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10. *UNCITRAL Model Law and its Effects in the United Kingdom*

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## **10. UNCITRAL Model Law and its Effects in the United Kingdom**

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### *Introduction*

The Model Law is perhaps the best reaction to the international system's inability to cope with the challenges of international insolvency in the 1990s. It provides a smooth-moving and user-friendly response in the context of insolvent debtors in many jurisdictions. It is different from other international conflict of laws conventions because on this occasion there was not merely the standard diplomatic gathering for negotiations at an international level. Significantly, the board of negotiators was not only composed of experts and diplomats but also of insolvency practitioners. Moreover, it must be borne in mind that the idea of the Model Law is not to go through extensive negotiations resulting in a fixed text to be ratified by all contracting states but to offer up an agreed menu of model articles to states that are willing to adopt the text into their own legislation. Therefore, there is also no reciprocity requirement.

To date, the UNCITRAL Model Law has been implemented by around eighteen states or territories in the world. The United States of America passed legislation in 2005 to enact the Model Law as Chapter 15 in the U.S. Bankruptcy Code. In the United Kingdom, the Insolvency Act 2000 Section 14 (the 'enabling provision') authorized the enactment of the Model Law by means of secondary legislation with or without modification. Here the challenge was whether the text would remain intact or would include extensive modifications. As it has turned out, the modifications imported into the U.K. enactment of the Model Law are extensive, and of considerable interest and significance.

### *Effects of recognition*

A good example is Article 20 of the Model Law, concerning the effects of recognition and the benefits that follow from it. Comparing Article 20 as implemented in British Law to Article 20 of the Model Law, shows that the latter (original) version is quite succinct. The British version of the stay is more elaborate, and the effects of recognition are carefully defined. If proceedings are recognized by English courts, an automatic stay will take place, equivalent to that which would result from an order for winding up a company or for the bankruptcy of an individual. Here, the stay is automatic yet flexible. This means that a secured creditor is able to enforce the security in spite of the existence of the stay. Similarly, in the case of a hire purchase agreement (and analogous types of transactions) the owner is able to take back his goods.

In the design of this provision, the voice of the City of London, expressed via its financial and legal advisors, was influential. It wanted to avoid making the automatic stay a comprehensive one. Creditors who have taken security over an asset anywhere within the United Kingdom would be alarmed at the prospect that in the event of the debtor's insolvency in some far away country, the English collateral would be locked up. This could happen when the foreign representative came to apply for recognition in the UK: the assets would be frozen. The solution adopted was to define the stay in limited terms, but with the extra possibility for the foreign representative to apply to the court for extension of the stay so as to make it fully comprehensive. However, this would be done at the court's discretion and only if a persuasive case for doing so could be presented to the court.

The U.S. stay under Chapter 15 is initially comprehensive: section 1520 imposes an automatic stay, but a secured creditor still has the possibility to apply to the court and

show cause why it should grant an order to lift the stay with respect to the applicant, enabling it to enforce and realize the security while the insolvency proceeding is still under way. But the cost of doing so, and the delay and uncertainty caused in the meantime, represent a significant and adverse factor in the calculation of the risk of lending, and consequently the pricing of the transaction.

An important aspect of the drafting of key concepts within the Model Law lies in the fact that many of the same terms are used as in the EC Insolvency Regulation, such as the concepts of 'establishment' or 'centre of main interests' (hereafter referred to as COMI). However, with respect to the Model Law matters of interpretation will be quite tricky because there is no centralised court. The interpretation of each notion could then be fragmented, according to the practices followed by different enacting states. Over time divergent approaches might also develop, as between the Model Law states and the states that are bound by the EC Regulation. For the same word and concept there could then be conflicts with the interpretation given by the European Court of Justice. For example, the COMI definition might start to fragment in different countries' traditions. At present, there are indications that courts are striving to maintain harmony of approach regarding the interpretation of the two texts. There are examples of judges in the United States, where the courts apply Chapter 15, who in a ruling regarding a point of definition have referred to the interpretation of the equivalent term developed by the European courts, especially the European Court of Justice. A common approach is thus being sought judicially, albeit on a voluntary and somewhat tenuous basis.

