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Pooling Arrangements in Cross-Border Insolvencies

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Introduction

Every liquidator's dream is the collapse of a multi-million dollar enterprise with subsidiaries, assets and liabilities scattered throughout the world. But in a scenario where there has been long-term and wide-spread intermingling of funds between the separate entities which make up the corporate structure, the dream could turn into a nightmare. Complex practical and legal issues surrounding the realization of assets outside the jurisdiction, ascertainment of liabilities, and reconciliation of the inter-company debt position which require the cooperation of competing insolvency practitioners appointed in different jurisdictions are inevitable. Unless a pragmatic solution is found to the problem of collecting and distributing the world-wide assets among the global body of creditors, sleepless nights are ahead.

The outline above is hardly novel given some of the spectacular collapses in the previous two decades – Blue Arrow, Maxwell, BCCI, Enron, to name but a few. This article examines how pooling arrangements, whereby typically all assets are collected in one account and distributed rateably among all the creditors wherever situated, have been used by office-holders in cross-border insolvencies and how they have been regarded by the English courts.

Re Macfadyen & Co

The use of a pooling arrangement is most usually associated with the BCCI liquidation. However, as early as the first decade of the last century, the English court was asked to approve such an arrangement. In Re Macfadyen & Co, ex parte Vizianagaran Co Ltd[1] the High Court (Bigham J) considered an agreement in relation to a firm of merchants and bankers who operated out of London under the name of P Macfadyen & Co and out of Madras, India under the name of Arbuthnot & Co. The agreement for the pooling of assets and their rateable distribution among the English and foreign creditors was drawn up by the English trustee in bankruptcy and the official assignee in Madras. There were over 1000 creditors of Macfadyen & Co in England and liabilities of about 400,000 sterling; and about 7000 creditors of Arbuthnot & Co in India and liabilities of over 1 million sterling.

The two office-holders concluded an agreement whereby the two insolvent firms were to be treated as one and the same business, all creditors were to be entitled to share rateably in the pooled assets and there was to be cooperation between the trustee and assignee in order to give full effect to the agreement. The agreement was subject to the approval of the English and Indian courts, which was granted. Meanwhile, as a result of the large numbers of creditors in India it was not practical to hold a representative general meeting of creditors and a question arose as to the trustee's capacity to enter into the scheme. A large creditor of Macfadyen & Co then applied to the English court for a declaration that the trustee was not legally entitled to enter into the agreement. Bigham J in upholding the agreement stated in a succinct judgment:

> I will make an order authorizing Mr Cooper to enter into the proposed agreement. I consider it is clearly a proper and common-sense business arrangement to make, and one manifestly for the benefit of all parties interested. I think both parties were entitled to come to the Court and ask for its protection, which the order I now make will give them.

Re BCCI SA

The facts relating to the winding up of the Bank of Credit and Commerce International SA and its many related companies are well known. When it went down on 5 July 1991, the liabilities of the bank were thought to be between USD 10bn (GBP 7bn) and USD 20bn (GBP 14bn), making its global insolvency probably the largest ever in terms of liabilities. With branches in some 69 countries, it was also thought to have involved more jurisdictions outside the countries of incorporation than anything that preceded it. The bank's records comprised more than 100,000 boxes of

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1 [1908] 1 KB 675.

documents, with each box containing at least 1,000 pages.

In trying to unravel the corporate web of dealings, Lovells, who advise the English liquidator Deloitte & Touche, have had to deal with 64 countries and thrash out agreements between hundreds of creditors and dozens of branches on.

The pooling agreement

With the aim of overcoming some of the inherent cross-border issues which were likely to arise, a pooling agreement and separate contribution were drawn up, which formed a consensus between all of the principal BCCI companies that all their assets would be pooled and that creditors to each liquidation would receive the same rate of dividend out of the pool. Without such an agreement, the intermingling of the affairs of the BCCI companies was such that it could have taken years to determine which company was entitled to which assets. This would not have been cost-effective nor in the interests of creditors as a whole.

As regards SA alone, there were 47 branches and offices of BCCI SA in 13 jurisdictions. The liquidators estimated that worldwide there may be 140,000 individual and corporate creditors of BCCI SA. By far the largest proportion of these by both number, some 70,000, and value, USD 2,752 million, were the creditors in the books of the UK branches of BCCI SA, but only an estimated 50,000 of these were UK resident. Some 20 per cent or 14,000 of the creditors in the books of the UK branches were accounts which either bore the instructions 'no correspondence', or which had incomplete addresses.

The pooling agreement was also designed to deal with the practical problem of 'ring-fencing' which operates under the company and insolvency law provisions in certain jurisdictions. Under English law, as under the laws of Luxembourg and the Cayman Islands, realizations by the liquidators are applicable, subject to payment of preferential creditors, in paying all creditors worldwide pari passu. But in many other jurisdictions, for instance in some states of the United States, that is not the law. In such jurisdictions, where a branch of an international company incorporated elsewhere is wound up, the proceeds of realization of the assets of the branch may be applicable exclusively, after payment of preferentials, in paying off the creditors of that branch, in priority to all creditors of other branches. This practice is known as 'ring fencing' in that the branch is ring-fenced and isolated from other liabilities.

