Legal update

Although England has long subscribed to the principle of universality in cross-border insolvency, the path has been an uncertain one. Nigel Barnett asks if we have now reached the 'nirvana of universality'?

Europe and beyond

The EC Regulation on Insolvency Proceedings was a major step towards the ideal. However some countries (in particular England) have been willing to assert jurisdiction over foreign companies by holding that the economic or management control of the company rests with the parent (conveniently) located in their jurisdiction. That issue was brought to a head in the Ireland v. Italy slugfest otherwise known as *Eurofood*. The European Court has now delivered its final decision (Re *Eurofood IFSC Ltd* [2006] ECC 397).

To recap, Article 3(1) of the EC Regulation on insolvency proceedings provides that there is a rebuttable presumption that the place of the registered office will be the centre of main interests of the company. However the Italian court in Parma, in a stark exercise of territoriality, had sought to assert that *Eurofood's* COMI was in Italy because its affairs were effectively controlled by an Italian parent company. The European court held that in order to rebut the presumption one had to show factors 'which are both objective and ascertainable by third parties' which establish on the facts that the COMI rests elsewhere. It roundly rejected the concept of economic control stating:

> *'… where a company carries on its business in the territory of the Member State where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another Member State is not enough to rebut the presumption laid down by the Regulation.'*

The court went on to hold that once main insolvency proceedings have been opened by a court of a Member State those proceedings *must* be recognised by the courts of the other Member States without the latter reviewing the jurisdiction of the court of the opening State. The only safeguard is Article 26 of the Regulation, which provides that a Member State can refuse recognition if it would be

> *'manifestly contrary to that State's public policy, in particular its fundamental principles or the constitutional rights and liberties of the individual.'*

All well and good – or is it? The fact is that major corporate groups are not structured (or at least managed) on a country basis. It is the norm for there to be local companies but for all of them to be managed centrally or along service lines. The ability to file insolvency proceedings for all companies within one jurisdiction brings with it significant strategic advantage. It empowers the restructuring professional to develop a co-ordinated plan for the entire group whilst maintaining the flexibility to deal with specific local problems as appropriate. That proposition is amply demonstrated in Re *Collins & Aikman Europe SA & Others* (Lindsay J 9 June 2006). The decision is reported more fully on page 26 of this issue but, in short, Lindsay J addressed the issue of whether administrators should honour promises made to creditors that in return for not opening secondary proceedings local priorities would be respected.

The Collins & Aikman group within Europe comprised 24 group companies spread over 10 countries. Administration orders were made in respect of all 24 European companies on the basis that their respective centres of main interest were in England. The English administrators were »

alive to the potential disruption that could be caused to their group strategy were creditors to open secondary proceedings in the various countries. Accordingly, they gave oral assurances to creditors that if no secondary proceedings were commenced the local creditors' respective financial positions under the relevant local law would, as far as possible, be respected in the English administration. The issue that the court faced was whether the administrators should be authorised to honour their earlier assurances when distributing to creditors.

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Lindsay J found that he had jurisdiction to grant the relief sought pursuant to paragraph 66 of Schedule B1 of the Insolvency Act 1986.

Having found jurisdiction the judge then considered the exercise of his discretion. It was notable that not only had the creditors' committees approved unanimously the joint administrators' proposal, but the various North American creditors, who were the only substantial creditors who would suffer any detriment by virtue of the honouring of the administrators' assurances, were also supportive of the proposal. In the circumstances the judge granted the directions sought.

The decision reflects a measured and practical response to a cross-border insolvency. However, if the *Eurofood* decision had pre-dated *Collins & Aikman* it is doubtful whether administration orders would have been made in respect of the European companies (at least without considerable mental gymnastics to justify an English COMI). What would have been the alternative – a collection of main proceedings, governed by differing local practices with different individuals managing each company? Hardly an appetising prospect.

The position with regard to non-European companies has also been subject to recent legislative development. The Cross Border Insolvency Regulations 2006 incorporate the UNCITRAL Model Code on Bankruptcy. Under the 2006 Regulations, the court can recognise a foreign main or non-main proceeding and grant relief to a foreign representative. Indeed, by virtue of Article 21(2) the court can entrust distribution of the insolvent estate to the foreign representative provided that the court is satisfied that creditors' interests are 'adequately protected'.