When proceedings are opened abroad, and the foreign representative needs help in the United Kingdom, he has to seek an early hearing before the High Court. And for the foreign proceedings to be recognised as main proceedings, he must demonstrate that the COMI of the debtor is in that foreign state. Alternatively, to obtain recognition as non-main proceedings the representative must show that the debtor has an establishment in the state in question. The relevant averments must be made on the prescribed form for the application, and they must be supported by some evidence to confirm the true nature of the proceedings, either main or non-main. If it turns out that the proceedings are neither main nor non-main proceedings, there can be no reliance on the Model Law at all, but as an alternative the foreign representative may apply for recognition and assistance under the long-established principles of common law, which have not been abrogated by the enactment of the Model Law in the United Kingdom. It may therefore still be possible to obtain assistance.

In contrast to the British policy of retaining the former common law principles of assistance by enacting the Model Law, the United States have shut things down under Chapter 15. Before October 2005 they used to adopt a liberal approach, based initially on the doctrine of comity and subsequently on the statutory provisions in Section 304 of the Bankruptcy Code. In this way U.S. courts could give assistance and recognition to foreign insolvency proceedings opened in a wide variety of circumstances. These alternative grounds for giving assistance, including Section 304 itself, were abrogated when Chapter 15 was introduced, making the Model Law the single gateway to obtaining assistance in the U.S.A. Conversely, when the United Kingdom enacted the Model Law it intentionally retained the historic common law basis of recognition, which is in fact a very flexible (if little known) body of law and which still exists alongside the Model Law. Consequently, multiple opportunities exist in practice to provide assistance to a foreign representative, depending on the circumstances of the case, if it proves impossible to rely on the Model Law: in addition to the common law, the EC Insolvency Regulation may apply, as may (in a limited number of cases) the statutory provisions of section 426 of the 1986 Insolvency Act.

As a further example, if a corporate entity is excluded from the scope of Article 1 of the Insolvency Regulation (because it is an insurance company, for instance) so that the

Model Law is not available, it may be possible to seek common law recognition of foreign proceedings involving that corporate entity if the case meets the common law criteria for exercising jurisdiction by the foreign court.

#### *Additional relief*

Article 21 deals with additional relief that can be granted to the Court on request. Such relief is not automatic, but if the Court makes a reasonable case for extending the effects of the stay it is empowered to do so. This is an especially enhanced moratorium originally put in the British Statute book for the purpose of reinforcing attempts to reorganise and rescue a company or its business activities by the procedure that is known as administration. When a company goes into administration, the stay is comprehensive: no security can be realised without either obtaining the consent of the administrator or going to the court. The Court then does a balancing act in which it decides whether or not the prejudice towards or hardship inflicted upon the secured creditor is disproportionate.

In terms of international restructuring, the extended, 'administration type' stay that can be granted under Article 21 may be a vital means of ensuring the possibility of achieving a successful rescue. If it can be shown that the restructuring effort is unlikely to accomplish anything unless key assets that are located in the jurisdiction of the English courts are allowed to remain available for use by the company, the essential components of its business can be kept intact for the time being, instead of being repossessed or subjected to enforcement by the secured creditors. If the only way to have a chance of bringing about the rescue is for the freezing effects of the stay to be extended to the secured assets for the time being, then the foreign representative could come to the English courts and seek extra relief under Article 21 in the form of a court order that will keep all matters intact.

#### *Avoidance transactions*

As regards the avoidance of prior transactions, this matter is dealt with in Article 23. The original Model Law version of this article only authorises the extension of the remedies of the enacting state's domestic law so as to make them available to the foreign representative coming from another jurisdiction and seeking to attack a transaction, when property that represents the fruits or benefits stemming from that transaction is now located in the territory of that state.

In the United Kingdom version of Article 23 reference is made to specific provisions of the Insolvency Act that, in their usual context, allow transaction avoidance only where a domestic insolvency proceeding is under way (e.g. bankruptcy, winding up of a company or where the company is in administration).

The special feature of this version of Article 23, however, is that it does not require any U.K. insolvency proceedings to be opened under domestic law: the foreign representative, following recognition, can invoke the specified sections of the Insolvency Act under the Model Law and get the remedy to attack a transaction without going through the trouble and expense of opening local insolvency proceedings of any kind. Under the Model Law as transposed in the United Kingdom the remedy is accessible to foreign main and non-main proceedings, but in the case of non-main proceedings the Court has to be satisfied that the property against which the foreign representative seeks to move is property that, under the law of Great Britain, ought to be properly administered under the foreign, non-main proceedings. With that proviso, the same spread of avoidance rules is at the disposal of the foreign representative, whether main or non-main, to attack the transaction previously entered into by the debtor before the English courts by proceedings brought against parties that are amenable to the jurisdiction of the court. The remedies include the impeachment of transactions at an undervalue, preferences, floating charges granted in respect of pre-existing debts,

excessive contributions to pensions funds that the debtor has made, and transactions made in fraud of creditors.

