CENARGO: A TALE OF TWO COURTS, COMITY AND (ALLEGED!) CONTEMPT

The Cenargo case has been the subject of numerous articles about forum shopping, writes Susan Moore, a Partner in Denton Wilde Sapte's Reconstruction and Insolvency Group. However, a relatively unexplored area is how the two courts in which the proceedings were ongoing interacted with one another. This article examines the relationship between the courts (which included a telephone conference), records some of the courts' comments about comity and examines their differing approaches to invoking the jurisdiction of contempt.

The facts

The Cenargo group (the **Group**) is a shipping group, with services primarily across the English Channel and the Irish Sea, and in the Mediterranean. On encountering financial difficulties, the companies in the Group filed on 14 January 2003 for protection under Chapter 11 of the US Bankruptcy Code, and became debtors in possession (the **DIPs**).

The companies in the Group were all English incorporated (save for a Hong Kong and a Manx company) and all of their assets and business operations were in the UK or other European territories. All of the creditors other than a group of bondholders were based in the UK or Europe. None of the companies had assets or conducted business in the US, but two of the companies opened bank accounts in New York shortly prior to the Chapter 11 filings.

The Chapter 11 filings were extremely unwelcome as far as a major leasing creditor (the **Petitioner**) was concerned. It thought that the appropriate jurisdiction for any insolvency proceedings was the UK and that the Chapter 11 proceedings had been selected to frustrate its contractual rights[1].

As a result, on 28 January 2003, the Petitioner applied to the English Court for orders appointing provisional liquidators to certain of the DIPs. The Petitioner realised that its actions did not sit happily with the Chapter 11 stay (which purports to have effect worldwide), and drew this to the attention of the English Court. Nevertheless, the English Court appointed Joint Provisional Liquidators (the **JPLs**), observing that the Chapter 11 proceedings were an abuse. In the orders appointing them, the JPLs were given power to present administration petitions (the Petitioner was unable to make out a case for administration at the outset) and to apply to the US Court to dismiss the Chapter 11 proceedings.

To ensure that the provisional liqudiations were not undermined by any steps taken in the US Court, the English Court granted an injunction which prevented the directors and their agents from taking any further steps in the Chapter 11 proceedings without the consent of the English Court, and in particular from making any allegation based on contempt of the US Court.

Following service of the English Court's orders, and at the request of the US lawyers acting for the DIPs (the **DIPs' lawyers**), the US Court made an order restraining the JPLs from taking any action in the provisional liquidations and made an order to show cause why the Petitioner and the JPLs were not in contempt of the US Court (the **US Order**) for having breached the Chapter 11 stay.

The competing injunctions created a hiatus: as a matter of English law, the directors were divested of authority upon the appointment of the JPLs, whereas the US Order prevented the JPLs from discharging their duties under English law. There followed a number of hearings in the US: an indication on the part of the JPLs that they intended to seek remedies in the English Court (of which they were officers) provoked further allegations of contempt from across the Atlantic based on failure to comply with the US Order.

[1] The stay under Chapter 11 case is wider than the moratorium in English administration in that it prevents contractual counter-parties from exercising rights to terminate contracts even if they do not intend to take further action.

During the following hearings and discussions, the US Court showed no inclination to release the JPLs from its injunction and admonished the JPLs to work with the DIPs. It became clear to the JPLs that the Group needed to be placed in administration due to mounting creditor pressure[2]. However, the US Court refused to allow the JPLs to present administration petitions and instead indicated that the DIPs should present their own petitions.

In the event, on 7 February, the English Court made administration orders in respect of the companies in provisional liquidation and all but two of the remaining DIPs[3]. At the hearing, the DIPs' lawyers confirmed that they had obtained the US Order without having received instructions from the DIPs, and indicated that they were under some fiduciary duty to take this step. The English Court:

- ordered the DIPs' lawyers to file an affidavit explaining their actions;
- ordered that the costs of the JPLs and the Petitioner in dealing with the US contempt litigation (the **US litigation**) be expenses of the administrations and gave the Administrators liberty to apply for an order that any penalties imposed by the US Court against the JPLs or the Petitioner be paid as expenses; and
- sent a Letter of Request to the US Court which stated that if the US Court gave favourable consideration to imposing no penalty in the US litigation then the English Court could similarly give favourable consideration to any apparent contempts of the English Court.

