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Cross-Border Insolvency - Untangling the Web?

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7 August 2005

INTRODUCTION

Cross border insolvency is full of challenges.

We live in times of economic globalisation, with an increasing number of corporations trading across national boundaries. However, when insolvency knocks on the door, the legislative regime we have in Australia to address cross border issues has changed little since it was introduced in the century before last. Whilst other major trading countries such as England and the United States of America have revised their legislative framework for dealing with cross border insolvencies, Australia has not. That being the case, the prospect of legislative reform in this area through the adoption of the UNCITRAL model law on cross border insolvency is a welcome prospect.

I have been given the task of providing a practical perspective on the challenges of cross border insolvency as a practitioner who has grappled with the insolvencies of a number of Australian companies with international operations, and international companies with Australian operations.

I propose to identify three areas in the cross border insolvency arena where, I believe, problems currently exist in terms of achieving an efficient and co-operative framework for the administration of a cross border insolvency. As well as identifying the problems that I perceive to exist in each area, I will look at whether the adoption of the UNCITRAL model law will solve those problems.

The three areas that I propose to address are:

1. cross border recognition and assistance;

2. complexities relating to the distribution of dividends to creditors in multi-jurisdictional liquidations; and

3. complexities in international workouts and restructurings arising out of Australia's insolvent trading laws.

CROSS BORDER RECOGNITION AND ASSISTANCE

Where the insolvency of an Australian company placed in liquidation has international dimensions, the Australian liquidator may need assistance in foreign jurisdictions. Conversely, where, say, an English company is placed in liquidation in England and has trading operations in Australia or has assets or liabilities here, the English liquidator may need assistance from an Australian court.

Where the appointed liquidator needs such international assistance, there are two approaches that he or she may take, depending on the size and complexity of the insolvency's international aspects.

The first approach, and perhaps the more traditional, is to commence a separate insolvency estate in the foreign jurisdiction and have another liquidator appointed in that jurisdiction to administer the local estate. I will refer to this as the "multiple estates" approach. This can be achieved in at least two ways, being either through the issue of a letter of request by the Court in the jurisdiction of the company's incorporation requesting the Court of the foreign jurisdiction to appoint a liquidator within that jurisdiction, or through filing an application within that foreign jurisdiction for the appointment of a liquidator in accordance with local law.

Re *New Cap Reinsurance Corporation Holdings Limited*[1] provides a recent example of the appointment of an Australian provisional liquidator to a foreign company under provisional liquidation in its home jurisdiction. In the case of HIH, a provisional liquidator in England was initially appointed pursuant to a letter of request issued out of Australia, and this was later converted into a provisional liquidation under local law.

It is, however, not always appropriate for the liquidator to seek to have a second liquidator appointed in the foreign jurisdiction (or, for that matter, multiple liquidators appointed in all jurisdictions where assets are situated). For example, the assets or creditors in that other jurisdiction may be small, and the substantial costs associated with engaging a duplicate set of accountants and their lawyers may not be in the best interests of creditors generally. Accordingly, an alternative approach to the commencement of a separate estate in that foreign jurisdiction is for the Principal Liquidator[2] to obtain recognition and specific assistance from the Courts of that foreign jurisdiction. With the benefit of that recognition and assistance, the Principal Liquidator will seek to address issues in that foreign jurisdiction himself/herself. I will refer to this as the "bare recognition" approach, and will shortly address two recent examples of where the bare recognition approach was considered more appropriate than the commencement of multiple estates in each relevant jurisdiction.

Whether or not one takes a multiple estate approach or a bare recognition approach, division 9 of part 5.6 of the *Corporations Act* provides the legislative framework in Australia for requests for foreign insolvency assistance. Section 581 of the Act is in the following terms:

> **Courts to act in aid of each other**
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> **581(1)** **[Requirement of courts with jurisdiction under Act]** All courts having jurisdiction in matters arising under this Act, the Judges of those courts and the officers of, or under the control of, those courts must severally act in aid of, and be auxiliary to, each other in all external administration matters.
>
> **581(2)** **[Court to aid external Territories, States and prescribed countries]** In all external administration matters, the Court:
>
> (a) must act in aid of, and be auxiliary to, the courts of:
>
> (i) external Territories; and
>
> (ii) States that are not in this jurisdiction; and
>
> (iii) prescribed countries;
>
> that have jurisdiction in external administration matters; and
>
> (b) may act in aid of, and be auxiliary to, the courts of other countries that have jurisdiction in external administration matters.
>
> **581(3)** **[Powers of court upon request for aid]** Where a letter of request from a court of an external Territory, or of a country other than Australia, requesting aid in an external administration matter is filed in the Court, the Court may exercise such powers with respect to the matter as it could exercise if the matter had arisen in its own jurisdiction.
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> **581(4)** **[Power to request a court's aid]** The Court may request a court of an external Territory, or of a country other than Australia, that has jurisdiction

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[1] (1999) NSWSC 356.

[2] I will refer in this paper to the liquidator in the place of the company's incorporation as the "Principal Liquidator" and the liquidator(s) in other jurisdictions as "Ancillary Liquidator(s)".

> in external administration matters to act in aid of, and be auxiliary to, it in an external administration matter.

This provision both enables a letter of request to be issued by an Australian court to a foreign court, and also addresses the circumstance where the Australian court is the recipient of a letter of request from a foreign court.

"Bare recognition" approach

Good illustrations of this approach are provided by two current insurance insolvencies. AFG Insurances Limited (**AFG**) is an Australian insurance company which was placed in run off in the 1980s, and had not written any new business since then. Its directors appointed voluntary administrators to it in August 2002. Its remaining assets and liabilities were centred largely on the London insurance market. The company's reinsurance assets were largely London market based, but it held cash of $16,000,000 in a bank account in Sydney. It had only a handful of creditors, almost all being London or European based insurance and reinsurance companies that had participated with AFG in an insurance pool in the 1960s. AFG was, at the time of appointment, a defendant in court proceedings in the High Court of Justice in England in relation to that insurance pool.

The Australian voluntary administrators quickly formed the view that it would be inappropriate to commence a separate estate in England and subject creditors to two sets of professional fees in respect of an estate that had limited issues and only a handful of creditors. Accordingly, the administrators made swift application to the New South Wales Supreme Court for the issue of a letter of request to the English High Court of Justice requesting that court to recognise the Australian administrators when acting within that jurisdiction, and asking the English court to in effect stay the continuation or commencement of all actions within the jurisdiction of the English court as well as any attempts to levy execution against AFG's assets within that jurisdiction.