The concept of 'adequate protection' permeates the Regulation. Article 22 provides that in determining whether or not to grant relief upon recognition of a foreign proceeding, the court must be satisfied that creditors' interests and any other interested persons, including the debtor, are adequately protected.

Unhelpfully, the Regulations do not elaborate upon what adequate protection means. As noted above, Article 26 of the EC Regulation provides for recognition to be mandatory in the case of European companies unless contrary to public policy. A similar public policy exception appears within the 2006 Regulations but the concept of 'adequate protection' suggests that the English court has greater latitude to refuse recognition.

A more longstanding route to recognition has been s426 of the Insolvency Act 1986. That too has been subject to recent judicial scrutiny in the Court of Appeal decision in *HIH Casualty and General Insurance Ltd* [2006] EWCA Civ 732. The court was faced with the issue of whether English provisional liquidators could be directed to remit assets collected by them to the Australian liquidators for distribution in an Australian winding-up or scheme. Varying in part the decision at first instance the court held that there was jurisdiction to do so albeit whether to do so was a matter of discretion for the judge (and on the particular facts the court was not prepared to do so).

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The common law

The legislative provisions supplement, but do not displace, the common law. The low point in this respect was undoubtedly the decision of the Commercial Court in *Felixstowe Dock & Railway Co* v. *United States Lines Inc* [1988] 2 All ER 77. By way of brief reminder, United States Lines Inc (USL) commenced Chapter 11 proceedings in New York. It intended to close down its European operations and concentrate its business activity within the United States. By way of a pre-emptive strike certain English creditors obtained mareva injunctions, the effect of which was to require USL to retain sufficient assets within the jurisdiction to meet their claims.

USL sought to discharge the injunction on the basis that the English court should recognise the US proceedings on the basis of comity. Hirst J stressed that whilst 'in principle' the court would wish to co-operate with the US court, the appropriateness of so doing and the precise nature and extent of co-operation would depend on the sphere of activity in question and the applicable English law. Rejecting USL's application he held that the usual practice in such cases was to carry out an ancillary winding-up in England according to English bankruptcy procedures 'working in harmony' with the US court. He also held that the restraining order within the Chapter 11 proceeding was a decree *in personam*, which the English court would not recognise.

By way of contrast, the recent decision of the Privy Council in *Cambridge Gas Transport Corporation* v. *The Official Committee of Unsecured Creditors of Navigator Holdings Plc & Others* (16 May 2006) represents something of a volte face.

With some US$300 million financing raised on the New York bond market four European businessmen acquired five gas transport vessels. Each ship was owned by a separate Isle of Man registered subsidiary of a management company and all the shares in the management company were held by another Isle of Man registered company, Navigator Holdings Plc (Navigator). Indirectly Navigator was owned by a Cayman company, Cambridge Gas Transport Corporation (Cambridge), which in turn was owned indirectly by a Bahamian company, Vela Energy Holdings Ltd (Vela).

The venture was unsuccessful and Navigator commenced Chapter 11 proceedings in New York. In March 2004 the US Bankruptcy Court rejected Vela's reorganisation plan and confirmed a plan that had been approved by virtually all of Navigator's outside creditors, the effect of which was that, essentially, all assets would be taken over by the creditors. The intent of the plan was to vest the shares in Navigator in the creditors' representatives. The plan provided:

> *'Immediately upon entry of this confirmation order, title to the old common stock (of Navigator) shall automatically vest in the interim shareholders (the creditors' committee) without any further act by any person or under any applicable law, regulation, order or rule. The interim shareholders shall then, in their capacities as shareholders of (Navigator), take all necessary steps under the laws of the Isle of Man or otherwise to implement (the plan).'*

The US court issued a letter of request to the Isle of Man court asking for assistance in giving effect to the Chapter 11 plan and confirmation order. The Committee of Unsecured Creditors petitioned the Isle of Man court for an order vesting the shares in Navigator in their representatives. They were met with a cross-petition from Cambridge contending that they had never submitted to the

jurisdiction of the US court and that an order of that court could not affect its rights of property in the shares in the Isle of Man.

Much of the debate before the Privy Council concerned the issue of whether the US order was a judgment *in personam* or a judgment *in rem*. It was contended by Cambridge that if it was a judgment *in personam* it was not enforceable against Cambridge in the Isle of Man because the US court had no personal jurisdiction over Cambridge. Alternatively, if it was a judgment *in rem* it could not affect Cambridge's title to the shares in the Isle of Man.

