BEYOND THE SPHINX—IS CHAPTER 15 THE SOLE GATEWAY?

LT Allocation of jurisdiction; Centre of main interests; Company registration; Cross-border insolvency; Discretion; EC law; Offshore companies; United States

Introduction

In "Mystery of the Sphinx—COMI in the US",[1] I set out a detailed analysis of the judgment of Judge Drain in *Sphinx Ltd, Re.* That was a case of a Cayman registered company which had no substantial connection with Cayman and where the main connection was with the United States. I suggested that since the attempted use of c.15 judicial assistance in that case was an abuse of process because it had an improper ulterior purpose, Judge Drain was absolutely correct in refusing recognition as a main proceeding. However, I could see no basis for his recognition of the Cayman Liquidation as a non-main proceeding, since there was no evidence of any "establishment" in Cayman, as that term is defined in c.15, even though the definition is less restrictive than that in the EC Regulation on insolvency proceedings (1346/2000).[2]

I was also critical of some of the reasoning, in particular the idea that COMI was not a purely objective fact-based concept. I speculated that Judge Drain may have been troubled by the suggestion, deriving from the legislative history of c.15, that it is the *only* mode of seeking assistance for foreign proceedings. I suggested that such a view would create a serious gap in situations where there is a proceeding in the place of registration but where the COMI is elsewhere and there is no "establishment" in the place of registration, but there may be proper reasons why no proceedings are launched in the place of COMI. I suggested that the United States should and could, without doing violence to the language of c.15 itself, hold that there is a residual common law discretion which can be used in special cases and referred to our own wide common law jurisdiction as applied to the Isle of Man by the Privy Council in the *Cambridge Gas and Navigator* case.[3]

The wider context

The world used to be divided into two main camps. One group, including the United Kingdom, focused on the place of the registered office as being the domicile of a company and regarded insolvency proceedings at the place of the registered office as the main proceedings.[4] Proceedings in other countries would be "ancillary" proceedings and should in principle act in aid of the main proceedings.[5]

This approach fitted in conveniently with the fact of the British Empire, in which many companies were registered in the United Kingdom but traded in other parts of the world. With the demise of the British Empire and the widespread use of places of registration of convenience for tax and regulatory reasons, this is no longer an appropriate model.

The civil law countries used a different model, based on the location of the "seat" of the company. This was a more realistic approach than the registered office model and fits in much better with current reality. The invention of the concept of "centre of main interests" or "COMI" which ended up in EC Regulation 1346/2000 on insolvency proceedings owes much to the "seat" theory. In order however to create a new autonomous European law concept, new language was used and in order to placate the common law/Scandinavian world a presumption was used that the COMI was in the place of the registered office unless the contrary was demonstrated.[6]

The current 27 countries of the European Union (except Denmark) are, of course, all "COMI" countries pursuant to EC Regulation 1346/2000 on insolvency proceedings (as amended), as long as COMI can be found within their borders. The United States and other non-EU countries who have adopted the UNCITRAL Model Law have to that extent also adopted the COMI approach. However, the rest of the non-EU world, apart from countries whose systems are based on civil law, remain in the registered office camp. In particular, both the United Kingdom and the United States have a special interest in the offshore tax havens that use English law-based concepts and in particular those just outside the European Union or the United States. The most significant jurisdictions for this purpose are perhaps Bermuda, the British Virgin Islands,[7] Cayman, Jersey and Guernsey.

The existence of completely different approaches as to where main proceedings ought to be gives rise to potential clashes between jurisdictions which should be avoided, if at all possible, in the interests of creditors. Avoiding such conflict requires a flexible approach to judicial assistance for foreign proceedings. In particular, in the most difficult cases, where the place of registered office has neither the COMI nor an "establishment" as defined, the question arises as to how far judicial assistance can or should be given.

A concrete example

S Ltd is registered in Cayman. However, apart from the registered office and the fact that audits have to be carried out by Cayman accountants and the role of Cayman regulators where appropriate, S Ltd has no connection whatsoever with Cayman. Its business, assets, shareholders, directors and creditors are all outside Cayman. The Cayman courts make a winding-up order.

With this basic situation, let us try out three different hypothetical cases.

Case (1)

In case (1), all the other connections are with the United States. Accordingly, case (1) is similar to the *Sphinx* case, except that we will assume that there is a proper purpose for seeking judicial assistance in the United States, e.g. to collect assets for distribution in the Cayman liquidation. We will assume that no creditor or other relevant party wants to start a proceeding in the United States, even though COMI is in the United States, because of the additional expense and trouble and all the creditors are content with Cayman insolvency law and distribution rules (which they thought they were contracting into by dealing with S Ltd).

