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ARTICLE

UNCITRAL Model Law Gathers Momentum in Australia

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The UNCITRAL Model Law on Cross-Border Insolvency ('Model Law') has been introduced into Parliament in Australia. The Cross-Border Insolvency Bill 2007 ('Bill') had its second reading speech on 20 September 2007 in the last sitting of Parliament under the current Coalition Government. By the time this article is published, the general election on 24 November 2007 will have occurred.

Whether a new Government is elected or the current Government re-elected, it seems unlikely that the Bill will be enacted in 2007.

The adoption of the Model Law in Australia was first canvassed in a Treasury paper entitled CLERP8 and released in 2002. The Model Law has since seen a raft of legislative changes in the insolvency and restructuring sphere float by, most notably the recent amendments to the Corporations Act 2001 contained in the Corporations Amendment (Insolvency) Act 2007. The Bill anticipates that, once passed, it will have effect upon a day to be fixed by Proclamation, and if no such Proclamation is made, following a period of six months after Royal Assent. Even if passed in the near future, the Bill may not take effect until late 2008.

Readers of this journal will be familiar with the Model Law conceptually, particularly following adoption in the UK and USA. As a general comment, the Bill takes a conservative line by annexing the Model Law in its entirety, but with comments on its application in the operative parts of the Bill. The Bill is generally consistent with the original intention of the drafters with minimal changes, mainly to meet local conditions.

For those unfamiliar with the Model Law and as a refresher for those who are, the objectives of the Model Law are:

(a) Cooperation between the courts and other competent authorities of the State and foreign States involved in cases of cross-border insolvency;

(b) Greater legal certainty for trade and investment;

(c) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;

(d) Protection and maximisation of the value of the debtor's assets; and

(e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

To achieve these objectives, the Model Law:[1]

(a) Sets out the conditions under which persons administering a foreign insolvency proceeding have access to local courts;

(b) Sets out the conditions for recognition of a foreign insolvency proceeding and for granting relief to the representatives of such a proceeding;

(c) Permits foreign creditors to participate in local insolvency proceedings;

(d) Permits courts and insolvency practitioners from different countries to co-operate more effectively; and

(e) Makes provision for co-ordination of insolvency proceedings that are taking place concurrently in different States.

The Bill anticipates that regulations will be drafted; a draft of the regulations was not provided although some of the intended contents are alluded to in the Explanatory Memorandum. The Bill also is intended to apply to both personal insolvency and corporate insolvency, which are dealt with separately under Australian Law. The Bankruptcy Act 1996 addresses personal insolvency and the Corporations Act 2001 addresses corporate insolvency.

Some of the notable aspects of the manner in which the Bill proposes to enact the Model Law are set out below. We focus on only the corporate insolvency provisions for the purposes of this article.

(a) Deposit-taking institutions and insurance companies are anticipated to be excluded from the

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1 Explanatory Memorandum to the Bill, pp. 2-3.

operation of the Bill. This because particular insolvency arrangements apply to these entities under Australian domestic legislation. The possibility that such entities would be excluded is recognised in Article 1(2) of the Model Law. The list of excluded entities is expected to be contained in the regulations, which have not yet been released. The Explanatory Statement recognises that regulations may be amended at a future date to allow for banks and insurance companies to be subject to the Model Law, and also that there might be other entities which will be excluded when the regulations are released.

(b) The Bill sets out the parties authorised to act in foreign states on behalf of a proceeding under Australian insolvency law. The Bill states that a registered liquidator will be so authorised to act. The stated intention in the Explanatory Statement is that a registered liquidator may act in a number of different roles, such as voluntary administration and liquidation. However, the registered liquidator will only be so authorised if acting in relation to proceedings under Chapter 5 (which relates to external administration generally) and s601CL (winding up of locally registered foreign companies) of the Corporations Act, although excluding Parts 5.2 (relating to receivers and controllers) and 5.4A (relating to liquidation on grounds other than insolvency, such as on the just and equitable basis). The exclusion of Part 5.4A might be overly restrictive as s561, which is contained in that Part, provides for a number of grounds for winding up which might ultimately occur in circumstances of insolvency. An example is winding up where the company has by special resolution resolved that it be wound up by the court. The shareholders might make such a resolution in circumstances of insolvency (which circumstances might not have been apparent at the time of the resolution or court application) and yet the liquidator would not be authorised under the Model Law to appear abroad on behalf of the company. It would appear that as drafted, an administrator under a deed of company arrangement is intended to be authorised to represent a local proceeding abroad, even though a deed of company arrangement, like voluntary administrations, does not involve court proceedings as a matter of course.