The transaction avoidance rules contained in statutes for domestic application usually include a certain time limitation: a transaction can only be attacked if it took place within a certain time frame before the onset of the insolvency as specially defined for this purpose by reference to certain events, such as the commencement of winding up or the appointment of an administrator. The time period specified for this purpose is colloquially called the ‘hardening-off period’: if a transaction has taken place and no insolvency proceedings are opened within the time period specified, the beneficiary is able to retain the benefit even though the transaction would have initially been impeachable. Hence this hardening-off period is very crucial. With regard to an international application of the avoidance provisions, the question arises from what point in time you must start counting backwards to determine if the transaction has happened during the hardening-off period or not. If one decides to count back from the date on which the English law provision was invoked by application of the foreign representative, rather than from the time of commencement of the original proceedings in the state where they were opened, the additional period of time between these two events may be sufficient to “run out the clock” in relation to the actual date on which the transaction took place. To reduce the possibility of such an hiatus giving rise to the retention of improperly-obtained benefits at the expense of the general body of creditors, Article 23 states that you should start counting backwards from the date of the opening of the foreign proceedings and not from the time of granting the request to use the English provision in relation to property within the English territory. Moreover, any rule of the foreign law whereby the proceedings are deemed to have opened at an earlier time (i.e. any ‘relation-back’ rule) is to be taken into account for this purpose. Thus, the hardening-off period is actually increased in the sense that you start counting back from that earlier point in time and the requisite number of months or years is calculated backwards from that point. If the time that elapsed between the actual date of the transaction and the effective date of commencement of the *foreign* proceedings does not exceed the length of time specified as the ‘hardening-off period’ for the purposes of the *English* avoidance rule that has been invoked, the impeachment of the transaction may well succeed, provided that all other requirements of the relevant section of the Insolvency Act are shown to be met in the actual case.

When the Cross-Border Insolvency Regulations were being drafted in the United Kingdom, the *Eurofood*<sup>1</sup> litigation before the European Court of Justice was in mid-progress. Advocate General Jacobs had delivered his opinion, but the Court itself had yet to pronounce its judgement. Among the various questions submitted by the Irish Court, one regarded the time of opening of the Irish proceedings for the purpose of the EC Insolvency Regulation. There were two possible ways to assert that the Irish proceedings predated the Italian proceedings opened in Parma. One was based on the fact that the requirements under the Regulation for the opening of insolvency proceedings under Irish law with respect to Eurofood IFSC Ltd. were completed by the Irish court making an order for the appointment of provisional liquidators in response to the application made concurrently with the presentation of a petition for the company to be wound up. Accordingly, the argument was that the request for the appointment of provisional liquidators triggered the opening of the main proceedings in the Irish territory, and that the making of the order of appointment several days before any competing order was made by the court in Parma marked ‘day one’ of the Irish proceedings. The second possible argument was that when the Irish court subsequently made a winding-up order on hearing the petition itself, at a later date than when the rival proceedings opened in

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<sup>1</sup> Case C- 341/04, Eurofood IFSC Limited, ECHR I-3813

Italy because the Parma court made its order for the winding up of Eurofood, the Irish process could still take precedence by virtue of the rule under Irish Insolvency law that the effect of the court order related back to the date on which the petition was originally presented.

Advocate General Jacobs expressly accepted both arguments: *firstly* the provision of the provisional liquidators triggered the opening of the proceedings, and *secondly* the relation-back rule of the Irish Statute would lead to the same conclusion with respect to the winding-up order itself. However, when the European Court of Justice (ECJ) ultimately delivered its judgement it based its ruling solely on the first proposition, and made no pronouncement as to the correctness of the second proposition. Meanwhile the drafters of the U.K. regulations enacting the Model Law, and in particular Article 23, possibly anticipating that the ECJ would align itself with the reasoning of the Advocate General on this point, had already made express provision in paragraph 4 that for the purpose of paragraph 3 the date of the opening of the foreign proceedings shall be determined in accordance with the law of the state in which the foreign proceedings are taking place, including any rule of law by virtue of which the foreign proceedings are deemed to have opened at an earlier time. Consequently, the advantage of Article 23 is significant, because it enables a party that can invoke this provision of the Model Law in the United Kingdom to benefit from any relation-back rule within the law of the state where the insolvency proceedings have opened, albeit purely in the context of transaction avoidance proceedings brought in the United Kingdom.