Since neither COMI nor an "establishment" exists in Cayman, no assistance under c.15 can be given in case (1). If c.15 is the sole entry point, no assistance at all can be given and the liquidators are stuck. The creditors would have to suffer the additional time, trouble and expense of starting separate proceedings in the United States and then attempting to co-ordinate the US and Cayman proceedings. This would be a complete and unnecessary waste of time and resources, to the detriment of creditors.

If I am right in thinking that there is, or should be found to be, a residual common law discretion in the US Federal Bankruptcy Courts to assist even outside c.15, along the lines of the *Cambridge Gas and Navigator* case, the unnecessary delay and expense would be avoided and the US court could simply give judicial assistance to the Cayman liquidator to collect the assets in the United States and distribute them in accordance with Cayman law.

Case (2)

For the purposes of case (2), I will assume that all the other connections are with England. Since the COMI in case (2) is within the European Union, the EC Regulation would apply to any application to open insolvency proceedings anywhere in the European Union, but such proceedings are not desired by the company or the creditors. Since the Cayman winding-up proceeding takes place outside the European Union, there is nothing in the EC Regulation obliging the United Kingdom to recognise the Cayman proceeding under the EC Regulation, nor is there any facility within the EC Regulation for doing so. On the other hand, the English courts have no difficulty in such a case because Cayman is a designated law-country for the purposes of s.426 of the Insolvency Act 1986 and this enables the English courts to assist the Cayman court under that statutory provision.[8]

As in the United States, the UNCITRAL Model Law does not assist in England in case (2), since its enactment in the United Kingdom by means of the Cross-Border Insolvency Regulations 2006 only helps in the situations where the foreign liquidator is appointed in the place of the COMI or "establishment", the latter being defined more narrowly than in the United States but more widely than in the EC Regulation. However, England does have the further route of the common law jurisdiction exemplified in the *Cambridge Gas and Navigator* case in the Privy Council. Under this heading, just as under s.426, the English courts could normally allow the Cayman Liquidator to remove the assets to Cayman for distribution there.

Case (3)

In case (3), I assume that all the relevant connections are with the Isle of Man. The Isle of Man has neither s.426 nor the UNCITRAL Model Law. However, once again judicial assistance can be given on the basis of common law principles, as happened on appeal in the *Cambridge Gas and Navigator* case.

Does US case law prevent the application of a residual common law discretion?

I have been referred by one of the US bankruptcy judges to a very early case on c.15, *United States v Jones Construction Group LLC*,[9] in the US District Court for the Eastern District of New York.

In this case, the US Government sued the defendant construction company which appears to have been registered in Canada. The case was heard by Marilyn D Go, a US Magistrate Judge. The defendant construction company commenced bankruptcy proceedings in Canada and the interim receiver applied for a stay of the US proceedings in accordance with Canadian bankruptcy law. The Judge in her judgment refers to the introduction of c.15 and points out that relief under c.15 is only available after a foreign representative commences an ancillary proceeding for recognition in accordance with c.15. She then states:

> *"In the absence of recognition under Chapter 15, this Court has no authority to consider Mr Breton's request for a stay".*

Unfortunately, there appears to have been no argument putting forward, and no consideration of, any inherent jurisdiction to grant a stay under common law principles. Nevertheless, despite requiring an application for recognition under c.15, the Judge stated as follows:

> *"Under these circumstances and given the comity that American courts should accord foreign bankruptcy proceedings, the receiver of LBL's parent should be given an opportunity to seek appropriate protection of that corporation's assets. Thus, this Court stays this action for an additional 60 days to give Mr Breton or other authorised person an opportunity to seek appropriate relief under Chapter 15 with respect to LBL."*

The result of this case is therefore somewhat contradictory: having said that there was no jurisdiction apart from c.15 to grant a stay, the Judge grants a stay pending a c.15 application. I would suggest that in reality what the Judge is saying is that in a normal case c.15 is the proper route that must be taken but that there is an inherent jurisdiction to stay proceedings under the principle of comity. Thus *US v Jones* is not, when properly understood, a decision which denies the existence of a residual common law discretion, but rather one which affirms and exercises such a common law discretion, albeit in this case only on a temporary basis, since there is no reason to think that c.15 would not be available as the proper route in this case.

I would suggest, therefore, that whilst the c.15 route must be taken whenever possible and in all ordinary cases, whenever there is an exceptional case such as that of S Ltd above, and in particular where any further proceedings in the United States would be a waste of time and money, the residual common law discretion should be exercised.