On 14 February 2003, the US Court made a conditional order suspending the Chapter 11 proceedings finding that the "center of gravity" of the cases was in the UK, but reserved jurisdiction over the US litigation and the quantification of the fees of the professionals employed in the Chapter 11 proceedings (the **US Professionals**). It also ordered (a) the creditors' committee appointed in the Chapter 11 proceedings (the **Committee**) to have carriage of the US litigation, and (b) the Administrators to seek authority from the English Court to pay the US Professionals' fees as administration expenses[4], and asked that there be a short protocol to give effect to this. In its order, the US Court asked the English Court to accord comity to its ruling on the US Professionals' fees.

The Administrators then prepared a draft protocol, but it soon became apparent that it would not be possible to agree terms. The position of the US Professionals was that it was for the US Court to determine all issues in connection with their fees and that the US Court's order should, as a matter of comity, be rubber stamped by the English Court to facilitate payment. Conversely, the Administrators considered that they should provide the English Court with all facts and matters relevant to the question of what the priority should be given to the fees allowed by the US Court, particularly in light of their view that the Chapter 11 proceedings were an abuse and of no benefit to the companies or their creditors.

The Administrators applied for directions to determine what position they should take. This triggered:

- A motion being filed by the Committee with the US Court alleging that the Administrators were in contempt of the US Court's order suspending the Chapter 11 proceedings [5].
- An approach on the part of the US Judge to the English Judge who had dealt with the previous hearings in the English Court.

[2] Whilst the moratorium under provisional liquidation provided some protection (and was relied on by the DIP's lawyers), it was not as extensive as that available within administration. In contrast to an order for provisional liquidation, the making of an administration order amounts to the "opening of insolvency proceedings" for the purpose of the EC Regulation on Insolvency Proceedings 2000, which means that the administration order is recognised throughout the EU (except Denmark).
[3] On 20 February 2003, administration orders were made in respect of the final DIPs, one of which was incorporated in Hong Kong and the other in the Isle of Man, on the basis that these debtors' centre of main interests were in the UK and therefore "main proceedings" for the purpose of the Regulation could be opened in the UK.
[4] There was insufficient cash in the US jurisdiction to meet the fees.
[5] It later became apparent that this contempt motion had been filed by the Committee's US lawyers without instructions.

There followed a telephone call between the Judges (commented on below), after which the Administrators' directions application was heard. At the hearing, the English Judge ordered the Administrators to bring all relevant matters to the attention of the Court when seeking directions as to what priority should be given to the US Professionals' fees, and he sent a second Letter of Request to the US Judge which proposed a split between the courts of the issues relevant to the US Professionals' fees on the basis that matters subject to the US procedure and US law should be issues for the US Court and vice versa.

The fee approval hearings in the US Court then took place. The Administrators had objected to the fees of the US Professionals on various grounds, including that:

- Insolvency proceedings should have been initiated in England rather than the US, and the Chapter 11 filing did not benefit the DIPs and caused unnecessary expense (many creditors had asserted that the Chapter 11 stay did not affect them and some acted in breach of it).
- No credit for services performed after 28 January 2003 should be given, on the grounds it was unauthorised work because the appointment of the JPLs divested the directors of their powers.
- In particular, the DIPs' lawyers had no authority to file a contempt motion and in doing so, violated the injunction of the English Court of 28 January 2003.

The US Court rejected most of the Administrators objections. It found that (among other things):

- There was a valid basis for the Chapter 11 filing, supported by reasonable professional judgment. While the decision not to file originally for administration in England was open to question, that basis for a fee reduction might impact adversely on the future exercise of professional judgment.
- That the appointment of the JPLs did not divest the boards of the DIPs because the appointments were in violation of the US automatic stay and therefore void.
- It was reasonable for the DIPs' lawyers to believe that they had to respond to the Petitioner's "unilateral action" in order to protect the integrity of the US Court's jurisdiction and the DIPs' lawyers had an independent obligation to start the US litigation.