In essence, the pooling agreement in the BCCI proceedings provided for the pooling of assets and liabilities of SA, incorporated in Luxembourg and Bank of Credit and Commercial International (Overseas) Ltd, a company incorporated in the Cayman Islands and in liquidation there. SA carried on business through branches in England where it had very substantially more branches than in any other country and was in liquidation here as a result of a compulsory winding-up order made on the petition of the Bank of England.

The essence of the contribution agreement was that it was a compromise of cross-claims between the majority shareholders and certain other parties in Abu Dhabi associated with them and the liquidators in England, Luxembourg and the Cayman Islands of SA and Overseas.

Court sanction

These agreements were subject to the approval of the courts in England, the Cayman Islands and Luxembourg. The agreements were approved at first instance by the English High Court (Sir Donald Nicholls V-C), whose decision[2] was appealed by certain creditors to the Court of Appeal (Dillon, Russell, Farquharson LLJ).[3]

The application for approval of the pooling agreement (and the separate compromise agreement) was made under paras 2 and 3 of Pt I of Sched 4 to the Insolvency Act 1986. These are in the following terms under the heading in Pt I 'Powers exercisable with Sanction':

> 2. Power to make any compromise or arrangement with creditors or persons claiming to be creditors, or having or alleging themselves to have any claim (present or future, certain or contingent, ascertained or sounding only in damages) against the company, or whereby the company may be rendered liable.
>
> 3. Power to compromise, on such terms as may be agreed – (a) all calls and liabilities to calls, all debts and liabilities capable of resulting in debts, and all claims (present or future, certain or contingent, ascertained or sounding only in damages) subsisting or supposed to subsist between the company and a contributory or alleged contributory or other debtor or person apprehending liability to the company, and (b) all questions in any way relating to or affecting the assets or the winding up of the company ...

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2 *Re Bank of Credit and Commerce International SA* (No 3) [1993] BCLC 106.

3 *Re Bank of Credit and Commerce International SA* (No 3) [1993] BCLC 1490, [1992] BCC 715.

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The section conferring these powers is s 167(1) of the 1986 Act which provides:

> Where a company is being wound up by the court, the liquidator may – (a) with the sanction of the court or the liquidation committee, exercise any of the powers specified in Parts I and II of Schedule 4 to this Act (payment of debts; compromise of claims etc. …)

These provisions came into the 1986 Act from the Companies Act 1985. Corresponding provisions in substantially the same terms have been included in all the successive major Companies Acts since the original 1862 Act.

Challenge by the creditors

The appellant creditors sought to challenge the pooling and contribution agreements on the ground that the liquidators had failed to have any regard to the views and wishes of the overwhelming majority of SA creditors in spite of s195 of the 1986 Act and settled practice. Further, in relation to the pooling agreement they alleged that it established something which could only be achieved by a scheme of arrangement pursuant to s425 of the Companies Act 1985; and as regards the contribution agreement that certain aspects of it infringed the pari passu principle.

At first instance the Vice-Chancellor found that, although not insurmountable, there were considerable practical difficulties in convening the necessary meetings of creditors in order to sanction a scheme of arrangement. He was also in no doubt that the pooling agreement was for the benefit of creditors. He noted that the affairs of BCCI SA and BCCI Overseas were so hopelessly intertwined that a pooling of their assets, with a distribution enabling a like dividend to be paid to both companies' creditors, was the only sensible way to proceed. The Court of Appeal agreed.

As regards the opposing views of the creditors, the Court of Appeal noted that use of 'may' as opposed to 'shall' in s195 of the 1986 allowed the court to exercise its discretion in this regard. It held that the complexities of the case meant that it was not practicable to hold creditors' meeting with the requisite class meetings and that the judge was not precluded from making his decision by the views of the majority of creditors.

As regards the use of a pooling agreement rather than a scheme of arrangement, the Court of Appeal agreed with the Vice-Chancellor that the liquidator's powers exercisable with approval of the court under the 1986 Act were wide and included the agreements envisaged and that, in so far as the package involved departures from pari passu rule, he would in normal circumstances expect the scheme of arrangement procedure to be followed but if that procedure were followed in the exceptional case before him, the proposals would flounder and sink in a morass of elaborate legal procedures which could not be the right way to proceed.

As regards the departure from the pari passu rule the Court of Appeal noted further that this was permissible not only under s425 but also if the departure was merely ancillary to an exercise of any of the powers which were exercisable with the sanction of the court under Pt I of Sched 4 to the 1986 Act.

The contribution agreement and the pooling agreement were approved in the Grand Court of the Cayman Islands. In Luxembourg, however, the application for approval of the two agreements ran into difficulties. Both the agreements, as originally agreed, had contained a clause nominating English law as the proper law and England as the venue for the arbitration of any disputes. These provisions were objected to by the judge in Luxembourg. She approved the agreements subject to a requirement that the provisions regarding English law and regarding the venue of any arbitration should be deleted. The majority shareholders and the English and Cayman Island courts agreed to the deletions. As regards the contribution agreement, this had to be renegotiated so as not to infringe the pari passu rule before the Luxembourg court would approve it.