A normal case

After the complications of the *Sphinx* case and the apparent contradiction in *US v Jones*, it is helpful to look at a relatively straightforward application of c.15 in the case of *Tri-Continental Exchange Ltd, Re*,[10] in the Bankruptcy Court for the Eastern District of California. The case was heard by Bankruptcy Judge Klein. The company in this case was an International Business Company registered in St Vincent and the Grenadines. The company's only offices were located in St Vincent where it had about 20 employees. By the time of the application for c.15 relief, however, there were no employees and no business being conducted. Between 1995 and 2004 the debtor (and other St Vincent companies in the group) sold approximately 5,800 insurance policies in the United States and Canada. The estimated liabilities were greater than the premiums received. The debtor company lacked the necessary insurance licences and falsely represented that the cover was backed by licensed and rated insurers. The "impresario" of the insurance scam was a US citizen who had gone to live in St Vincent and the Grenadines. He was eventually arrested and died in pre-trial custody.

The joint liquidators in St Vincent and the Grenadines believed that they had identified up to US$7 million worth of assets from various international locations including property in Ireland, Barbados and possibly Spain. In the United States, over US$1.6 million were tied up in an asset forfeiture and a part of this was to be released to the joint liquidators if the US bankruptcy court recognised the liquidation proceedings in St Vincent.

The application for recognition was opposed by a US creditor who had judgment against the debtor companies and who argued that the COMI was in the United States because most of the creditors were insureds located in the United States. The US creditor also claimed a security interest over assets of the debtors in the United States.

In discussing the question of where the COMI was located, Judge Klein referred to an article by Professor Westbrook, one of the leading commentators in the United States on bankruptcy law, which stated amongst other things:

> *"The drafters of Chapter 15 believed, however, that such a crucial jurisdictional test should be uniform around the world and hope that its adoption by the United States would encourage other countries to use it as well."*

Judge Klein goes on to explain by reference to the Guide to Enactment of the UNCITRAL Model Law that the COMI concept was modelled on the use of that concept in the EU Convention on Insolvency Proceedings (later the EC Regulation). Judge Klein gives the following interesting view of the presumption that COMI is at the place of the registered office:

> *"In effect, the registered office (or place of incorporation) is evidence that is probative of, and that may in the absence of other evidence be accepted as a proxy for, 'center of main interests'. The registered office, however, does not otherwise have special evidentiary value and does not shift the risk of non persuasion, ie the burden of proof, away from the foreign representatives seeking recognition as a main proceeding".*

Judge Klein also pointed out, in relation to the claim for security that the US creditor had, that under c.15 any handing over of assets in the United States for distribution to the foreign representative would be subject to the court being satisfied that the interests of US creditors were "sufficiently protected": see s.1521(b). This follows the approach of UNCITRAL Model Law, Art. 21. Judge Klein pointed out that the US version uses "sufficiently protected" instead of the Model Law's "adequately protected" in order to avoid confusion with the US Bankruptcy Code's defined term "adequate protection".

Judge Klein recognised the St Vincent liquidation proceedings as main proceedings. This was plainly right, since on the facts set out by him in his judgment, the COMI was clearly in St Vincent. Not only was that the place of the registered office but in fact all the "head office functions" were carried out from there. The fact that the selling operation was in the United States and Canada and that assets were held in various locations did not alter that conclusion.

The *Tri-Continental* judgment is thus an excellent illustration of the working of the UNCITRAL Model Law in the form of c.15 towards the goal, mentioned by Judge Klein of maximising "the value of the cross-border estate that is available for distribution to creditors".

Conclusion

The UNCITRAL Model Law expressly envisages that a court will use every means available to give assistance in cross-border insolvency cases, whether pursuant to the enactment of the Model Law or otherwise.[11] As far as I am aware, no country other than the United States has raised the possibility that the Model Law must be, without exception, the sole entry point for foreign representatives and the only means of seeking recognition or judicial assistance. Such an approach would seem to be directly contrary to the intention of the Model Law.[12]

It would be a great pity if the United States, rather than using c.15 as simply the normal route in the usual case, excluded resort to the common law residual jurisdiction in cases where resort to that is necessary and appropriate. I suggest that there is nothing in the wording of the statute or in the case law which requires such an approach and there is everything to be said for a practical comity-based approach which uses the residual common law discretion as an additional weapon in the armoury of cross-frontier co-operation.

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1 (2007) 20 Insolv. Int 4.
2 Art.2(h) of the Regulation states: "'establishment' shall mean any place of operations where the debtor carries out a non-transitory activity with human means and goods". (The word goods is a mistaken rendering of "*biens*" and should read "assets".) Section 1502(2) of the US Bankruptcy Code states: "'establishment' means any place of operations where the debtor carries out a nontransitory economic activity." The text of the Regulation can be found with a commentary in Moss, Fletcher and Isaacs, *The EC Regulation on Insolvency Proceedings* (OUP, 2002).
3 *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2006] UKPC 26; [2006] 3 All E.R. 829.
4 *English Scottish and Australian Chartered Bank, Re* [1893] 3 Ch. 385 at 394.
5 *ibid.*
6 Art.3(1).