The application for the issue of a letter of request was refused by Barrett J[3]. His Honour considered that the application was problematical in several respects.

One problematical issue related to the request that the English Court recognise the right and title of the administrators when acting within the jurisdiction of that court. His Honour noted that private international law principles in England will produce that result in any event[4], and this being the case, "*it is therefore not clear that a request by this court that the English court recognise the administrators and their agents will have any meaning or significance.*"[5]

Secondly, his Honour identified what he perceived to be conceptual problems with making a request of the English Court that it order a general stay on the commencement or continuation of proceedings in England against AFG. Such an order would mirror the prohibitory regime which applies within Australia not by virtue of any order of the Australian Court, but by virtue of the legislative provisions in the *Corporations Act*. This being the case, the action requested of the English Court was not something that his Honour considered was in any way "in aid of or auxiliary to" the Australian Court in exercise of its jurisdiction: the moratorium was the product of legislation, not court order. Moreover, the voluntary administration regime is not a court-initiated process, and the Australian Court did not, according to his Honour, have any control or general superintendence of the administration. The Australian Court's only role would be where a specific application is made to the Court under various provisions of the *Corporations Act*. On this point, his Honour decided:

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[3] *Re AFG Insurances Ltd (No 1)* (2002) 20 ACLC 1,588.

[4] Identification of officers who may act for a foreign corporation is a matter to be determined by reference to the law of the corporation's domicile. The operation of sections 437A and 437B of the *Corporations Act* would produce the result that the administrators have the requisite authority to act on behalf of an Australian company in voluntary administration.

[5] *Re AFG Insurances (No 1)*, at 1,592.

> "*This makes me think that, in the administration context (much more perhaps, than in the case of a winding up ordered by the court), a foreign court can be regarded as acting in aid of or auxiliary to this court only where this court has become seised of a particular proceeding relevant to the administration and the full and effective exercise of this court's jurisdiction will be assisted by some ancillary order of a foreign court.*"[6]

Of further concern to his Honour was the fact that a request made under s.581 must be made "*in an external administration matter*"[7]. His Honour held that there is no "*matter*" within the meaning of s.580 unless and until a specific issue is identified as an issue within the administration requiring specific assistance. A request that the English Court make a general moratorium order that was not specifically related to identified persons or circumstances was not a "*matter*" so as to attract the jurisdiction of the Australian Court.

His Honour suggested that an available option for the Australian voluntary administrator, assuming he could attract the Court's jurisdiction by demonstrating insolvency[8], would be to seek the issue of a letter of request requesting the making by the English Court of an administration order under Part II of the *Insolvency Act 1986*, appointing an English administrator. The English administrator could then administer a parallel proceeding within the United Kingdom's jurisdiction with all the protections available under UK law.

A fresh application for the issue of a letter of request was made by AFG's administrator three weeks later, following an actuarial review of the reinsurer's balance sheet. Evidence was advanced in the application that satisfied Justice Barrett that AFG was, indeed, insolvent within the meaning of s.95A of the *Corporations Act*, this having been a further impediment identified by his Honour (and which is addressed below).

The fresh application sought declarations from the court that AFG became subject to voluntary administration under the *Corporations Act* on 14 August 2002, and that the administrators became voluntary administrators on that day. Relevantly, Barrett J held that those declarations:

> "*will constitute orders of this court attracting, in the particular circumstances of this case (where AFG's assets, liabilities and activities are concentrated largely on the London market and it is a party to significant legal proceedings in England), a need for the English court to act in its jurisdiction in aid of and to be auxiliary to this court in recognising and giving effect to those orders.*"[9]

The revised application also sought to include, in the letter of request, a specific request for the English court to make:

> "*such orders as it would be open to the Supreme Court of New South Wales to make within its jurisdiction applying and giving effect to:*
>
> *(a) the statutory protection set out in s.440D and 440F of the Corporations Act 2001 (Cth);*
>
> *(b) the administrators' statutory entitlements to the books of the company set out in s.438C of the Corporations Act 2001 (Cth);*
>
> *(c)" the operation of s.437D of the Corporations Act 2001 (Cth) to transactions or dealings affecting property of the company;*
>
> *[or orders applying equivalent English statutory provisions]*"

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[6] *Re AFG Insurances (No 1)*, at 1,592.
[7] *Re AFG Insurances (No 1)*, at 1,592. s.581(4).
[8] This issue, which provided a further impediment, is addressed below.
[9] *Re AFG Insurances (No 2)* (2002) 43 ACSR 60, at 61.

On the face of it, such a request was inconsistent with Justice Barrett's earlier judgment where his Honour indicated that a specific "*matter*" was required. The administrators submitted that "*a future matter in which the jurisdiction of this court might be invoked in relation to an administration is properly regarded as a matter within the purview of s.581(4).*"[10] Justice Barrett noted that this submission "*involves a somewhat broader view of "act in aid of, and be auxiliary to" than I was inclined to think available when the earlier application was made before me.*"[11]

In accepting this submission, his Honour noted that sections 580 and 581 are directed to the resolution of the following difficulty: The Australian Court's *Corporations Act* jurisdiction is not territorially limited but, the effective exercise of the Court's jurisdiction in other countries may be hampered. His Honour considered that a broader view of the operation of these provisions than that given in his earlier judgment was warranted, and stated, at 62:

> "*The relevant concept of acting in aid of and being auxiliary to this court is not, I think, confined to recognising or giving effect to an order of this court, although the concept certainly has that aspect. An additional aspect, I am persuaded, involves the making by the foreign court, within and for the purposes of its jurisdiction, of orders that this court could have made in relation to the relevant subject matter had this court's jurisdiction, in the territorially limited sense, extended that far.*"[12]

A final matter that emerges from Justice Barrett's second judgment relates to the suggestion in his Honour's first judgment that the appropriate order to be made would be for the issue of a letter of request asking that the English Court make an administration order under UK legislation, and appoint an English administrator of AFG's English estate, ie, take a "multiple estates" approach. In this regard, it is to be noted that both the first and second letters of request sought only a "bare recognition" order, including relevant protections. In this regard, Justice Barrett observed in his second judgment, at 62, that expert advice[13] tendered to the Court was that the Australian administrators should not commence a parallel English insolvency proceeding, and that the "bare recognition" approach requested in the letter of request would, in the expert's view, receive the assistance of an English Court.

