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New Cross Border Insolvency Regulations: UNCITRAL Model Law adopted

The UNCITRAL Model Law on Cross Border Insolvency will shortly be adopted in Great Britain. Provision was made for the adoption of the Model Law by way of secondary legislation in section 14 of the Insolvency Act 2000. The Cross Border Insolvency Regulations 2006 (the Regulations) containing a slightly amended text of the Model Law at Schedule 1 will shortly be laid before Parliament with the intention of bringing them into force on 6th April 2006 or as soon after that date as proper Parliamentary process permits. The Regulations state that the Model Law in the form set out in Schedule 1 of the Regulations shall have the force of law in Great Britain. In the remainder of this briefing "the Model Law" means the form in the Regulations not the original UNCITRAL text. Adoption of the Model Law will greatly facilitate the process for obtaining recognition of foreign insolvency proceedings in domestic courts.

Key Issues

UNCITRAL Model Law on Cross Border Insolvency to be adopted

Reciprocity not necessary - foreign representative's home State need not have adopted the Model Law

Automatic "liquidation" like stay on recognition of foreign main proceedings

Stay not to affect security and set off

Recognition process made easier

European Insolvency Proceedings Regulation takes precedence where it applies

Jurisdiction under section 426 Insolvency Act 1986 retained

Background

The Model Law has been adopted by a number of countries - the first being Eritrea and the most recent the United States where a version of the Model Law was recently incorporated as a new Chapter 15 into the US Bankruptcy Code; see our client briefing *US Bankruptcy Code - A New Chapter on Cross-Border Proceedings in the US*. Furthermore, a number of jurisdictions including Australia, New Zealand and South Africa are in the process of adopting the Model Law. The aim of the Model Law is to facilitate the recognition of foreign insolvency proceedings by standardising, insofar as possible, the process by which recognition of such proceedings is obtained and the effect in law of recognition once granted. It does not seek to harmonise insolvency law in other respects or alter the substantive rights of creditors against the debtor's estate.

Adopting the Model Law Text

Countries adopting the Model Law strive to do so in a form that is as close to the original text as possible. This gives rise to a problem of construction because the original text is inherently general in nature. The intention with the new Regulations is to deviate from the original text only where absolutely necessary. This means that where there are lacunae in the Regulations and Model Law it will be for practitioners, their advisors and ultimately the courts to fill in the gaps in a manner that ensures they work in practice.

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Guidelines

There is a Guide to Enactment of the Model Law (available on the UNCITRAL web site) that was produced by UNCITRAL to assist legislators, the judiciary and practitioners in interpreting and using the original Model Law. The Guide will be relevant along with the other working papers leading to the development of the Model Law. Regulation 2 of the Regulations states that courts may consider such documents in ascertaining the meaning or effect of any provision of the Model Law.

Scope of the Model Law

Article 1 defines "foreign proceedings" in terms that make it clear that the Model Law will affect only "collective" insolvency proceedings and so receivership, for example, would be outside of their scope. Certain other limits on the scope of the Model Law are made by way of excluding insolvency proceedings relating to banks, insurers and other entities subject to special insolvency regimes. Many regulated industries that also have special insolvency regimes are also outside of the scope of the Regulations. There may be legislation in the future to bring some of these excluded institutions within the scope of the Model Law.

In addition, due to the focus in the Model Law and Regulations on "insolvency proceedings" it is unlikely that it is going to be possible to use the Model Law to achieve the cross border recognition of a foreign scheme of arrangement (under a provision analogous to section 425 of the Companies Act 1985) as part of a restructuring unless (arguably) such a scheme is also implemented within an insolvency procedure. This contrasts with the position under Chapter 15 of the US Bankruptcy Code where a "foreign proceeding" is more broadly defined and would allow recognition of proceedings "whether or not conducted under a bankruptcy law". This focus on insolvency proceedings may represent a missed opportunity to facilitate other kinds of restructuring.

No Reciprocity Needed

There is no requirement for reciprocity in the Regulations. As the draftsmen of the original Model Law intended, foreign representatives from States that have not yet adopted the Model Law may apply for recognition under the Regulations.

Interaction with other Laws

British insolvency law

Regulation 3 states that British insolvency law (as defined in article 2 of the Model Law) is to apply "*with such modifications as the context requires for the purpose of giving effect to the provisions of these Regulations.*" It goes on to state that in any case of conflict the Regulations are to prevail. This provision was considered necessary to ensure that foreign insolvency representatives had the ability to commence insolvency proceedings under article 11 of the Model Law. Article 3 is widely drawn and it is to be hoped that it will not be construed so as to alter a creditors substantive rights against the debtor which was clearly not the intention of UNCITRAL or the drafters of the Regulations.

European Insolvency Proceedings

Article 3 of the Model Law states that where it covers the same ground as the EC Insolvency Regulation (Council Regulation (EC) No. 1346/2000 of 29th May 2000 on Insolvency Proceedings) (EUIR) the EUIR will take precedence. The Regulations will thus have most impact in relation to insolvency proceedings that fall outside of the ambit of the EUIR.

Section 426 Insolvency Act 1986

A decision was taken not to remove the jurisdiction of the courts to grant assistance in foreign insolvency proceedings under section 426 of the Insolvency Act 1986. It was felt that this jurisdiction could co-exist with the Model Law and retaining it would give courts the maximum flexibility when dealing with issues involving foreign insolvency proceedings.

Financial collateral

Article 1 (4) states a court shall not grant or modify relief, co-operation or co-ordination under the Model Law if and to the extent such relief, co-operation or co-ordination would be inconsistent with rights arising under a number of provisions. These are;

- Part 7 Companies Act 1989 (Financial markets and insolvency),
- Part 3 of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999;and
- the Financial Collateral Arrangements (No.2) Regulations 2003.