(c) Foreign creditors are to be ranked no lower than unsecured claims of local creditors, unless they have tax or social security claims, which remain excluded. The same priority will apply to foreign creditors as applies to local creditors. Priorities of creditors are determined by s556 of the Corporations Act, which gives certain claims of employees a priority over claims of unsecured creditors. Foreign creditors would enjoy the same priority as local creditors if they fell within the relevant class of creditor under s556.

(d) An application for recognition of foreign proceedings must be made to the Federal Court or the Supreme Courts of each state. The Model Law requires that the application must be accompanied by a statement of all known foreign proceedings (Article 15 para 3). The Bill proposes to extend the statement beyond that anticipated in the Model Law, and requires a statement of any known receiverships or other controllers (such as mortgagees-in-possession) in relation to the property of the debtor, and any local proceedings under Chapter 5 or s601CL of the Corporations Act, which may include voluntary administration or deeds of company arrangement (as they fall within Chapter 5 of the Corporations Act). That disclosure obligation is a continuing obligation.

(e) The Bill does not alter the language of Article 16 para 3 of the Model Law, which states that in the absence of 'proof' to the contrary, the location of the debtor's registered office is presumed to be the centre of the debtor's main interests ('COMI'). The consequence of such a presumption is that recognition of foreign proceedings which are located in the COMI will make the foreign proceedings the foreign main proceedings, with automatic relief being granted. The equivalent section of Chapter 15 of the US Bankruptcy Code, section 1516(c), casts the presumption as applying in the absence of 'evidence' to the contrary. It was explained in the recent Bear Stearns decision[2] that the change was intended to put the ultimate burden on the foreign representative to prove that the COMI is the same location as the registered office. The distinction appears to have been material in the Bear Stearns decision, as although there was no evidence in opposition to the application by the Cayman provisional liquidators for recognition, the provisional liquidators' own evidence and pleadings provided adequate material for the court to conclude that the COMI was in the US, or certainly not in the Cayman Islands. If the language stays as 'proof', there may be sufficient scope to argue that the onus would be on any objecting party to prove that the presumption should be rebutted. On the facts of the Bear Stearns decision, that would

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2 *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund (In Prov Liq)* and in *re Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund* No. 07-12383 and No. 07-12384 (Bankr. S.D.N.Y. Aug 30, 2007).

not be a difficult burden to discharge. However it would put the onus on creditors to take an active role in proceedings for recognition in Australia if they objected to the terms of the application.

(f) Upon recognition of a foreign main proceeding, there is a mandatory stay of individual actions or proceedings concerning the debtor's assets, rights and obligations or liabilities, execution against the debtor's assets is stayed and the right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended (see Article 20 para 1). The Bill provides that the scope and the modification for termination of the stay or suspension of enforcement process is to be the same as if the stay or suspension arose under Chapter 5 of the Corporations Act. It therefore appears intended that Australian law exceptions to the extent of the stay on enforcement process or legal proceedings in liquidation will apply. The most important will be the ability of secured creditors to enforce their security rights.

However, the Bill refers generally to the exceptions and modifications to the stay set out in Chapter 5 of the Corporations Act (excluding those parts which deal with receivership and winding up on grounds other than insolvency). It does not appear to recognise that voluntary administration, deeds of company arrangement and liquidation are all contained in Chapter 5. The scope of the stay and suspension of enforcement of security in voluntary administration and liquidation are different.

