act as a watchdog. The watchdog's approval was needed for any asset sales over a certain threshold. Any disagreement was taken back to court in the jurisdiction where the assets were to be sold. The key to the success of the protocol lay in the following factors: the acceptance by the New York court that the English administrators constituted the debtor in possession for the purpose of the Chapter 11 proceedings, the appointment of an experienced insolvency practitioner as examiner, and the mutual respect which the principal administrator, Mark Homan of Price Waterhouse, and the examiner, Richard Gitlin, showed each other.
36. Judge Brozman described the events following the adoption of the protocol⁷:-

“In February 1993, building on what the Protocol had created, the joint administrators, with the concurrence of the examiner, filed their plan of reorganisation (plan) and scheme of arrangement (scheme). Although separate plan and scheme documents exist, the plan and scheme are mutually dependent and, in their effect, constitute a single mechanism, consistent with the laws of both countries, for reorganising MCC through the sale of assets as going concerns and for distributing assets to creditorsRather than carving up the assets for distribution by the two courts to different groups of creditors, the plan and the scheme set up a single “pot” for distribution to all creditors. In keeping with the single distribution mechanism, creditors were permitted to submit a claim in either jurisdiction which would suffice for participation under both the plan and the scheme.....

⁷ In Re Maxwell Communication Corp 170 B.R.802.

Voting on MCC's plan was completed on July 1, 1993 with holders of 99.3% in number and 99.98% in amount of class 3A (general unsecured) claims voting to accept the plan. I confirmed MCC's plan on July 14, 1993. The UK Court sanctioned MCC's scheme pursuant to section 425 of the Companies Act 1985 the following week, with holders of 99.3% in number and 99.7% in amount of scheme claims voting to accept the scheme."

37. Thanks in large to the protocol, the restructuring plan was filed in just 16 months and yielded about 75 cents on the dollar for creditors. It demonstrated that allowing a company to restructure its debts and continue operating yielded better results for creditors and employees. However restructuring needs co-operation between the different jurisdictions where the company operates.
38. The plan and scheme left open the possibility of actions by the administrators in the UK or the examiner in the US with respect to possible preferential payments.
39. Shortly before the company went into administration (or Chapter 11) it paid \$30 million to Barclays Bank in repayment of a loan facility which it had been granted by the bank. The loan facility was granted by a London branch of an English bank to an English company and was repayable in London. The transaction was governed by English law. Because English law requires that the payor be "influenced by a desire"⁸ to prefer the recipient it appeared unlikely that the payment could be avoided in England but the US had no such subjective requirement.
40. Barclays Bank Plc sought an injunction from the English Courts to prevent the English Administrators from bringing a preference action against it in the US Chapter 11 proceedings. Hoffman J (and then the Court of Appeal)

⁸ Section 239 Insolvency Act 1986.

refused the injunction⁹ on the basis that it was for the US Court to decide whether or not to entertain the proceedings and if so what law to apply. Hoffman J said that “an injunction could serve no useful purpose except to antagonise the New York court and prejudice the co-operation which had previously prevailed between the courts administering the Chapter 11 and the administration proceedings”. He did say that if the New York judge did not think that there was sufficient connection with the United States to justify preference proceedings she would dismiss them.

41. Thereafter the Administrators and the Examiner brought actions in the US challenging the payments. Bankruptcy Judge Brozman (and the Appeal Court) held that US law did not apply and dismissed the complaints¹⁰.

Protocols Today

42. Since Maxwell there have been a number of other occasions when Courts of different jurisdictions have adopted protocols to facilitate a multi-national insolvency.
43. Protocols have been used most often between the US and Canada which is perhaps not surprising given their proximity to each other and the similarity between Canadian insolvency proceedings and Chapter 11. The co-operation between the US and Canada has progressed to the extent that cross-border joint hearings have been held. Those hearings were at first conducted by way of a telephone conference, but now video-conferencing is used.
44. *Maxwell* was what has been described as a “single-purpose arrangement”¹¹ Since then there have been various moves to produce rules of more general application.