The revised letter of request was issued by the NSW Supreme Court, and was promptly acted upon by the English Court.

Independent Insurance Company Limited

A very recent case, Independent Insurance Company (**Independent**), provides an example of a letter of request issued in the opposite direction. Independent, one of the United Kingdom's largest insurers, had written insurance policies in favour of a number of Australian residents, and 317 of those policies remained current at the time of the application for a letter of request. Those policies had given rise to 666 outstanding claims with an aggregate potential liability exceeding £41,000,000. In addition, Independent had assets in Australia in the form of reinsurance receivables and had a sizeable shareholding in an Australian company, which also owed Independent the sum of £1,600,000. One claim against Independent was in the course of being prosecuted in an Australian court at the time the application was filed (but had been compromised by the time the application was heard), and the provisional liquidators had an apprehension that other policyholders may seek to bring claims in Australian courts. For these reasons, the English provisional liquidators procured the issue of a letter of request by the High Court of Justice in England to the Supreme Court of New South Wales requesting that the New South Wales Court grant similar protections in favour of the estate as would have applied had provisional liquidators been appointed to the company within Australia - for example, a stay on proceedings being commenced or proceeded with against the company.

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[10] *Re AFG Insurances (No 2)* (2002) 43 ACSR 60, at 62.
[11] *Re AFG Insurances (No.2)*, at 62.
[12] *Re AFG Insurances (No 2)*, at 62.
[13] The expert was an English solicitor specialising in insolvency law.

The New South Wales Court's jurisdiction to act on the letter of request is provided in both s.581(2)(a) and s.581(3). Justice Barrett made the following observations with regard to these two provisions:

> "Sections 581(2)(a) and 581(3) are thus quiet different in purpose and effect. Section 581(3), which is activated only by receipt of a letter of request, allows the court, in effect, to treat the foreign matter as if it were a matter that had arisen within the court's own jurisdiction and to make any order within its own armoury of orders relevant to such a domestic matter. Section 582(2)(a), on the other hand, imposes a requirement to act. It is not triggered by a letter of request (in the sense that the court may act under it in the absence of a letter of request), although the absence of any request from the court of the external territory or prescribed country is likely to mean that the Australian court does not know what action by it is (or might be thought to be) "in aid of" or "auxiliary to" the other court. A letter of request is thus, in that way, a means of giving content to the s.581(2)(a) requirement, as well as bringing s.581(3) into play."[14]

Justice Barrett described the relief sought in the application as "unusual". His Honour noted that the claim for an order prohibiting the commencement of proceedings was:

> "Advanced apart from any lis inter partes and seeks what I described in the first AFG Insurances case ... as "an order expressed to be binding on the whole world in the manner of legislation"."[15]

His Honour later observed that "*the order, if made, would be an indiscriminate command to unidentified persons not to commence or to continue any proceeding against Independent Insurance or its property in Australia while the provisional liquidators remained in office (or after a winding up order is made), except with leave granted by the English court under the English legislation.*"[16]

His Honour accepted that such an order would be an order made in aid of the English court.[17]

In support of the application, counsel for the English provisional liquidators relied on a number of cases where a court has, in exceptional circumstances, made an order expressed to be binding on unidentified persons. In support of the proposition that cross border insolvency should provide an additional exceptional circumstance, the court was referred to the fact that courts in the United States and Ireland had, in relation to Independent Insurance, made orders of the kind sought from the New South Wales Supreme Court, and the fact that in other cross border matters, the High Court of Justice in England has made similar orders upon a letter of request from an Australian court, and therefore that this order ought be made as a matter of comity.

The above submissions were rejected by Justice Barrett for two principal reasons. Referring in particular to the Victorian Court of Appeal's decision in *Maritime Union of Australia v Patrick Stevedores Operations Pty Limited* [1998] 4 VR 143 his Honour held "*an injunction should not be made in terms which are indefinite as to the persons to be bound.*"[18] Secondly, His Honour considered it inappropriate that "relief be granted ex parte except in circumstances of urgency." In relation to the second point, His Honour referred to the New South Wales Court of Appeal's decision in *BP Australia Limited v Brown* [2003] 58 NSWLR 322 where, at page 348, Spigelman CJ (with whom Mason P and Handley JA agree) held:

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[14] *Independent Insurance Company Ltd* [2005] NSWSC 587 at para 14.
[15] *Independent Insurance Company Ltd* [2005] NSWSC 587 at para 17.
[16] *Independent Insurance Company Ltd* [2005] NSWSC 587 at para 26.
[17] *Independent Insurance Company Ltd* [2005] NSWSC 587 at para 27.
[18] *Independent Insurance Company Ltd* [2005] NSWSC 587 at para 46.His Honour later (paragraph 29) made the observation that the application would enable the Australian court to make an order restraining a specific person amenable to the Australian court's jurisdiction from initiating or continuing, without the leave of the English Court, a proceeding against Independent. [Paragraph 29].

> "The obligation to comply with procedural fairness imports a higher level of content when imposed on a court than in decision making processes conducted by administrators or tribunals. It requires, in my opinion, that a person likely to be adversely affected by the order of the court is given an opportunity of making submissions to the court before any such order is made ..."

In the *BP Australia Limited v Brown* decision, an order had been made ex parte, but with the ability of any person affected by the order to apply to vacate or vary the order after it was made. Spigelman CJ described such a state of affairs as "an exceptional situation", and the Chief Justice observed that nothing on the facts of the case before the Court was "such as to justify the exceptional course."

In the *Independent Insurance* case, Barrett J similarly found that there were no circumstances of urgency warranting the grant of ex parte relief. The provisional liquidators had been appointed four years previously, the letter of request was issued in July 2004, with the application to the New South Wales Supreme Court having been filed in November 2004 but not pursued until May 2005. Further, there was no suggestion that any person was threatening to commence or continue relevant proceedings against Independent at the time of the application.

