The introduction of the UNCITRAL Model Law on Cross-Border Insolvency: the Cross Border Insolvency Act (Cth) 2008

The international background to the UNCITRAL Model Law on Cross-Border Insolvency

The United Nations Commission on International Trade Law[1] ('UNCITRAL') was formed in 1966 with the express mandate to further the progressive harmonisation and unification of international trade law. Increasingly, model laws developed by UNCITRAL working groups have been adopted by different states leading to a harmonisation of laws in specific subject areas. The success of this harmonisation has been quite remarkable, given that the model laws are often adopted by countries from both a common law and civil law tradition. Recent examples of UNCITRAL model laws that have been adopted and enacted into Australian law include the 1985 UNCITRAL Model Law on International Commercial Arbitration (now a schedule to the International *Arbitration Act 1974* (Cth)) and the 1996 UNCITRAL Model Law on Electronic Commerce (enacted into both Commonwealth and state legislation, relevantly, the *Electronic Transactions Act 2000* (NSW) and the *Electronic Transactions Act 1999* (Cth)).

In May 1997 UNCITRAL adopted the Model Law on Cross-Border Insolvency[2] ('Model Law') and in 2004 published a legislative guide to its enactment[3]. The Model Law applies to both corporate and individual debtors. The Model Law takes into account other international efforts[4]. The preamble to the Model Law states its purpose is to provide effective and efficient mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of cooperation between courts, greater certainty for trade and investment, fair and efficient administration of cross border insolvencies that protect the interests of creditors and other interested persons, protection and maximisation of the value of assets and facilitation of the rescue of financially troubled businesses.

The Model Law is said to be an example of another 'Model soft law' – where a country may adopt a standard law drafted by international experts but may also incorporate minor differences to address unique domestic concerns[5]. The Model Soft Law approach to harmonisation is increasingly being used where domestic policy concerns make hard law (such as that created by binding conventions) uniformity difficult and in countries that lack modern legislation covering the substantive topics.[6]

The Model Law takes a 'universal' approach which assumes that one insolvency proceeding will be universally recognised by the jurisdictions in which the entity has assets or carries on business (to be compared with a territorial approach which assumes that each country will have exclusive jurisdiction over the insolvency of a particular debtor and that separate proceedings for each country under that country's laws will be undertaken).[7]

UNCITRAL describes[8] the Model Law as respecting differences among national procedural laws and concedes that it does not attempt a substantive unification of insolvency law. Rather it is said to offer 'solutions' in a 'significant way'.

Some criticise the Model Law as being part of a push by the 'Washington Consensus' (the World Bank and USAid) which assumes neo-liberal economic globalisation policies[9]. Others speak of the Asian Financial Crisis of 1997 as being a major jolt to the adoption of new insolvency laws in East Asia[10].

An updated list of countries that have adopted the Model Law is available on the UNCITRAL website and includes a number of other Western nations and trading partners of Australia, notably Great Britain (excluding Northern Ireland), the United States of America, Japan and New Zealand.[11]

Due to the fact that the Model Law is not binding on state signatories (compared to the binding nature of international conventions or treaties) and that states can change its terms on implementation, there is some controversy as to whether some states, notably Japan, have fully implemented the Model Law, or whether they have changed it unrecognisably.[12] Likewise, although Canada has implemented changes to its insolvency law based on the draft Model Law by adopting 'elements' of that law, it is not listed on the UNCITRAL website as a country which has adopted the Model Law.[13]

The European Union ('EU') has for sometime had in place Regulation 1346/2000 (in force from 31 May 2002) (the 'EU Regulation') which is said to be largely based on the Model Law. It applies only in relation to matters arising between EU member states, i.e. intra EU. The EU Regulation has been a source of case law which is likely to influence how the Model Law is interpreted. With Great Britain adopting the Model Law, it is expected that other EU member states will follow suit, although Great Britain will continue to apply the EU Regulation to cross-border insolvency issues relating to other EU states (other than Denmark which is not a party to the EU Regulation and so in relation to proceedings involving Denmark in Great Britain the Model Law will apply).

While Australia has been somewhat inexplicably slower to implement the Model Law than a number of its trading partners, the Australian Labor Government under the leadership of Prime Minister Kevin Rudd has continued a process started by the Howard Coalition government[14] to implement the Model Law into Australian law.