Disapplying statutory law

A further question arose before the English court in *Re Bank of Credit and Commerce International (No 10)*[4] in relation to the BCCI pooling agreement and the extent to which the mandatory rule of set off applicable in English insolvency law contained in Rule 4.90 of the 1986 Rules could be disapplied.

In the course of the discussions which led to the pooling agreement it had been recognized that the difference between the respective set-off laws of England and Luxembourg presented a problem. On the one hand, Luxembourg, the country in which BCCI SA was incorporated, was the country in which the principal liquidation would be taking place. On the other hand, persons who were both creditors and debtors of BCCI SA would, if obliged to prove in Luxembourg, be deprived of the advantage in an English winding-up of the debts they owed being set off against the debts owing to them. The pooling agreement as signed contained express provision for BBCI SA debtors liable to be sued in England and Wales to retain the benefit of Rule 4.90 set-off.

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4 [1997] Ch 217.

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Sir Richard Scott V-C, hearing the application, held that the court had no inherent common law or statutory jurisdiction to disapply Rule 4.90 or any other substantive provisions of the statutory insolvency scheme. This was contrasted with the statutory powers which liquidators have (with the sanction of the court) to compromise claims and thereby give effect to a variation of the pari passu rule. The Vice-Chancellor commented in this regard:

> The accumulation of judicial indorsements of the concept of ancillary liquidations have, in my judgment, produced a situation in which it has become established that in an 'ancillary' liquidation the courts do have power to direct liquidators to transmit funds to the principal liquidators in order to enable a pari passu distribution to worldwide creditors to be achieved. The House of Lords could declare such a direction to be ultra vires. But a first instance judge could not do so and I doubt whether the Court of Appeal could now do so.

Re Dobb White & Co

More recently, the English court[5] had to consider again a pooling agreement on an application by the liquidator of Dobb White & Co, a firm of accountants. The background to the case was an alleged international 'Ponzi Scheme' which operated on both sides of the Atlantic.

Ponzi Scheme

A Ponzi Scheme is where generous returns are promised to investors to be paid on purported 'investments' where in fact, no such 'investments' are ever made. Instead funds from new investors are paid out as purported interest. A number of unconnected entities on both sides of the Atlantic appeared to have been involved in the scheme. The Financial Services Authority petitioned for the winding up of the accountancy partnership, Dobb White & Co, and petitioned for the bankruptcy of the individual partners alleging insolvency and among other matters that they were involved in an unauthorized collective investment scheme. A liquidator and trustee in bankruptcy were appointed in the High Court following winding-up and bankruptcy orders in respect of the partnership and partners. Prior to that a receiver had been appointed by the United States District Court as receiver of the estate of an individual and related entities and also the Vavasseur Corporation in the US, which were alleged to be involved in the scheme. Judgment against the Vavasseur Corporation has been entered by the US District Court for the Western District of Virginia in favour of the US Securities and Exchange Commission for many millions of dollars. The chief orchestrator of the scheme in the US, Terry Dowdell, had previously pleaded guilty to criminal charges of securities fraud, wire fraud and money laundering relating to its operation.

It appeared that monies paid to the Vavasseur Corporation had become intermingled with monies paid to the Dobb White entities. There were over 1,000 investors in the scheme and funds and property had been discovered worldwide in numerous jurisdictions.

The cooperation agreement

The English liquidator and the US receiver entered into an agreement (subject to the sanction of both the English and US courts) providing for the cooperation between themselves in collecting the assets of their respective estates. This agreement provided for a pooling of assets realized and collected outside the United States. It further provided that in the event of a dispute as to the division of the monies in the joint account, the dispute should be resolved by arbitration. One of the reasons for using arbitration as opposed to the jurisdiction of the English court was that it was understood that the US receiver would be in difficulty with the US court if he simply consented to the jurisdiction of the English court. Lewison J heard the application of the liquidator supported by the US receiver who also appeared and sanctioned the agreement. It was subsequently sanctioned by the US court.

Conclusion

The agreements reached between office-holders in different jurisdictions in these cases, which provide for cost-effective and practical solutions to cross-border challenges, are to be welcomed. There can be no benefit to creditors overall in the vast majority of cases in having protracted hostile and invariably costly litigation to resolve highly complex factual and legal issues relating to the intermingling of assets within related or unrelated entities scattered across the globe. In this regard the English court has shown itself to be flexible and pragmatic in its approach to the schemes and prepared to support agreements where it can see that it is in the best interests of creditors as a whole to do so, even in the light of challenges made by the majority of creditors. The precedents created in the above cases as to the use of innovative and creative strategies to compromise and circumvent competing claims should be considered and adopted in all appropriate cases.

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5 *Re Dobb White & Co (in liquidation)* Ch D (Lewison J) decision of 8 April 2004.

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