Comment

Conceptually, both the above applications were unremarkable[19] in terms of the relation between the relief sought and the international dimension of the insolvency. In *Independent*, the English Court, on the application of the Court appointed insolvency practitioners, sought no more from the New South Wales Supreme Court than the basic protections that would have applied had the formal insolvency appointment been made in New South Wales. The same can be said, in reverse, in *AFG*. One might well think that in today's global marketplace, upon an insolvency appointment being made to a company, there should be little impediment to obtaining the barest and most basic relief in foreign jurisdictions where there are assets or other interests to protect. Such relief - a stay against proceedings and execution against assets - is unremarkable and demonstrably is to the benefit of its estate and its creditors. Such relief is granted readily in the UK, USA and other jurisdictions. Regrettably, however, where Australia is either the place of the principal appointment, or the foreign jurisdiction where there are assets or other interests to protect, the position is problematical under s.581.

While s.581 is the cause of these problems, some observations relating to the approach taken by Barrett J are also pertinent.

His Honour's principal concern with requesting or making an order prohibiting the commencement of proceedings was that such an order would be "indefinite as to the persons to be bound"[20]. While his Honour accepted that the Court had jurisdiction to make such an order, and noted that in some contexts such orders were quite properly made, the general rule is that such orders are inappropriate, and his Honour saw no reason to depart from that general rule.

I would respectfully observe that his Honour has correctly distilled the relevant legal principles governing the making of such orders, but would raise for consideration whether the principles have been correctly applied to the circumstances here. Specifically, should the circumstance of a court in one country seeking the assistance of a court in another to act in aid of it in an external administration matter be treated as an exceptional circumstance warranting a departure from the general principle? My view is that a respectable case can be advanced that this is an exceptional circumstance.

The existing exceptional cases where the making of such orders has been considered appropriate included the protection of human rights and the protection of the integrity and utility of the court's processes. There is a public interest in the protection of such matters. In

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[19] Except, perhaps, in terms of the delay in approaching the Court in *Independent*.
[20] *Independent Insurance Company Ltd* [2005] NSWSC 587 at para 46.

contrast, examples where the grant of such an order was considered inappropriate are generally the protection of private rights.

The contention can be made that when an English court appoints a liquidator provisionally to administer the affairs of an insolvent insurance company pending the Court's decision as to whether it should wind the company up, and the court then issues a letter of request to an Australian court requesting basic insolvency protections, interests such as the administration of justice and the protection of collective rights, as distinct from the assertion of mere private rights, are in play. Whilst there are some conceptual differences between the role of the Court in a provisional liquidation, as distinct from a court ordered liquidation, the following observations regarding the interests being protected by the liquidation process made by Justice Barrett in one of his recent HIH judgments[21] appear pertinent:

> The first is the public interest in the due and beneficial administration of the estates of insolvent companies under the *Corporations Act* by liquidators appointed by and answerable to the court, that administration being for the benefit of creditors. The public interest in the due administration of the insolvent estates of the HIH companies is particularly pronounced where there are many thousands of creditors from all walks of life. The liquidators are officers of the court and are entitled to have the court appropriately facilitate such actions as they may properly take in the interests of creditors and in the furtherance of the public interest to which I have just referred. ... Although there have been changes in the legislative landscape since the decision of Marks J in Re Timberland Limited; Commissioner for Corporate Affairs v Harvey [1980] VR 669, I think it is still generally true to say, as his Honour there said, that "[t]he winding up is by the court which for the purposes the liquidator is". ... The fact that a winding up is a winding up by the court means that it [is] in its own right an aspect of the process of the administration of justice.[22]

I would suggest that what his Honour refers to as "the public interest in the due administration of ... insolvent estates" is what distinguishes the AFG and Independent circumstances from cases generally involving the assertion of private rights, and makes a compelling case for relief in cross border insolvencies to be treated as an exception to the general rule.

A second issue of principle raised by his Honour's judgment in *AFG Insurances No.1*[23] is that his Honour refused to request the English court to recognise the right and title of the administrators when acting within the jurisdiction of that court. His Honour's view was that private international law principles produced that result in any event and therefore such a request would not have any meaning or significance.

My view is that such a request (and the consequential recognition order of the English court) would have significance in at least two respects. Firstly, it would relieve the administrators of the burden of needing to demonstrate, by reference to private international law principles, their right and title to appear and conduct proceedings on behalf of the relevant company in all subsequent proceedings that may need to be undertaken in that jurisdiction. Secondly, and perhaps more importantly from a practical perspective, the formal order of the English court expressly recognising their right and title when acting within England can be regarded as an important document to table in dealings that the administrators have in that jurisdiction with third parties. To the extent that third parties, such as banks that may have credit balances in accounts, or creditors or debtors with whom the administrators need to deal, might have issues concerning the local authority of the foreign administrators, those issues are promptly and unambiguously dealt with merely by tabling the Court's recognition order.

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[21] Re Applications of McGrath and Honey (in their capacity as liquidators of HIH Insurance Limited), Barrett J, 20 July 2005.
[22] Ibid, paras 10 and 12
[23] Re AFG Insurances (No.1), at 1, 592.

Requirement that there be an "External Administration Matter"

A final issue that arises out of the AFG and Independent decisions relates to the fact that the Australian Court only has jurisdiction to act under s.581 in respect of an "external administration matter".

Section 580 provides a definition of external administration matter in the following terms:

> **External administration matter** means a matter relating to:
>
> (a) winding up, under this Chapter, a company or a part 5.7 body; or
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> (b) winding up, outside Australia, a body corporate or a part 5.7 body; or
>
> (c) the insolvency of a body corporate or of a part 5.7 body.

This requirement is unambiguously satisfied when the company the subject of the application is in the course of being wound up (see subparagraphs (a) or (b), depending on whether it is a foreign or a domestic winding up). However, there are numerous other forms of external administrations of insolvent companies - for example, voluntary administration, insolvent schemes of arrangement and provisional liquidation. Which of these are covered by the provision?

This issue has been considered in the context of both provisional liquidation and voluntary administration by Justice Barrett in two recent decisions.