⁹ Barclays Bank v Holman [1993] BCLC 680

¹⁰ Maxwell 170 BR 818

¹¹ Farley J: Cooperation and Coordination in Cross-Border Insolvency Cases – 6th February 2004.

45. The European Regulation on Insolvency Proceedings came into force on 31 May 2002. Its aim is to secure the simplification of formalities governing the reciprocal recognition and enforcement of court decisions and tribunals in insolvency proceedings. It provides that in every corporate insolvency the main insolvency proceedings shall take place in the country in which the company has the “centre of its main interests”. This is presumed to be the state where it has its registered office until the contrary is proved. All other Member States are obliged to recognise the orders of the court in which the main proceedings are taking place and the liquidator, administrator or other officer appointed by that court, who may exercise all the powers he has under the law of the State which appointed him in any other Member State. There is, however, nothing to prevent the commencement of insolvency proceedings in the courts of any other Member State in which the company has an “establishment”. Such secondary proceedings can be started by a creditor or by the liquidator or other officer appointed in the main proceedings, for example, because he wants to use procedures of interrogation available through the courts of another state. The officers in the main proceedings and in the secondary proceedings are under a duty to co-operate and give each other information.
46. The United Nations Commission on International Trade Law (“UNCITRAL”) began a study of the feasibility of achieving higher levels of cooperation in the international insolvency area in April 1994. The objective was to establish a set of uniform principles that would deal with the requirements which a foreign insolvency representative would need to meet in order to have access to the courts of other countries in cross-border cases. However the project evolved into a much broader work and ultimately became an agreed-upon international model for domestic legislation dealing with cross-border insolvencies that could be adopted anywhere in the world with or without variations that would reflect local domestic practices and procedures. The primary goal of UNCITRAL’s Model Law on Cross-Border Insolvency is to facilitate domestic

recognition of foreign insolvency proceedings and to increase cooperation in multinational cases.

47. It has not yet found its way into the statute books in either the UK or the US.

(1) In the UK enabling legislation for adoption has been passed and enacted.

(2) In the US it has been passed by both Houses of Congress several times but not enacted. Apparently for reasons unrelated to the model law, the legislation is now mired in committee.

Do they work?

48. Cross-Border Insolvency Protocols attempt to do a number of things:-

(1) Mandate co-operation by the various courts involved.

(2) Authorise for each jurisdiction an accredited representative to participate in the foreign court proceedings.

(3) Attempt to adopt a common set of timely and effective procedural rules covering matters such as:-

(a) Court hearings in the different jurisdictions.

(b) The financing or sale of assets.

(c) Recoveries for the benefit of creditors and equality of treatment among the general body of unsecured creditors.

(d) Claims filing processes; and

(e) Plans or Schemes in different jurisdictions.

49. They are invariably expressed to be effective only upon their adoption and approval by each of the Courts involved in accordance with the local law and practice of each local jurisdiction. They do not attempt to oust jurisdiction but rather to ensure that the appropriate Court deals with matters that fall within its jurisdiction and defers to another Court if a matter falls within the jurisdiction of that Court.
50. Cross-border insolvency protocols do work.
- (1) The very presence of a protocol can eliminate direct court involvement and enable the parties to proceed smoothly accordingly to the principles contained in the protocol.
- (2) They encourage judicial restraint in favour of co-operation and depend upon the respect by courts of different countries for each other.
51. However their effect is procedural rather than substantive. If there are real substantive differences between the attitudes (legal or otherwise) of different countries it is difficult to see how any protocol can enable a worldwide plan or scheme to be adopted.
52. Should the situation that arose in *Felixstowe* occur again, it might be that a different approach would be adopted. The English company could be placed into administration or liquidation in the UK and a protocol entered into to provide the framework from which a re-organisation of the companies could be proposed which would ensure the survival of the US company without treating the English creditors unfairly.