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UK and US bankruptcy judges rekindling that special relationship?

On 30 July, just before the start of its summer vacation, the Court of Appeal did its bit to improve international relations with the US. In the case of *Rubin & Lan -v- Eurofinance S.A. & Ors* [2010] EWCA Civ 895, English judges extended their spirit of co-operation to recognising not only US Chapter 11 bankruptcy proceedings, but also the enforcement of US claw back proceedings. This is a significant decision in the context of cross border insolvency and is a further development in the common law principles of universalism – i.e. bankruptcy proceedings commenced in the home state receive worldwide recognition.

Key Issues

English Court of Appeal to give effect to US judgment

Recognition of US bankruptcy extends to claw back actions

Promotes universal effect of bankruptcy process

Philip Hertz, partner in the restructuring and insolvency group, comments "*During the recent downturn, there have been an increasing number of formal insolvencies and restructurings that have crossed jurisdictional boundaries. It remains to be seen whether the principles of co-operation exemplified in this case are going to be extended further*. "

He adds "*It will be interesting to see whether this recent decision has any impact in the context of the Lehman Brothers' collapse and in particular the Perpetual litigation, where there are currently competing decisions in the US and UK courts regarding the effectiveness of an English law governed "flip clause". Will similar indulgence from the English Courts be sought so that the US interpretation of the flip clause prevails? Interestingly in this regard we understand that on 2 August, the BNY Corporate Trustee Services Ltd filed an appeal in the US challenging the judgment that determined the priority payment clause was contrary to US bankruptcy law. This means that appeals are currently being pursued in both the UK and US Courts. Adopting a universal approach could therefore simplify such cases, although this would be an unexpected result for those involved in the original structuring of such arrangements*."

Firm handshake or passing nod?

Before supporters of the universal approach to bankruptcy law get too carried away, it is worth bearing in mind a number of key factors that clearly influenced the decision in the Eurofinance case.

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Key factors:

1. The defendants to the claw back proceedings were UK resident/located and considered to be a party to "repugnant activity" resulting in a multimillion dollar judgment in the US;

2. They had chosen not to participate in the US proceedings and "took their chance" that no proceedings could be brought against them in the UK; and

3. the nature of the claw back claim, which essentially allowed officeholders in the US to bring actions against these individuals for the benefit of the general body of creditors had "striking similarities" to provisions of English insolvency legislation.

These factors appear to have justified the English Court taking a 'harmonising' approach in concluding that the claw back proceedings were "part and parcel of the insolvency proceedings." In the context of the Perpetual case referred to above, however, the issue of whether a contract expressly governed by English law can be effectively 're-written' by the US Bankruptcy court in order to expunge provisions which are apparently offensive to US bankruptcy law and then be enforced in the UK on its 're-written' terms, when the English Court has rendered a conflicting judgment, may be a step too far, even in the name of universalism.

Background
By way of background, Eurofinance S.A. ("**Eurofinance**"), a BVI company, established The Consumers Trust (the "**Trust**"). The Trust was established to carry on a sales promotion scheme, which offered consumers a cashable voucher, which promised a rebate of up to 100% three years down the line provided certain conditions were met. Such conditions were complex, and the road to recovering the rebate effectively impassable. A challenge to the activities carried on by the Trust - launched by the Attorney General of the State of Missouri - resulted in a settlement requiring the trustees to pay $1.65 million, as a result of which Eurofinance and the Trust sought relief under Chapter 11 of the US Bankruptcy Code.

Recognition of the Chapter 11 proceedings as the foreign main proceedings for the purpose of the UNCITRAL Model Law on Cross-Border Insolvency (as set out in Schedule 1 to the Cross Border Insolvency Regulations 2006) (the "**Model Law**") was sought in England. In addition the receivers of the Trust also commenced proceedings in the US Bankruptcy Court against Eurofinance and its directors (the "**Claw Back Proceedings**") on the basis of (amongst other grounds) unjust enrichment, restitution, fraudulent conveyance and avoided transfers. In order to avoid liability, Eurofinance and its directors (who were located in England) chose to take no part in the Claw Back Proceedings in the US. A default judgment was therefore entered in relation to these proceedings. An application was then made by the receivers to the English High Court for an order recognising the Chapter 11 and Claw Back Proceedings as 'foreign main proceedings' so as to give direct effect to the enforcement of the default judgment.

At first instance, the English Court recognised the Chapter 11 proceedings in the US as foreign main proceedings, and therefore the appointment of the receivers as foreign representatives, but dismissed the application in relation to the Claw Back Proceedings and enforcement of the default judgment. The receivers appealed against this dismissal, whilst Eurofinance cross-appealed against the order of recognition.

Issues on appeal
The Court of Appeal was asked to consider the following two issues:

(1) whether the bankruptcy proceedings (including the Claw Back Proceedings) should be recognised as a foreign main proceeding in accordance with the Model Law; and

(2) whether the default judgment of the U.S. Bankruptcy court be enforced as a judgment of the English court.

For the purpose of their conclusions regarding enforcement and recognition, the Court of Appeal considered the decision of the Privy Council in *Cambridge Gas Corporation v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2006] UKPC 26, and the House of Lords in *Re HIH Casualty and General Insurance Company Ltd* [2008] UK HL 21 (in which this firm acted and was successful) and the Model Law.

In his leading judgment, Lord Justice Ward held:

(1) that the ordinary rules relating to the enforcement of foreign judgments, which effectively oblige the claimant to issue separate proceeding in England in order to enforce the foreign judgment, did not apply to bankruptcy proceedings;

(2) 'Bankruptcy proceedings' included the antecedent transaction provisions of sections 238 and 239 of the Insolvency Act 1986, and thus, relevant in the present case, the equivalent provisions in the US. He highlighted that the ability to challenge 'antecedent transactions' was central to the collective understanding of bankruptcy and such procedures were not simply incidental;

(3) the status of the Claw Back Proceedings as 'bankruptcy' proceedings, when considering enforcement, was subject not to the general rules of private international law relating to enforcement but laws relating to bankruptcy.

Model Law – not so ideal ?
In his closing thoughts, Lord Justice Ward highlighted the anomaly that, amongst the specific forms of cooperation set out in Article 27 of the Model Law, enforcement is not included and, indeed, the guidance to the Model Law is entirely silent on enforcement, irrespective of the fact that in its general, overarching concept, such is considered central to the operation of the Model Law. However, he did note that the requirement (albeit discretionary) of the court to cooperate *'to the maximum extent possible*' in relation to any request made of it by a foreign court (Article 25) was likely to include enforcement, yet refrained from expressing a concluded view. Thus the recognition of the Claw Back Proceedings rests entirely on common law principles.

A brief encounter?

The Court of Appeal also confessed in its closing remarks that it had not found the case to be "*straightforward, involving as it does what may arguably be described as a novel, though we believe inevitable and desirable, development of the common law*." Notwithstanding this, the Court of Appeal did not give permission for the decision to be appealed. Permission may however be sought from the Supreme Court itself. In recognition of this and to avoid any complications in getting money back from New York a stay of execution was also granted.

David Steinberg, a partner in the restructuring and insolvency group, adds "*We will have to wait and see if this latest encounter with a universal approach to bankruptcy law, where the home state bankruptcy receives worldwide recognition, blossoms into a more permanent spirit of co-operation. In relation to the Perpetual case, where the US and English courts agree to disagree on the effects of the flip clause, it is difficult to envisage that an English court, would, in the absence of bad faith/fraud, co operate with the US court to the extent that it has the effect of contradicting its own findings.* "