In Re *AFG Insurances Limited (No. 1)*, Justice Barrett was considering an application by a voluntary administrator. As the company was merely in voluntary administration, subparagraphs (a) and (b) of the definition of "external administration matter" had no application. Accordingly, jurisdiction depended upon a finding under subparagraph (c) that the voluntary administration of AFG constitutes "*the insolvency of a body corporate*". His Honour held that the fact that the company had been placed in voluntary administration did not of itself amount to "the insolvency of" the entity. His Honour noted that the word "insolvency" was not defined within the *Corporations Act*, and proceed to hold that *"there is no insolvency in relation to a person or entity unless the person or entity is "insolvent" within the meaning of s.95A."*[24] Section 95A provides that:

> "A person is solvent is, and only if, the person is able to pay all the person's debts, as and when they become due and payable."

Section 95A(2) provides that a person who is not solvent is insolvent.

His Honour considered that it would be necessary to affirmatively demonstrate to the Court that the company is not "able to pay all [its] debts as and when they become due and payable".

As evidence was not placed before the court to demonstrate that the company was insolvent (in the cash flow sense of the term as required by s.95A) his Honour was not satisfied that he had jurisdiction to make any orders.

In relation to the provisional liquidation of Independent, his Honour noted that the insolvency of the company within the meaning of section 95A was proven on the evidence.

Comment

This result is problematical from a practical perspective. If, as a prerequisite to procuring the issue of a letter of request by an Australian Court, or acting upon a letter of request received by an Australian Court, it is necessary to demonstrate that a company that has been placed in voluntary administration, or provisional liquidation, is insolvent, a very

[24] Re AFG Insurances No. 1 at 1, 590.

substantial burden is imposed on the appointed insolvency practitioner. AFG Insurances is a case in point. It was a reinsurance company that, at the date of the administrator's appointment, had $16,000,000 cash in its bank account and negligible current liabilities. Nowhere in the board papers or other documents of the company was there any evidence pointing expressly to insolvency. The only substantial liabilities of the company were reinsurance liabilities entered into in the 1960s. The company's books and records suggested that the $16,000,000 cash would cover those liabilities. Accordingly, on the face of it, the Australian voluntary administrator would be hard pressed to secure, via the letter of request route, appropriate protection in England.

Following rejection of AFG's application for the issue of a letter of request, the administrators engaged actuaries to review the company's liabilities. Its major liabilities, incurred in the 1960s, were asbestos related, and the actuarial analysis concluded that the liabilities were likely to exceed the company's assets. Following presentation of this evidence at a second application to Justice Barrett (Re AFG Insurances (No. 2)), his Honour accepted that AFG was insolvent within the meaning of that term in the *Corporations Act*, and this jurisdictional requirement for the issue of a letter of credit was met.

Although the delay occasioned to AFG Insurances by the necessity to prove insolvency was only several weeks, it may have been much longer had the book of reinsurance business been larger or more complex. Even outside of the insurance and reinsurance sphere, issues of valuation of assets or liabilities may be particularly difficult. The complexity, size or geographic dimensions of the company's businesses may make a swift solvency assessment impractical, or indeed the true position of the company may be obscured by questionable accounting practices. Any of these factors may mean that it is many weeks or perhaps months before an insolvency practitioner can properly form a view, and demonstrate to the court by admissible evidence, that the company is insolvent. The risk of delay becomes more serious where the application is contested and the question of insolvency is placed in issue. The prospect of competing independent experts reviewing the books and records of the company, preparing their reports, being cross examined and then having judgment reserved by the Court on what may be a vigorously contested issue of fact, may result in substantial delay. Meanwhile, the overseas assets of the company, and its international interests generally, would remain unprotected, at least by recourse to remedies available pursuant to a letter of request.

Delay may have substantial adverse consequences for the estate and its creditors. Even if the delay involved is merely weeks or, perhaps, days, this can be enough for the interest of creditors to be severely prejudiced by events in a foreign jurisdiction where no relief has yet been granted. Creditors with judgment debts may levy execution against assets of the company, and considerable expense may need to be incurred in preparing for litigation on foot within that jurisdiction that is not automatically stayed.

I would also offer the observation that the approach of Justice Barrett to the meaning of "the insolvency of a body corporate" is perhaps not the only approach that is open in the interpretation of that provision. An alternative approach would be to characterise subparagraph (a) as being directed to conferring jurisdiction in relation to the winding up of Australian bodies corporate, subparagraph (b) as being directed to winding up bodies corporate outside of Australia, and subparagraph (c) as providing a generic description to cover all other forms of formal external regimes for the administration of insolvent bodies corporate. On this approach, "a matter relating to ... the insolvency of a body corporate" addresses all formal external insolvency regimes other than winding up, such as voluntary administration, deeds of company arrangement, provisional liquidation and insolvent scheme of arrangement (and analogous overseas procedures such as chapter 11 in the United States.) On this approach, the relevant concept is whether the company is subject to an external insolvency regime, not whether the company can be demonstrated to be insolvent. It is arguable that if the approach taken by Justice Barrett had been the intention of the legislature, the definition in subparagraph (c) would have been "a body corporate or part 5.7 body that is insolvent" so as to pick up the definition of "insolvent" in s.95A, or a subparagraph (c) could have been added to section 95A providing "there is an insolvency of a person where the person is insolvent."

Indeed, the use of the heading "external administration matter" in s.581 hints at a state of affairs involving both an "administration" (ie a form of management of the body corporate) that is "externally" controlled.

Finally, it is important to note the important role of the courts in all formal insolvency procedures in Australia. Even outside of the area of court windings up, the court has specific powers to review, exercise a supervisory jurisdiction and direct the conduct of, all other forms of external insolvency procedures. It might be thought surprising if division 9 of part 5.6 of the *Corporations Act* was not intended to confer jurisdiction on the Court in relation to all such external insolvency procedures, rather than being confined outside of a winding up context to companies where actual insolvency can be demonstrated.

What is the effect of the introduction of the UNCITRAL model law?

Will the introduction of the UNCITRAL model law avoid the above problems and issues?

The answer is "yes" and "no". It is "yes" in the sense that issues of recognition, the consequences of recognition, and the evidence required to secure such relief, are clearly and favourably dealt with in the legislation. The answer is "no" in the sense that the CLERP No.8 proposal for the adoption of the UNCITRAL model law in Australia proposes that banks and insurance companies be excluded from the operation of the Act.