Section 471C, which applies in relation to liquidation, would appear intended to apply. That section states that the stay of proceedings, suspension of enforcement and suspension of powers to deal with property do not affect a secured creditor's rights to realise security. By contrast, voluntary administration prevents enforcement of security, subject to rights to continue enforcement already commenced and for creditors who hold security over the whole or substantially the whole of the assets of the debtor to take enforcement action during a 10-day decision period following appointment of the voluntary administrator. It would appear that section 471C is intended to apply, but that position may require clarification, particularly as, subject to public policy exceptions, the Court is not given a discretion on whether to impose the moratorium on recognition of a foreign main proceeding;

(g) Following recognition, a foreign representative would have standing to initiate voidable transaction proceedings under Australian law. The Bill states that the foreign representative would be entitled to bring actions under Division 2 of Part 5.7B of the Corporations Act. That division contains provisions relating to recovery of unfair preferences, uncommercial transactions, unfair loans and unreasonable director-related transactions. Claims for insolvent trading, whereby directors can be liable for debts incurred by the insolvent debt are contained in Division 3 of Part 5.7B and would therefore not be available to a foreign representative unless a local winding up were initiated.

(h) Upon recognition of a foreign proceeding, the Model Law provides the ability to grant discretionary relief at the request of the foreign representative (see Article 21 para1). The Bill provides that foreign representatives would be able to request any additional relief that may be available to a registered liquidator under the laws of Australia. Quite what that means is not clear, as a registered liquidator is a qualification, rather than a role. That is, the additional relief available to a registered liquidator would depend on the form of insolvency administration to which the registered liquidator is appointed. By drafting the Bill in this way, the widest variety of relief would therefore appear intended to be available.

(i) The Bill does not remove the existing provisions for recognition and assistance for foreign insolvency proceedings contained in the Corporations Act. In particular, there are sections 580 and 581 which address co-operation between Australian and foreign courts in external administration matters and Part 5.7, which provides for winding up of bodies other than companies, such as foreign companies. The Bill provides that if a provision of the Model Law or a provision of the Bill is inconsistent with Division 9 of Part 5.6 (ie sections 580 and 581) or Part 5.7 of the Act, the Model Law/Bill will prevail. In relation to co-operation, that will effect a substantial change to current practice, as s581 makes it compulsory for an Australian court to provide assistance to the courts of prescribed countries, which include New Zealand, the UK and USA but is otherwise a limited list of countries. It is otherwise discretionary for the Australian courts to act in aid of the courts of other countries which have jurisdiction in external administration matters. The Model Law also extends the jurisdiction of the Australian courts to provide relief in the nature of a moratorium and stay beyond the jurisdiction that has recognised to date. For example, in *Re Independent Insurance Company Limited* (2005) 23 ACLC 1337, the New South Wales Supreme Court refused to grant relief requested in a letter of request from the High Court of Justice of England and Wales by way of orders preventing persons from commencing or continuing any proceedings against Independent while provisional liquidators were appointed in England. The basis of the refusal was the lack of jurisdiction to grant such an injunction in the absence of express legislative power to do so.[3] It

might be that s581 will in fact provide a better ground to obtain relief, or certainly an alternative ground, where application for assistance from one of the prescribed countries is made. For example, relief was refused altogether under the Model Law in Bear Stearns in circumstances where the court did not consider that either foreign main or foreign non-main proceedings existed. Had the same application been made in Australia in the alternative under s581, the court might have been prepared to provide some protection from specific creditors (particularly if the application been made by foreign representatives from a prescribed country).

We expect that the Model Law will be enacted, to bring Australia into line with some of its major trading partners. The Bill contains few changes to the Model Law and therefore remains faithful to the intentions of the drafters of the Model Law. The Bill may yet see some further amendment and regulations will contain further detail. The Model Law offers clear advantages over the existing domestic legislation for obtaining relief when practitioners are appointed to debtors with cross-border interests in Australia and should be implemented. The timing, however, remains uncertain. We will report on any further developments.

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3 See further, S. Harris, 'Requests for Cross-Border Assistance: Limitations on Relief Available in Australia', (2005) 2 *International Corporate Rescue* 322.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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