A bill to implement the Model Law was introduced by the Howard Coalition government into the House of Representatives on 20 September 2007 but was not passed before the election was called and therefore lapsed.

The *Cross-Border Insolvency Bill 2008* (Cth) (the 'Act') was introduced into the Senate by the Rudd Labor government on 13 February 2008 and was passed by parliament on 15 May 2008 (hereafter 'the Act'). The Act commences on royal assent, except for Parts 2, 3, 4, and Schedule 1, which will commence on a day fixed by Proclamation, or six months after royal assent, whichever is the earlier (see s2 of the Act).

Once enacted, the Model Law will apply generally and its application does not depend on reciprocity[15] or that the state of origin of the

foreign representative or party seeking to rely on the Model Law has itself enacted the Model Law (cf for example the 1958 UNCITRAL Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the 'New York' convention) which applies where there is reciprocity between signatory states).

The application and scope of the Model Law and an outline of the important provisions of the Model Law

Cross-border insolvency is a term used to describe circumstances in which an insolvent debtor has assets and/or creditors in more than one country[16].

A number of complex issues may arise in the context of cross-border insolvency.[17] An insolvency administrator may have limited access to assets of the company that are located in another country. There may be special rules providing local creditors with access to local assets before funds go to a foreign administration. There may be limited or no recognition of foreign creditors. There may be inconsistency in the priority of creditors (particularly in relation to employee claims) across jurisdictions. There may be difficulties for foreign creditors seeking to enforce securities over local assets.[18]

The Act proposes that the Model Law will be enacted as a stand alone schedule to the Act (s6 provides that the Model Law has force of law in Australia). By comparison, the implementation in other countries, for example the US, has involved the incorporation of the Model Law into existing legislation.

The Model Law will apply to both corporate and personal debtors, with the only exclusions from its application being deposit taking institutions and insurance companies (s9 of the Act and proposed regulations to the Act as identified in the explanatory memorandum[19]). The courts nominated under the Model Law are, in respect of individual debtors, the Federal Court; and in respect of non-individual debtors, the Supreme and Federal courts (s10 of the Act). The Model Law will extend to liquidations arising from insolvency, reconstructions and reorganisations under Part 5.1, and voluntary administrations under Part 5.3A of the Corporations Act. It does not extend to receiverships involving the private appointment of a controller or a member's voluntary winding up or a winding up by a court on just and equitable grounds, as such proceedings may not be insolvency related.[20]

Any inconsistencies between the Model Law and the existing *Corporations Act 2001* (Cth) ('Corporations Act') and *Bankruptcy Act 1966* (Cth) ('Bankruptcy Act') are dealt with by sections 21 and 22 of the Act which in general terms provide that the Model Law will prevail over both the Corporations Act and the Bankruptcy Act in the event of inconsistency.

Essentially the changes to be made by the Model Law will be procedural in nature. The Model Law contains 32 articles which in summary[21] deal with the following:

- Chapter II – sets out the conditions under which the person administering a foreign insolvency proceeding, and foreign creditors, will have access to the Courts of a Model Law state;
- Articles 13-14 – allow foreign creditors to participate in proceedings in the local jurisdiction;
- Chapter III – sets out the conditions for recognition of a foreign insolvency proceeding and for granting relief to the representative of such foreign proceeding;
- Chapter IV – permits courts and insolvency administrators from different countries to cooperate more effectively; and
- Chapter V – makes provision for the coordination of insolvency proceedings that are taking place concurrently in different states.

A 'foreign proceeding' is defined in article 2 of the Model Law as a collective judicial or administrative proceeding (including an interim proceeding) pursuant to a law relating to insolvency which must entail control or supervision of the assets and affairs of the debtor by a foreign court; it must be for a purpose of reorganisation or liquidation. A foreign proceeding will be classified by the Model Law as either a foreign main proceeding (where the proceeding is taking place in a state in which the debtor has its centre of main interests ('COMI')) or a foreign non-main proceeding. The term COMI is not defined in the Model Law[22], however, article 16(3) of the Model Law contains a presumption that in the absence of proof to the contrary, the debtor's place of registration, or where the debtor is an individual – his or her habitual residence – is the COMI. A foreign non-main proceeding is defined as a foreign proceeding which is not a foreign main proceeding where the debtor has an establishment in the foreign state. A number of the European cases to date under the EU Regulation have related to disputes concerning the COMI of the debtor and the consequential classification of proceedings as foreign main proceedings.[23]

If recognised as a foreign main proceeding then commencement or continuation of individual actions or proceedings concerning the debtor's assets, rights, obligations or liabilities in the state in which the application is made will be stayed, and any execution against the debtor or its assets and the right to transfer, encumber or otherwise dispose of the debtor's assets will also be stayed (articles 20 and 21 of the Model Law). Proceedings by the foreign representative to seek to 'clawback' antecedent transactions may be commenced (article 23 and s17 of the Act).