The US Court reduced the DIPs' lawyers fees by just under 30% but allowed their expenses in full. It also halved the expenses of the DIP's financial advisers and allowed their (fairly modest) fees in full. Settlements were reached with the two sets of professionals acting for the Committee and so no ruling was given in this regard. At the time of giving judgment, the US Court dismissed the US litigation.

Subsequently, the Administrators issued a directions application to determine what priority if any should be given in the administrations to the allowed fees of the US Professionals. However, agreement was reached between the DIPs' lawyers and the Administrators as to what proportion of their fees allowed by the US Court should be paid from administration funds. Therefore, the English Court did not need to rule on the directions application. The Chapter 11 proceedings were dismissed shortly afterwards.

The key companies in the Group have now been successfully restructured through CVAs which became effective in December 2003, at which time the English administration proceedings came to an end.

The approach to contempt

The differing approach between the Courts to invoking the contempt jurisdiction was stark. The US Court positively encouraged the proceedings based on contempt of the US Court and indicated on a number of occasions that it was important from a precedential point of view that the US litigation be allowed to proceed. The US Court was concerned about a principle being established which could be asserted by parties to say that they can take unilateral action in a foreign jurisdiction such as the Petitioner had done and not violate the stay.

The writer has considerable sympathy with this in so far as the Chapter 11 proceedings relating to US companies, or even non-US companies with significant assets in the US, are concerned. However, the concept that the stay in respect of a foreign company subject to Chapter 11 prevents a foreign creditor seeking relief in the jurisdiction of the company's incorporation – particularly when the company has no or little nexus with the US – is very difficult to comprehend.

An interesting aside is that, when appointing the Committee to pursue the US litigation, the US Judge seemed to envisage that any fee protocol would permit payment of the Committee's costs of the US litigation – costs which the English Court had been asked as a matter of comity to allow to be paid, notwithstanding that the US litigation was directed at officers of the English Court.

Conversely, the English Court was less willing to resort to its contempt jurisdiction. At the hearing on 7 February, an application was before the Court which dealt with allegations of contempt and the English Court simply adjourned that application, in an attempt not to further aggravate matters. It also agreed to send the first Letter of Request to the US Court. At a hearing on 14 April, the English Judge observed "*it is totally unproductive when you have trans-national litigation of this sort where you have different philosophies in many regards in the two jurisdictions to fall back on the jurisdiction contempt as that seems to be calculated to promote far more acrimonious litigation and problems which may prove at the end of the day unsolvable. … The answer is, I hope that questions of contempt in the States will be abandoned and then the same productive line can be taken here. But if and so far as contempt in the States is relevant, which I hope it will not be, I cannot see how one can take that into account without also taking account of contempt here…*".

During the telephone conference between the Judges, the English Judge observed that the bringing of contempt proceedings against the Administrators as a matter of English law was a contempt of the English Court because they are officers of the English Court[6]. The English Judge also made his views about invoking the contempt jurisdiction clear - i.e. that it was unhelpful and would likely create a very serious conflict of jurisdictions, observing that outside the US the scope of the Chapter 11 stay is considered excessive. The English Judge also indicated that the US litigation should be concluded before he ruled on the US Court's request for comity as regards the US Professionals' costs.

Ultimately the US Judge dismissed the US litigation. In his judgment, the US Judge stated that he agreed with the English Court that the imposition of penalties for contempt would be counterproductive and that it did not seem worthwhile for the parties to incur additional costs in connection with the litigation. However, the following should be borne in mind:

- The English Court would probably not have granted the request for comity in connection with the fees of the US Professionals had the US Court not dismissed the US litigation.
- The JPLs were immune from suit under the FSIA (see below).
- The Petitioner was not subject to the jurisdiction of the US Court[7].
- The dismissal meant that the US Judge did not need to comment on whether it would give effect to an equivalent provision in foreign legislation (which the English Judge had requested him to do): if a US company with all of its business in the US was subject to a foreign insolvency proceeding which gave rise to a stay, any suggestion that the company was not free to file for Chapter 11 without first seeking permission from the foreign court is unlikely to be acceptable to the US Court.

