Banking and Financial Services Law and Practice Conference

Recent experiences involving cross-border insolvencies -

By S J Parbery

In a time when we can cruise around the globe with the ability to spy upon our neighbours' every move with computer software such as "google earth", even insolvency practitioners, who are not known for their worldliness, have trouble escaping the impact of globalisation.

I have been associated with two recent insolvency matters involving cross border insolvency issues which I think raises matters of interest. In the case of Parmalat it raises interesting questions in light of the proposed introduction of the UNCITRAL Model Law.

Nauru Royalties Phosphate Trust

Nauru is a small Pacific Island nation, which became independent in 1968. Located approximately 3500 km from Brisbane it has a population of over 10,000 people but has insufficient arable land to make a full contribution to food resources. It relies upon desalination plants to provide it with fresh water.

In researching the history of Nauru it is of interest to note that at one time it was a substantially wealthy nation. In 1963 it had one of the highest per capita incomes in the world. Its wealth was primarily created out of the mining of super phosphate. There was awareness that the super phosphate reserves were of a finite nature and there was a need to invest a significant proportion of its income in long-term assets. Unfortunately the bulk of all earnings were placed in communal trusts, which appear

to have been either mismanaged or loaned back to the government to support its budget.

In 2004 I was appointed receiver to a substantial amount of the assets owned by the Nauru Royalties Phosphate Trust and associated entities, with debts owing to my appointor in excess of $230 million. While the owners of the assets were primarily Nauruan entities, the assets were managed and located in Australia.

Control of the trust lay with trustees who were appointed from time to time by the Nauruan government. Unfortunately frequent political changes in Nauru resulted in frequent changes to the control of the trust. This factor and the apparent mismanagement of investments owned by the trust resulted in a depletion of the assets of the trust.

During the receivership I was confronted with a number of issues, which were quite unique:

- Sensitive negotiations to relocate the Nauruan Consulate from Nauru House in Melbourne, as it was occupying valuable leasing space.

- Confidential talks with the Commonwealth Government, who is sensitive to the position of the Nauruans, especially with respect to them being hosts to asylum seeking process centres under a memorandum of understanding with the Nauruan government.

- Discussions with Australian Taxation officers to determine the currency of a long-standing tax exemption, giving sovereign immunity to the trust for income earned in Australia.

- Dealing with constant offers of refinancing through third-parties through periods when political changes resulted in changes to the officeholders in the trust. During the same period the Nauruan government was deadlocked due to a constitutional crisis which resulted in the President declaring a state of emergency and calling a general election.

- In the period prior to my appointment Nauru had attempted to raise funds for its survival by becoming involved as an offshore tax haven. The end result of this was the attraction of money-laundering activities and the United States declaring Nauru a rogue state under the 2001 Patriot Act. This made it particularly difficult for me to consider refinancing offers received from third parties.

I have now primarily completed my role as receiver, having sold the assets under my control for in excess of $340 million, paid out the secured creditor and now have surplus funds available to return to the borrower.

A further complication has now arisen, with the traditional landowners claiming to be beneficiaries under the trust and as a consequence are seeking to prevent me from returning funds to the trust and instead are making claims directly against the remaining funds.

Due to the existence of these claims and the claims of other creditors within Australia, the local courts will play a role in arriving at a solution to this matter. While this is not a strict cross border insolvency issue it has arisen as a result of the insolvency of the trust.

The issues include:

- A foreign entity with assets and liabilities located in Australia

- Unsophisticated legal system in the country of origin of the trust.

- Foreign beneficiaries seeking to make a claim against assets held in Australia through the Australian legal system.

- The receiver attempting to retire and at the same time ensuring that outstanding claims are both settled here in Australia and Nauru.

A solution, which has been recommended, includes the adoption of laws within Nauru to enable a scheme of arrangement to be put in place whereby a settlement can be reached with all claimants. With the major assets being held in Australia and certain liabilities also to be dealt with here, there is a possibility of this matter being handled by the Australian courts. This of course will be as much a diplomatic challenge as a legal one.