As described below the automatic stay that comes into effect under article 20 upon an application for recognition being succesful does not affect enforcement of security or the assertion of rights of set off against the debtor. Article 1(4) was thought necessary to make it clear that where special provisions apply to an insolvency involving the financial markets or in relation to security over cash or shares nothing in the Model Law gives the foreign representative the right to apply for relief that could potentially override rights conferred upon a party by these specific provisions.

Main Provisions of the Regulations

Insolvency Proceedings

The Regulations and the Model Law are concerned not with unification of substantive insolvency law but with the provision of a framework to effectively address instances of cross border insolvency proceedings. They apply only to "collective" insolvency proceedings.

A distinction is made between "foreign main proceedings" - a proceeding taking place in the State where the debtor has its centre of main interests (COMI) - and foreign non main proceedings. The latter are insolvency proceedings where the debtor has an establishment in the relevant State but its COMI elsewhere.

A debtor's COMI is to be ascertained having regard to relevant case law including cases under the EUIR.

Application for recognition

Article 9 gives a foreign representative in both main and non main proceedings a right to apply for recognition. Article 11 gives him a right to commence insolvency proceedings. The Regulations contain detailed provisions and forms which are required for the application for recognition. The application needs to be supported by an affidavit that gives details of the foreign insolvency proceeding, any steps being taken in connection with any rescheduling of the liabilities of the debtor and other relevant details. Applications under the Model Law will be dealt with by the specialist Chancery District Registries as well as the High Court, Chancery Division in London. There will be provisions for transferral of proceedings between courts.

Automatic Stay on Recognition

The automatic stay that applies under Article 20 applies only upon the recognition of a foreign main proceeding. The stay is similar in scope to the automatic stay that applies upon the winding up of a company under the Insolvency Act 1986. Article 20 (3) states explicitly that the automatic stay does not affect rights to enforce any security held, to repossess goods in the debtors possession under any hire purchase agreement or the ability to set off against the debtor. If the foreign main proceedings are in the nature of a rescue or reorganistion the stay that is imposed automatically could be extended - so that it resembled, for example, the type of stay that is found in an adminsitration of a company - but only if the foreign representative applied for further discretionary relief under article 21 of the Model Law. If the proceedings recognised are non main proceedings there is no automatic stay and the foreign representative would have to apply for all relief under Article 21.

Article 19 gives a foreign representative the ability to apply to the court for interim relief upon the filing of an application for recognition but before it is dealt with. This might be used to impose a stay in cases of urgency where the hearing of the application for recognition is at a later date if, for example, the papers relating to the recognition application had to be served on a number of parties in advance of the hearing of that application.

Discretionary relief

The following types of discretionary relief may be granted by the court on an application under article 21;

- stay of proceedings or execution over the assets of a debtor;
- suspending the right to transfer or encumber the assets of the debtor;
- examination of witnesses in relation to the business and affairs of the debtor;
- entrusting the administration or realisation of all or part of the debtor's assets located in Great Britain to the foreign representative or another person designated by the court; and
- granting any additional relief that the court would be able to grant to an officeholder in domestic insolvency proceedings including the imposition of a moratorium similar to that which would exist in an administration of a company under paragraph 43 of Schedule B1 of the Insolvency Act 1986.

The court must be satisfied before granting relief under article 21 that the interests of creditors in Great Britain are adequately protected and in any non main proceedings that the relief relates to assets that should properly be administered by the foreign representative.

Antecedent transactions

Article 23 contains provisions allowing a foreign representative to investigate antecedent transactions under the Insolvency Act 1986. This would include, in the case of a company, sections 238 (transactions at an undervalue), 239 (preferences) and 245 (avoidance of certain floating charges) of the Insolvency Act 1986. The period within which such a challenge can be made by a foreign representative will be calculated by reference to the commencement date of the foreign proceedings. In order to avoid forum shopping by foreign representatives seeking the most favourable jurisdiction within which to bring a claim in relation to prior transactions it is intended that the court must consider, before entertaining an application under article 23, whether the relevant transaction has a sufficient connection with this jurisdiction. Article 23(6) provides that where there is a British insolvency proceeding already underway the foreign representative can only commence actions under article 23 with the permission of the court. Article 29 provides that any such proceedings in progress at the time a British insolvency proceeding is commenced is subject to review by the court.

Foreign Revenue Claims

Article 13 represents a change to the current law (expressed in cases such as *Government of India v Taylor [1955] AC 491* and *Peter Buchanan Limited v McVey [1955] AC 516*) as it is intended to allow foreign revenue and social security claims to be admissible in British insolvency proceedings. A number of countries have moved from an absolute prohibition on enforcement of such claims to allowing these claims to be enforced when they form part of the debts of an insolvent. This change in law will bring British insolvency law generally into line with the cases where the EUIR applies.

Conclusion

The Model Law is drafted in relatively general terms. This inevitably means that its implementation is something of an act of faith and it is to be hoped that the judiciary will give effect to it in a manner that does not create uncertainty for practitioners. Much will depend upon practitioners and the judiciary interpreting the Model Law so as to achieve the objectives of the Model Law's framers and to provide a coherent and practical framework within which to conduct cross border insolvency.

It is likely that the adoption of the Model Law will result in foreign representatives having a higher profile in the market than was previously the case because it makes it easier for them to obtain recognition. One potential impact of this may be to increase the number of enquiries that financial institutions face from such representatives relating to the operation of customer accounts.The implementation of the Model Law is nevertheless a significant and welcome step which should help to reduce the time and expense of having foreign insolvency proceedings recognised.