Contempt in the US and officers of foreign courts

[6] This analysis applies equally to JPLs.

[7] Although the two corporate entities which together made up the Petitioner were members of a well known banking group, they themselves were not subject to US jurisdiction.

If faced with allegations of contempt of the US Court, insolvency office holders who are officers of their domestic court may do well to remember the Foreign Sovereign Immunity Act (**FSIA**). This US statute provides that "agents or instrumentalities" of a foreign state shall be immune from the jurisdiction of the US Court unless one of the limited exceptions applies (being the waiver of immunity or undertaking certain commercial activities). There is US case law to the effect that officers of a foreign court are "agencies or instrumentalities".

For example, in *Fabe –v- Ancco Reinsurance Undertaking Limited*, liquidators appointed by the Bermuda Court in respect of a Bermuda company were found to be agents or instrumentalities of a foreign state for the purposes of the FSIA. Also, in *Granville Gold Trust Switzerland –v- Commission del Fullimento/Interchange Bank* it was held that an administrative unit charged with administering Swiss bankruptcy matters was immune from suit under the FSIA and certain sanctions under Chapter 11were not warranted.

Comity

A number of requests for comity were made during the proceedings. For example, in the first Letter of Request, the US Court was asked to give favourable consideration to imposing no penalty in the US litigation. On the US Court's part, a request was made that the English Court accord comity to its ruling on the US Professionals' fees.

The position of the US Court was that whilst comity will be given to courts affording basic due process, because the proceedings filed by the Petitioner in the English Court were (allegedly) in contempt of the US Court, that was not due process and comity should not be given to the orders appointing the JPLs (hence the finding those orders were void). When the Chapter 11 proceedings were suspended, it was important to the US Judge that he was affording comity to the administration proceedings – which in his view had been commenced properly after permission from the US Court, in contrast to the provisional liquidation proceedings.

A number of comments about comity were made by the Judges during their telephone conference and they agreed that it was vital that there be harmony and comity.

The US Court did in some respects give comity to the English Court in dismissing the US litigation, but must have recognised that there was little prospect of comity being given to it had it not done so. There may also have been other reasons for dismissing the US litigation (see above).

However, whether comity would have been afforded by the English Court to all or part of the US Professionals' fee awards is a very difficult question. On the one hand, the English Court had been asked to afford comity, but on the other, the US Court made some findings in its judgment which may not have sat happily with the English Court, including that the Chapter 11 proceedings were not an abuse, and that the orders of the English Court appointing the JPLs were void and did not divest the directors of control[8]. The English Court had made it clear that the question of the propriety of the Chapter 11 filings (from an English perspective) was critically significant in deciding how far comity should be given. Sadly (from an academic viewpoint), these matters were not ruled upon.

The procedure for telephone conference between the Judges

There has been a great deal of interest in the telephone conference between the two Judges, which is thought to be the first ever such communication between a US and an English Judge.

[8] This is one of the most surprising elements of the US Court's judgement. Even under US law, the law applicable to the corporate governance of an English company should be English law. There is no doubt that in England, the orders appointing the JPLs were valid and had the effect of divesting the directors of control.

The procedure which brought about and was then adopted for the call was as follows. Initially, the US Judge attempted to speak to the English Judge direct. The English Judge reported this to the Administrators' lawyers so that a telephone conference including the various parties' counsel could be set up, and during the conference he commented that, under the English legal system, he is not free in any case to speak to another Judge officially on any matter without the consent and without the participation of the parties. At the end of the conversation, the English Judge invited the parties' lawyers to comment, on the basis that they were technically part of the discussion. After the call (and at the request of the English Judge) a transcript was circulated so that it could be agreed.

None of the parties to the call (including the Judges) mentioned the guidelines issued by the American Law Institute for court to court communications in cross border cases and as such there was no formal adoption of the guidelines. Had there been a need for one or more future calls between the Judges, it is likely that there would have been an opportunity to draw the guidelines to the courts' attention, which might well have resulted in them being adopted.

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