7 The BVI has legislation implementing the UNCITRAL Model Law (Pt XVIII of the Insolvency Act 2003) but it is not yet in force as far as I am aware.

8 Since distribution under Cayman law would normally be substantially similar to distribution in an English liquidation, there would seem to be no bar in the ordinary case to giving judicial assistance and remitting the assets for distribution to Cayman: *HIH Casualty & General Insurance Ltd, Re* [2006] EWCA Civ 732; [2007] 1 All E.R. 177, currently on appeal to the House of Lords.

9 (2005) 333 B.R. 637.

10 (2006) 349 B.R. 627.

11 Art.7 of the Model Law provides:

> *"Nothing in this Law limits the power of a court. . .. to provide additional assistance to a foreign representative under other laws of this state."*

12 See the commentary at para.90 to Art.7 in the Guide to Enactment.

SPECIAL BRIEFINGS

THE INSOLVENCY DIRECTIVE RELATING TO EMPLOYMENT RIGHTS

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LT Compensatory awards; Corporate insolvency; EC law; Employees' rights; Protective awards

The Legislative Background

Directive 80/987 (the Insolvency Directive) requires Member States to establish "guarantee institutions" that will guarantee outstanding claims resulting from contracts of employment relating to pay in the event of employers' insolvency. The Directive allows Member States to strike a balance between the rights of the employee and the obvious limits on social welfare budgets by allowing them to define what constitutes pay, and by limiting it to pay corresponding to a particular period for eight weeks in total.

In the United Kingdom, the Directive is implemented through Pt XII of the Employment Rights Act 1996 (ERA), ss.182–190. It is administered by the redundancy payments directorate of the Insolvency Service, an agency of the Department of Trade and Industry (DTI). The Act guarantees various payments including statutory notice, up to eight weeks' arrears of pay, up to six weeks' holiday pay and the basic award for unfair dismissal—all subject to a statutory weekly maximum, which is currently £290. Section 184(2) specifically states that remuneration under a protective award under s.189 of the Trade Union Labour Relation Consolidation Act (TULRCA) for failure to consult employees during a redundancy exercise is included in the eight weeks' arrears of pay limit.

Connor v Secretary of State for Trade and Industry

The extent of the ability of Member States to limit amounts paid to employees through their guarantee institutions has from time to time been the subject of challenge both in the domestic courts and at the European Court of Justice (ECJ). The most recent (and perhaps one of the boldest) challenges brought in the United Kingdom occurred in the case of *Connor v Secretary of State for Trade and Industry.*[1]

The facts, which were not in dispute before the Newcastle Employment Tribunal, were the following. The claimants were employed by a company called RJL, which closed down on September 25, 2002, resulting in the dismissal of all employees, and it entered into a company voluntary arrangement (CVA) on October 14, 2002. One of the directors of RJL established a phoenix company called ROS and employed some of the former workforce including the claimants. In October 2002 the claimants submitted claims to the Secretary of State for certain outstanding sums owed to them by RJL pursuant to the Secretary of State's guarantee obligations in Pt XII of the Employment Rights Act. On July 7, 2003, it was found by a decision of the employment tribunal that there had been a TUPE transfer from RLJ to ROS. Application was made, as a result, to the employment tribunal for further payments as against ROS, by a number of applicants including the two claimants.

Unfortunately for the luckless Connor and Hine, ROS could not survive and it went into voluntary liquidation on January 20, 2004. In March 2004 (following a hearing in January 2004), the tribunal declared that the claimants had been unfairly dismissed by reason of the transfer and made substantial basic and compensatory awards. It also made a declaration that RJL was in breach of the requirements of s.189 of TULRCA, and a protective award was made in favour of the claimants in respect of the maximum period of 90 days. ROS were also found to be in breach of the consultation requirements under TUPE but no further award was made in this respect as an award had already been made in respect of the same period under s.189 of TULRCA.

Although, as the transferee, ROS would be liable for all sums due, as it was in liquidation, the claimants had to turn to the DTI to meet the tribunal award. In turn, it paid the claimants up to the limits set out in the domestic legislation in the usual way. This included a payment for the award under s.188 up to eight weeks but with credit for sums already paid to the claimants as pay in October 2002. The claimants claimed the compensatory award, an award for breach of the TUPE consultation requirements and the balance of the protective award under s.188 of TULRA insofar as it had not already been paid. The tribunal ruled that the claimants were not entitled to any further sums that those paid by the Secretary of State under the domestic legislation.

On appeal to the employment appeal tribunal the claimants contended that the failure to pay the compensatory award was in breach of the Directive because it would create an unfair differential between employees of solvent and insolvent employers and

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