Rejecting Cambridge's submissions the Privy Council held that bankruptcy proceedings did not fall within either category. It held that whilst judgments *in rem* and *in personam* were judicial determinations of the existence of rights:

> *'The purpose of bankruptcy proceedings on the other hand is not to determine or establish the existence of rights, but to provide a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established.'*

The court recognised that 'the mechanism' can operate in different ways so, for example, in a personal bankruptcy in England the assets will vest in a trustee for realisation and distribution to creditors whilst in corporate insolvency the insolvent company continues to be the owner of the property but holds it in trust for the creditors. The court addressed the question of what limits applied to the assistance that the court could give. As a matter of common law the court thought it doubtful whether the assistance could extend to applying provisions of foreign insolvency law which did not form part of the domestic system but that the domestic court could at least provide assistance by doing whatever it could have done in the case of a domestic insolvency. Analysing Section 152 of the Isle of Man Companies Act 1931 (the legislative foundation for schemes of arrangement under Isle of Man law) the court held that the power to sanction an arrangement gave the court the power, in appropriate cases, to sanction a scheme which left the shareholders with nothing. Having decided that it was within the court's power to give assistance the court concluded that it was appropriate to do so as there was no suggestion of any prejudice to any creditor in the Isle of Man or any suggestion that any local law might be infringed by so doing. The court was also heavily influenced by the fact that whilst Cambridge may not have participated in the Chapter 11 proceedings the individuals behind it did through both Navigator and Vela. The court also had regard to the fact that Cambridge's shareholding in Navigator was 'completely and utterly worthless'.

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The willingness of the Privy Council to support the US court and the promotion of the plan is understandable in the circumstances of the case. The court plainly thought that the investors were seeking to 'have their cake and eat it' in that they were supportive of the Chapter 11 proceedings whilst they thought that there was a prospect that Vela's plan might be approved but then sought to derail the proceedings once the creditors' plan had gained approval. Indeed, the Privy Council broadly said as much, expressing the view that perhaps the only value in Cambridge's shares was that it gave rise to the possibility that Cambridge could

> *'wreck or delay implementation of the confirmed plan in an attempt to drive the creditors back to the negotiating table and secure better terms.'*

The *Navigator* decision concerns, of course, an Isle of Man registered company. However, there is no reason to assume that the law would be applied any differently were it an English registered company subject to Chapter 11 proceedings.

Has the battle been won?

The correct answer would seem to be 'not yet'. In the case of European companies it remains to be seen whether the courts will adopt the rigid *Eurofood* approach to COMI or whether the parental control test will revive phoenix-like in another guise. In the case of applications for recognition based on common law, s426 or the Cross Border Insolvency Regulations the court will reserve to itself a discretion as to the extent to which recognition will be given.

In exercising its discretion will an English court review afresh decisions made by the foreign court or will it adopt a more focused approach? An indication may be obtained from the decision of David Richards J in Re *T&N Ltd & Others* [2004] EWHC 2361. In that case the applicant administrators sought directions in relation to a reorganisation plan being promoted in Chapter 11 proceedings in the US. The strategy that had been agreed between the administrators and the plan proponents had been for the preparation of a US reorganisation plan which in turn would involve the administrators promoting either company voluntary arrangements or schemes of arrangement to give effect to the plan in relation to the UK companies and their creditors.

However, the administrators became concerned as to whether they could properly propose either CVAs or schemes because they perceived the reorganisation plan as being fundamentally unfair in its treatment of creditors of the UK companies. In his judgment David Richards J indicated that the English court had to approach the matter from a position of fairness and not follow blindly the position in the US. He said:

> *'The English courts would pay the closest regard to the US courts' analysis of the plan and its reasons for confirming it. The English courts, however, remain bound by statute to give their own consideration to the fairness of the CVAs or schemes of arrangement and, notwithstanding the strong cross-border element and the desirability of concerted action, have no right or power to cede or qualify that jurisdiction.'*

He went on to comment that he found it difficult to envisage a case where the court would sanction a scheme or not interfere with a CVA where the likely result was that some of the creditors might receive less than they would receive in a winding-up of the company.

So where are we left? The strict application of *Eurofood* is likely to be unhelpful in the restructuring of European groups. Outside of Europe, recognition remains (as it has always been) subject to the whims (exercised judicially of course) of the judge. ☐