The Commonwealth Department of Treasury's *Corporate Law and Economic Reform Program Proposals for Reform: Paper No. 8 Cross-border Insolvency: Promoting International Cooperation and Coordination* ('CLERP 8') describes the Model Law as covering the following 'procedural' issues:[24]

- inbound requests for recognition of foreign insolvency proceedings;
- outbound requests for assistance from a foreign state in connection with a proceeding in Australia under its laws relating to insolvency;
- requests for the coordination of insolvency proceedings taking place concurrently in a foreign state and in Australia in respect of the same debtor; and
- participation by foreign creditors or other interested parties in proceedings occurring in Australia.

The important changes that the Model Law is likely to bring about

Important changes that the Model Law will bring about are:

- automatic access by foreign representatives to Australian courts (articles 9 and 11) and the right to participate in a proceeding regarding the debtor (article 12);
- a streamlined procedure for the recognition of foreign proceedings – as either a foreign main proceeding or foreign non-main proceeding (articles 15-17);
- the automatic imposition of a moratorium or stay following recognition and increased ease of obtaining interim relief similar to the appointment of a provisional liquidator under the Corporations Act or interim trustee under the Bankruptcy Act in cross-border insolvency situations (article 19); and
- increased cooperation between Australian and foreign courts (the obligation on the Australian court to cooperate in article 25 is now mandatory and the form of cooperation is specified in article 27 – although states can identify additional forms of cooperation, Australia has not done so).

Justice Barrett of the New South Wales Supreme Court in an interesting conference paper delivered in early August 2005[25] reviewed cases that had arisen in 2005 involving cross-border insolvency issues and commented on how they may have been impacted upon if the Model Law had formed part of the law of Australia at that time. This paper gives a number of practical examples of the potential impact of the Model Law on proceedings.

Section 581 of the Corporations Act makes provision for an Australian court to act in aid of a foreign court that has jurisdiction in external administration matters, with a distinction being made between the degree of cooperation which will be extended to countries prescribed by the regulations (the court must act) and other countries (the court may act). This section will remain in force, although in the event of any inconsistencies between it and the Model Law, the Model Law prevails. Section 581 is likely to continue to be utilised, especially in relation to entities excluded from the application of the Model Law, such as insurance companies.[26]

Section 29(5) of the Bankruptcy Act is in similar terms to s581 of the Corporations Act and will remain in force following the Model Law coming into effect.

Article 10 of the Model Law provides that a foreign representative is (or the foreign assets and affairs of the debtor are) not subject to the jurisdiction of the Australian Courts solely due to the fact of making an application under the Model Law.

Australian cases which concern the Model Law are likely to involve reference to overseas authority concerning the relevant Model Law provisions at issue in the dispute, consistent with the interpretation provision in article 8 of the Model Law which expressly provides that in the interpretation of the Model Law regard is to be had of its international origin and the need to promote uniformity in its application. UNCITRAL maintains a website database of case law relating to the Model Law (called CLOUT – case law on UNCITRAL texts) which may assist in locating these case authorities.[27]

General comments/criticism of the Model Law

The Model Law will not do away with the potential for parties to engage in forum shopping in cross-border insolvency matters, particularly in relation to COMI disputes concerning the location of the foreign main proceeding.

One criticism of the Model Law is that it only applies to single entities as opposed to corporate groups[28] (although article 11 of the Model

Law provides that a foreign administrator of a group can bring proceedings).