Parmalat Finanziaria Spa

In December 2003 Parmalat collapsed in Italy owing creditors at least $14.3 billion. This is regarded as the largest business failure in European history, representing 1.5% of the Italian GNP.This international milk product company appointed Enrico Bondi as Special Administrator to the Parmalat group of companies, which were located throughout the globe.

Included in the group of companies was Parmalat Australia Pty Limited, which is the owner of a large milk processing business in Australia formerly known as Pauls Ltd. 100% of this business was purchased in 1998 for $436 million.

At the time of the appointment of Mr Bondi, Parmalat Australia Pty Limited, whilst a profitable company had considerable debts owing in Australia including large unsecured debts owing to a group of Australian banks. The local company relied heavily on those banks for ongoing banking facilities to provide working capital. Part of the reason for the need for funding arose out of the fact that the Italian parent would borrow surplus funds from its Australian Company to support what we now know to be some bad European habits.

The Australian banks had to move quickly to ensure that the local company remained in business. Mr Bondi had a lot on his plate, with the former directors and auditors being jailed in Italy. The local creditors needed assurances that the local company was sound despite the parent company being insolvent and allegations of large-scale fraud by the directors.

To ensure that the local company could continue, the Australian banks put in place new banking facilities, to provide ongoing support based on security being given by the local company. This ensured that a large and substantial asset was protected and gave Mr Bondi sufficient breathing space to develop a global scheme of arrangement to save this large international corporation.

The local directors also needed the comfort of having banking facilities put in place to ensure the ongoing solvency of the local company. A major issue for foreign company reconstructions is to ensure compliance with our insolvent trading law provisions during the period of organising a reconstruction. A diligent director of an Australian company will insist upon protecting himself during this period by indemnification and assurances that facilities are in place to pay for credit, which is going to be incurred.

The Australian banks effectively ring fenced the profitable Australian operations for the immediate benefit of Australian creditors, but by also preserving a substantial business, the global creditors will also benefit from on going profits from this business.

After an initial period of stabilisation, in which we assisted the banks' monitor the Australian operation, the company has since refinanced its interim facilities, and the business has been successfully restructured.

Parmalat- Post UNCITRAL Model Law

I have attempted to consider the impact of the proposed changes to the law, on the Parmalat matter, had the law been in place at the time of the restructuring and had the Special Administrator sought to pool assets globally within the group.

My understanding of the model law is that one of its intentions it to prevent local realisation of assets for the benefit of local creditors only. In the past it has been possible to ring fence local assets for local creditors to avoid pooling the benefit for all creditors, both local and foreign.

Other key aspect of the model law include:

- The local court is required to reach cooperation and coordination with the main foreign court. The objective being that the local proceedings achieves consistency with the foreign proceeding.
- The Model Law is not dependent on reciprocity. Accordingly in this case if Australia had adopted the law it would be possible for Mr Bondi to take advantage of the law notwithstanding that Italy had not adopted it.

A possible scenario under the proposed changes may have included Mr Bondi approaching our local courts to assist in restructuring the group. An argument could have been raised that it is for the benefit of all creditors that the assets of the group be pooled on an international basis. If this were a sustainable argument within the framework of The Model Law there would have been a major impact on local creditors.

My understanding is that under the now proposed global scheme of arrangement of Parmalat, creditors will convert debt to equity as part of the restructuring. Had the Australian Company not been restructured independently previously and had the Special Administrator sought to have local creditors included in the proposed international scheme, this may have resulted in a detrimental outcome for them, especially for a small dairy farmer dependent upon weekly cash flow.

Conclusion

The impact of the changes to the law on local credit providers where they are dealing with large overseas corporations is difficult to predict. Until such time as we have an understanding of judicial interpretation of the Model Law and its application in specific cases, there appears to be a level of risk for local creditors. One example, which comes to mind, is whether the recent US courts acceptance of adjusting employee entitlements in the restructuring of United Airlines could have be applied to Australian employees of that company.

In re-assessing their risks, local banks may have to consider whether taking security over local assets may circumvent the possible loss of control over assets to overseas courts. However in a competitive banking market borrowers may resist offering security.

To get some insight into the workings of the courts we can watch with interest the interpretations of the European courts in dealing with EC Insolvency Regulation, which significantly overlaps the INCITRAL Model.