Outside of the banking and insurance spheres, recognition would occur by the foreign insolvency practitioner applying to the Australian court for recognition of the foreign proceeding. The application must be accompanied by basic evidence of the practitioner's appointment and identification of all foreign proceedings in respect of the debtor that are known to the practitioner. Provided that the insolvency proceeding comes within the broad definition of a "foreign proceeding"[25], the Australian Court will recognise the foreign proceeding. Pausing here for a moment, it is important to note that there is no requirement that the insolvency of the relevant body needs to be demonstrated, nor must a discretionary case be made out as to why such an order should be made. So long as the formal prerequisites identified above are made out, recognition will be automatically granted.

The consequences that flow from recognition depend upon whether the foreign proceeding is a "foreign main proceeding" or a "foreign non-main proceeding". A foreign main proceeding is a foreign proceeding taking place in the jurisdiction where the debtor has the centre of its main interests.

If the foreign proceeding is a foreign main proceeding, article 20 provides that the following consequences flow automatically upon the recognition of a foreign main proceeding:

(a) commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed;

(b) execution against the debtor's assets is stayed; and

(c) the right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.

Article 20 does contemplate that the above relief may be made subject to exceptions, and CLERP 8 suggests that specific relief might be granted from the effects of the stay.

Article 21 confers a discretion on the court to order additional relief, such as provision for the examination of witnesses, and the delivery of information concerning the debtor's affairs.

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[25] Article 2(a) "Foreign Proceeding" means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation.

What is apparent from the above provisions is that not only is recognition automatically conferred upon formal proof of basic matters relating to the insolvency appointment, but basic relief is similarly granted automatically upon recognition being granted. The problems that have been identified by Justice Barrett in the AFG and Independent decisions that arise out of s.581 have been overcome.

As for insolvent banks and insurance companies, urgent reform of s.581 is, in my opinion, necessary.

COMPLEXITIES RELATING TO THE DISTRIBUTION OF DIVIDENDS TO CREDITORS IN MULTI-JURISDICTIONAL LIQUIDATIONS

Another issue with practical significance arises where a company is liquidated in multiple jurisdictions. How, in these circumstances, are distributions to be made to creditors? Should a creditor prove in, and receive a distribution from, the liquidation in each jurisdiction? Alternatively, is there a "principal" jurisdiction that is the ultimate recipient of all net realisations from around the globe, and which is responsible for assessing proofs of debt and paying dividends?

This issue was addressed by the leading English case *Re Bank of Credit and Commerce International SA (No.10)* [1996] 4 All ER 796 ("**BCCI (No.10)**"). The case concerned the liquidation of a major bank (BCCI) whose operations had been conducted in many countries. BCCI was incorporated in Luxembourg, and was the subject of winding up proceedings not only in Luxembourg, but in England, the Cayman Islands, and other jurisdictions throughout the world, with local liquidators appointed by the courts of each of those jurisdictions.

The distribution issue arose for consideration by the English court because English insolvency rules permitted rights of set-off, whereas Luxembourg law did not. Thus, creditors of BCCI that also owed money to the Bank and who were "net" creditors would be advantaged if they were able to prove under English law in the English liquidation, and receive a dividend from the English liquidators.

After an exhaustive review of the relevant authorities, the court identified the following principles as being relevant to an ancillary liquidation[26]:

> (1) Where a foreign company is in liquidation in its country of incorporation, a winding up order made by an English court will normally be regarded as giving rise to a winding up ancillary to that being conducted in the country of incorporation;
>
> (2) The ancillary nature of the English winding up necessitates that the English liquidators concentrate on getting in and realising the English assets and do not enjoy the usual power to get in and realise all the assets of the company worldwide;
>
> (3) The ancillary character of the English proceedings is extended into the process of distribution of the assets, which should be pooled on a worldwide basis in order to achieve pari passu distribution among all the creditors. For this purpose, it is the liquidators in the principal liquidation who are best placed to declare the dividend and distribute the assets in the pool accordingly;
>
> (4) Nonetheless, the ancillary character of an English winding up does not relieve an English court of the obligation to apply English law, including English insolvency law, to the resolution of any issue arising in a winding up which is brought before it.

[26] [1996] 4 All ER 796 at 820

It is the fourth of the above propositions that was contentious in the case. Following an exhaustive review of the authorities that, for more than a century, had identified the distinction between a principal liquidation and an ancillary liquidation, the English Court could identify no statutory or "*inherent common law power of the Court*"[27] to disapply English winding up rules by virtue of the English liquidation being an ancillary liquidation. The Court noted that in the early decisions in which ancillary liquidations were discussed, *"no attempt was made to spell out the effect of placing that description on the winding up in question or to analyse the source of the dispensing power that the Court was exercising".*[28] The Court came to the following conclusion:

> The accumulation of judicial endorsements of the concept of ancillary liquidations have, in my judgment, produced a situation in which it has become established that in an "ancillary" liquidation the courts do have power to direct liquidators to transmit funds to the principal liquidators in order to enable a pari passu distribution to worldwide creditors to be achieved. The House of Lords could declare such direction to be ultra vires. But a first instance judge could not do so and I doubt whether the Court of Appeal could now do so.
>
> But the judicial authority which has established the power of the Court to give, in general terms, the direction to which I have referred has certainly not established the power of the Court to disapply r4.90 or any other substantive rule forming part of the statutory scheme under the 1986 Act and Rules.
>
> Nor, in my opinion, has this line of judicial authority established the power of the Court to relieve English liquidators in an ancillary winding up of the obligation to determine whether proofs of debt submitted to them should be admitted or to see to it, so far as they are able to do so, that creditors whose claims they do admit receive the pari passu dividend to which, under the statutory insolvency scheme, they are entitled.[29]

To address the set-off issue in a manner consistent with the above principles, the court directed that the liquidators make provision in order to pay dividends to each of the "set-off creditors" to ensure that their "net debt" received a dividend equal to the dividend paid in the Luxembourg liquidation to all other creditors. Having made that provision, the balance of the funds held in the English liquidation were sent to the Luxembourg liquidators for distribution. It is important to note that the provision that is required to be made is not limited to local creditors, but worldwide creditors who choose to lodge a proof of debt in the English liquidation.