One commentator has suggested that there will be less likelihood of anti-suit injunctions being granted in states in which the Model Law applies given the express mandatory cooperation obligations imposed on courts by the Model Law.[29] The precise way that cooperation between the Australian courts and foreign courts will operate in practice remains to be determined.[30]

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Endnotes

1. Composed of 60 member states of the UN General Assembly who are elected for terms of 6 years. Australia is currently a member with its membership expiring in 2010.
2. http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html
3. http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html
4. Explanatory Memorandum ('Explanatory Memorandum') to the Cross-border Insolvency Bill 2008 at 3.
5. Kent Anderson 'Testing the Model Soft Law Approach to International Harmonisation: A Case-Study Examining the UNCITRAL Model Law on Cross-Border Insolvency' (2004) 23 *Yearbook of International Law* 1 at 2.
6. ibid.
7. The Commonwealth Department of Treasury's Corporate Law and Economic Reform Program Proposals for Reform: Paper No. 8 Cross-border Insolvency: Promoting International Cooperation and Coordination ('CLERP 8') at 17 and 21.
8. http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html – these 'solutions' include foreign assistance for an insolvency proceeding taking place in the enacting state; foreign representatives' access to courts of the enacting state; recognition of foreign proceedings; cross border cooperation; and coordination of concurrent proceedings.
9. Professor Roman Tomasic 'Insolvency law reform in Asia and emerging global insolvency norms' (2007) 15 Insolv LJ 229 at 234 and see the sources at footnote 29.
10. Id 241.
11. An updated status list can be found on the UNCITRAL website at http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html . According to that website, the following states have implemented legislation based on the Model Law on Cross-Border Insolvency: British Virgin Islands; overseas territory of the United Kingdom of Great Britain and Northern Ireland (2005), Colombia (2006), Eritrea, Great Britain (2006), Japan (2000), Mexico (2000), Montenegro (2002), New Zealand (2006), Poland (2003), Republic of Korea (2006), Romania (2003), Serbia (2004), South Africa (2000), and the United States of America (2005).
12. Anderson, supra 11-14.
13. Id 15.
14. On 12 October 2005 it was announced by the Australian Government that the reforms proposed by CLERP 8, one of which included the adoption of the UNCITRAL Model Law on Cross-Border Insolvency, would be implemented.
15. CLERP 8 supra 21.
16. Explanatory Memorandum supra 3.
17. The following list of issues summarises the Explanatory Memorandum supra 3.
18. ibid.
19. Explanatory Memorandum at Chapter 1 para [14].
20. CLERP 8 supra at 23.
21. Taken from CLERP 8 supra 22.
22. Explanatory Memorandum supra Chapter 1 para [7] which provides that: 'The Bill does not seek to define COMI as a considerable body of common law that exists in overseas jurisdictions in relation to that concept. It is expected that Australian courts will be guided by that body of law in considering the definition of COMI in the context of this Bill. Such an approach will ensure that Australian law is in harmony with other jurisdictions.'
23. Some cases under the EU Regulation are helpfully summarised by John Baird in 'Cross-Border Insolvency and the UNCITRAL Model Law' (2006) 18(1) *Australian Insolvency Journal* 4 at 8-10.
24. CLERP 8 supra 23.
25. RI Barrett 'Cross border insolvency – aspects of the UNCITRAL Model Law' available at http://www.lawlink.nsw.gov.au/lawlink/supreme_court/ll_sc.nsf/pages/SCO_barrett060805.
26. It is noted that in a recent case of *McGrath v Riddell* [2008] UKHL 21 delivered on 9 April 2008 arising out of the collapse of HIH, an application was made by the liquidator of HIH to the English Court under a similar provision found in s426 of the UK *Insolvency Act 1986* (which was unsuccessful at first instance but successful on appeal to the House of Lords). While this application was prior to the Model Law coming into force in Great Britain, the Model Law would not have applied in any event as in Great Britain, as is proposed in Australia, insurance companies are excluded from the application of the Model Law. This case, however, shows the UK court taking a 'universal' approach to the issue, consistent with the approach under the Model Law.
27. http://www.uncitral.org/clout/searchDocument.do;jsessionid=75F637934AA6785F7E13361EF7AC508F.WEB01
28. Raised as an issue by Richard Fisher in a paper entitled 'Current issues and developments corporate insolvency law & practice' delivered at a seminar organised by the Federal Court of Australia in Sydney on 2 April 2008.
29. Look Chan Ho 'Anti-Suit Injunctions in Cross-Border Insolvency: A Restatement' 52 ICLQ 697 at 732-734.
30. It seems that 'cooperation' is unlikely to involve a judge in Australia phoning a judge in, for example, the US for a chat.