Comment

The point of significance to come out of the *BCCI (No.10)* case is that the fact that the liquidation in a particular jurisdiction is only an "ancillary" liquidation does not relieve the liquidator of the obligation to apply local law to the distribution rights of creditors. In the case of *BCCI* the necessity to retain funds and adjudicate and pay certain creditors was necessitated by a difference in set off law. It would be consistent with this English decision for an ancillary liquidator to withhold funds to make provision for other divergences between the local distribution regime and the distribution regime in the principal jurisdiction. Examples that come to mind would be differences in the following distribution rules:

- the rule against double proof;
- employment priorities;
- treatment of an unsecured balance owed to a secured creditor following exhaustion of the security; and

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[27] [1996] 4 All ER 796 at 821.
[28] [1996] 4 All ER 796 at 821.
[29] [1996] 4 All ER 796 at 821

- inadmissibility of claims, or parts of claims, under other local law principles.

If one can imagine the *BCCI (No.10)* decision being applied in all of the jurisdictions around the world in which there is a separate liquidation, the result would be this - creditors, if properly advised, would forum shop for the jurisdiction in which their claim would be admitted for the highest amount, and the liquidator in that jurisdiction would be duty bound to hold back sufficient funds to ensure that the creditor receives a dividend on its (higher) proof of debt equal to what the worldwide creditors are receiving in the principal liquidation.

This result, it seems to me, is problematical from the perspective of an efficient, cost effective and orderly distribution to a company's worldwide creditors. The necessary imposition of competing distribution regimes (albeit limited to creditors "disadvantaged" in the principal jurisdiction) would necessitate delays in the distribution process, and additional cost. If the worldwide liquidation was a large and complex one, the position could potentially become quite chaotic.

An alternative approach (and the one advanced before, but rejected by, the Court in *BCCI (No.10))* would be for there to be a single worldwide distribution to creditors, made by the liquidator in the principal jurisdiction. All ancillary liquidators would remit all of the net proceeds to that liquidator. From the perspective of promoting an orderly and cost effective liquidation, such an approach would have much to commend it, provided there were certain safe guards. Safe guards would include that the law of the principal liquidation treated all worldwide creditors fairly in the sense that no inappropriate priority is given to local creditors, and the distribution regime is based substantially on the principle of a pari passu distribution to unsecured creditors.

Should one need to search for legal foundation for such an approach, one might perhaps characterise the numerous cases identifying and emphasising the "ancillary" nature of a local liquidation as an implicit application of a conflict of law principle, being that matters of distribution in a multi-jurisdictional liquidation are to be governed and administered by the law of the place of incorporation. If such an approach can properly be characterised in this way (and, it must be conceded, no analysis in any of the cases takes - or for that matter, rejects - this approach), then the English Court's concern at not identifying any power to disapply English insolvency law would be overcome. English law, in the form of its conflict of laws principles, would be applied.

Application of *BCCI (No.10)* in Australia

Does *BCCI (No.10)* have relevance in Australia?

The first point that needs to be made here is that the decision can be relevant where an Australian company in liquidation has English assets. The HIH liquidation provides an example here. A scheme of arrangement has been drafted on the assumption that the English provisional liquidators of HIH will be prevented by English law from remitting the proceeds of English reinsurance collections to the Australian liquidators for distribution in accordance with Australian law (as the law of the place of HIH's incorporation). The issue here arises out of s.562A of the *Corporations Act* which provides a priority in favour of direct insurance creditors out of the proceeds of reinsurance collections. English law is different - hence if the English proceeds are remitted to Australia, they will not be applied in a manner consistent with English law. This issue has resulted in the making of an application before the English High Court of Justice to determine whether such proceeds will be permitted to be remitted to Australia and applied in accordance with s.562A.[30]

[30] I am not familiar with the form of the application. I expect the Australian liquidator has procured the issue of a letter of request to the English court requesting the English court to exercise its discretion under s.426(5) of the Insolvency Act 1986 to apply Australian law to the distribution of the English reinsurance collections. Section 426(5) clearly confers jurisdiction on the English court to apply foreign law, and the Court's willingness to do so, even where the foreign law would constitute an abuse of process in England, has been endorsed by the English Court of Appeal in *Smith v England.* The fact that s.562A treats all international creditors equally, and has a similar effect to the distribution regime now in force in England by virtue of European insolvency regulation, suggests that such an application would have excellent prospects of success. Moreover, the *BCCI (No.10)*

As to whether the *BCCI (No.10)* decision will have application in Australia where the Australian liquidation is an ancillary liquidation, the correctness of the English decision will fall for consideration in the following ways. In the case of a foreign company being wound up as a Part 5.7 body, the issue will be considered in an identical context to that considered in *BCCI (No.10)*. If, however, the company is a registered foreign company being wound up in its place of registration and an ancillary liquidator has been appointed in Australia on the application of the principal liquidator (or ASIC), the distribution issue will be governed by s.601CL(15) of the *Corporations Act*. This section obliges the Australian liquidator to pay the net proceeds of realisation of Australian assets to the principal liquidator "*unless the court otherwise orders*". Although the existence of this statutory provision means the analysis in *BCCI (No.10)* is not directly applicable, many of the observations made in the judgment would nevertheless appear relevant to the issue that arises under s.601CL(15)(c) as to whether the Court should "*otherwise order*". No doubt creditors advantaged by Australian distribution principles would mount an argument that the court should make orders enabling Australian law to apply to their claims.

Effect of UNCITRAL model law

Article 21(2) of the UNCITRAL model law provides as follows:

> Upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in this state to the foreign representative or another person designated by the court, provided that the court is satisfied that the interests of creditors in this state are adequately protected.

Clearly, this confers a discretion on the court as to whether to remit the net proceeds to the foreign representative, and would permit the court to withhold sufficient assets to make provision for particular creditors if that was thought appropriate. This would, then, appear to leave open the question whether the approach taken by the English court in *BCCI (No.10)* should be followed in Australia, albeit in the exercise of the Court's discretion.

COMPLEXITIES IN INTERNATIONAL WORKOUTS AND RESTRUCTURINGS ARISING OUT OF AUSTRALIA'S INSOLVENT TRADING LAWS

Subject to defences, Part 5.7B of the Australian *Corporations Act* renders a director personally liable for debts incurred by a company whilst insolvent, with a five year jail term facing a director who dishonestly breaches the provision.

This law does not appear to give rise to any controversy in this country or calls for law reform. Yet, the mere cash flow insolvency of a company everywhere else in the world (with the possible exception of New Zealand), triggers no such consequences.

Only in Australia would you have as a leading case in this area the unfortunate circumstances of Mr Eise in the *National Safety Council* case. Mr Eise's only qualification was a plumber's licence. He was in his late 70s having retired 25 years previously to pursue community service in charitable and other community organisations such as the National Safety Council. He served as a director in a part time, non executive, honorary capacity. None of these factors, nor his diligent service in all non-financial areas of the Council's operations, nor the fact that he had never learnt how to read a balance sheet or a profit and loss statement, saved him from having breached Australia's insolvent trading laws, resulting in a judgment debt being entered against him at the age of 75 in the amount of $96,704,998.

What has any of this to do with cross border insolvency?

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analysis is neatly sidestepped by such an application, as s.426(5) provides what was absent in *BCCI (No.10)* - the legal foundation for adopting a foreign distribution regime.

Frequently, attempts are made to restructure insolvent or near insolvent entities as an alternative to a formal insolvency appointment. This approach is particularly prevalent in jurisdictions such as the United Kingdom and the United States where, unlike in Australia, there is a much stronger tradition and culture of rescue, and a focus on "value", as distinct from rights.

Where, say, a large English or American company is insolvent or facing possible insolvency, and attempts are made to restructure the company in an attempt to preserve value and achieve a better result for all stakeholders than would arise out of a formal insolvency appointment, the directors in those jurisdictions would not be subject to any law equivalent to Australia's insolvent trading laws. In America, for example, the directors remain subject to their fiduciary duties to the company, with reference to the interests of creditors where the company is of doubtful solvency. Importantly, they may continue to take ordinary operational risks in trying to save the company through methods they reasonably believe have a good chance of success[31]. In England, directors similarly owe fiduciary duties to the company, and in addition, there is a statutory liability for "wrongful trading" where a director has continued to trade the company when he knew or should have realised that there was no reasonable prospect of the company avoiding insolvent liquidation. Pausing here, it must be emphasised that this English concept of "wrongful trading" is very different to "insolvent trading" under Australian law as the trigger is not insolvency per se, but the absence of a reasonable prospect of avoiding a formal insolvency appointment. Accordingly, unlike in Australia, a company may continue to trade even though it is insolvent or of questionable solvency, provided that efforts being undertaken to restructure the company (so as to render it solvent) appear to have reasonable prospects of success.

The cross border complexities arise where, say, a US or English company or group of companies, with Australian operations or an Australian subsidiary, is or may be insolvent and is engaging in restructuring negotiations with its bankers, bondholders or other key stakeholders.

For example, assume that a US telecommunications group, with subsidiaries throughout the world including Australia, suddenly discovers that due to accounting irregularities its balance sheet is not what thought it was. Assume further that the irregularities need substantial investigation so as to determine whether the company is solvent or not[32]. Assume the bankers and bondholders have entered into a moratorium agreement with the Telco, but that a formal insolvency appointment to the Telco or any of its subsidiaries is an event of default, and all debts are immediately repayable. Assume also one of the following factors with regard to the Australian subsidiary -

(a) it is operating solvently, but was initially "capitalised" by a very substantial loan from the US Telco which is repayable on demand, and if demanded could not be met within a short period;

(b) alternatively, assume that the Australian subsidiary is trading cash flow negative and can only continue to operate with the continuing financial support of its parent, the US Telco.

As a final twist, assume a letter turns up from ASIC addressed to the directors of the Australian subsidiary indicating that ASIC has read newspaper reports about the demise of its parent, and would like an explanation as to how on earth the directors do not consider that the Australian subsidiary is insolvent and why they have not yet appointed voluntary administrators.

My experience with international restructurings run out of the US or UK is that the stakeholders involved in such restructurings are very focused on preservation of value, very

[31] Insol International, Directors in the Twilight Zone, page 402.

[32] Alternatively, perhaps the Teleco recognises that it is insolvent, but its bankers and bondholders have entered into restructuring discussions with a view to remedying its deficient balance sheet and all parties are optimistic that the company will be successfully restructured.

keen to avoid the "blood bath" that frequently accompanies a formal insolvency appointment (particularly in the Telco field) and have a proven track record of success. Bondholders and bankers are prepared to take a "haircut", often substantial, on their debt on the basis that the alternative of a formal insolvency appointment would produce far higher losses.

However, a formal insolvency appointment to one of the subsidiaries even on the other side of the world (such as the Australian subsidiary), may be an event of default that itself triggers a chain of events that is unable to be controlled, and may lead to formal appointments across the group. Alternatively, even if a formal appointment in Australia does not trigger formal appointments across the group, the Australian subsidiary may miss out on the fruits of a successful restructure, and the Australian business may be irreparably damaged by the process[33].

Businesses with cross border operations are often substantial. Application of the test of insolvency to an Australian subsidiary's circumstances can be complex and equivocal. Moreover, loss of value resulting from an insolvency appointment can be very substantial indeed. In one Telco matter with which I was involved, it was apprehended that a formal appointment could well result in a substantial deficiency to creditors. No formal appointment was ultimately made, the international group was successfully restructured, and the Australian subsidiary was recently sold as a going concern for a sum in excess of $100,000,000.

There is a further dimension to this issue. Generally, one or more of the directors of the Australian subsidiary of an international group are merely employees of the Australian business. They hold no equity in the company and, being salaried employees, they generally have not entered into asset protection strategies common amongst professionals and company directors. In short, when faced with an issue of insolvent trading, the Australian directors do not have the same financial interest in the preservation of the company as a director who is also shareholder would have, and often their house and assets are "on the line" should the company subsequently be placed in liquidation and an insolvent trading proceeding be commenced against them. Their only substantial interests, apart from observing their duties as directors and obeying the law, is in protecting their job and their house, and one might imagine the latter might take precedence. This may lead to the directors being unprepared to take any risk when questions of solvency of the subsidiary are complex and uncertain. It may well lead to the destruction of value in circumstances where the company may well be solvent.

While my personal perspective on this issue is that Australia's insolvent trading laws should generally be reviewed, a more immediate reform might be to exempt subsidiaries of foreign companies from the insolvent trading law provided that they comply with the relevant corresponding law applicable to their parent company in its home jurisdiction.

The UNCITRAL model law will have no application to these matters as it is only pertinent to formal insolvency appointments.

[33] One.Tel is a good example of the destruction in value that can occur upon a formal insolvency appointment, particularly in the telecommunications industry.