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A Phoenix Syndrome in Every Sense of the Word ...

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A recent but as yet unreported decision of the English High Court sitting in bankruptcy has reaffirmed what many have long regarded as being a basic principle of English insolvency law and practice. This is to the effect that the English courts have a discretionary common law ability and power to recognise and assist properly appointed foreign insolvency holders.

The basic principle has recently been authoritatively reasserted by the Privy Council in *Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2007] 1 AC 508. At paragraph 22 of the Opinion of the Board, Lord Hoffmann dealt with the assistance that the English can give to the courts of a foreign country by stating:

> 'What are the limits of the assistance which the court can give? In cases in which there is statutory authority for providing assistance, the statute specifies what the court may do. For example, section 426(5) of the Insolvency Act 1986 provides that a request from a foreign court should be authority for an English court to apply "the insolvency law which is applicable by either court in relation to comparable matters falling within its jurisdiction". At common law their Lordships think it is doubtful whether assistance can take the form of applying the provisions of foreign insolvency law which form no part of the domestic system. But the domestic court must at least be able to provide assistance by doing whatever it could have done in the case of a domestic insolvency. The purpose of recognition is to enable the foreign office holder or the creditors to avoid having to start parallel insolvency proceedings and to give them the remedies to which they would have been entitled if the equivalent proceedings had taken place in the domestic forum.'

In the matter of *Phoenix KapitalDienst GmbH* (Mr Registrar Jaques 8 April 2008: Case No 142 of 2008), the administrator of a German company called Phoenix had been appointed by the Frankfurt Insolvency Court on 1 July 2005 pursuant to insolvency proceedings opened on 12 March 2005. The administrator as applicant in the English proceedings sought an order that his appointment be recognised by the courts of England and Wales and that he be afforded the rights to exercise such rights and powers conferred upon insolvency practitioners under the English Insolvency Act 1986 including the power to exercise the provisions of section 236 of the Insolvency Act, namely the right to conduct private examinations and conduct other statutory investigations into the affairs of Phoenix.

Phoenix traded in the German futures market using third party funds received from individual investors. Many investors resided abroad including England. The funds which were deposited with Phoenix were paid into a single collective fund known as the Phoenix Management Account. Phoenix traded at a loss effectively from the outset in the late 1970s. The directors covered up the losses by creating a fictitious account into which what were passed off as profits were reported. This was done through the medium of another account called the MAN account. The Phoenix trading position appeared to be a profitable one and in those circumstances the company continued to attract investors who in all amounted to about 40,000, not only in Germany but in many other countries apart from England. It was significant that recovery proceedings had been issued in Austria where some investors resided as well as in the Scandinavian countries and full details of those proceedings were put before the English court.

At the heart of what was clearly a fraud was the placing into the bank via the use of the accounts mentioned above of new deposits to discharge Phoenix's overheads and most importantly for present purposes to pay out 'old' investors the so called profits. These profits were, of course, fictitious. This is a well known scheme often called a Ponzi scheme.

The main individual perpetrator of the fraud was the Managing Director. He died shortly before the institution of insolvency proceedings in Germany but his principal assistant continued with the fraud. However, in due course as is perhaps inevitable in such cases the fraud was uncovered by the relevant authorities and criminal convictions followed as well as the insolvency administration of Phoenix itself. A number of old investors who received the fictitious payouts were the subject of the other overseas proceedings referred to above. Many of them reside in this country and formal demand has been made of them although no proceedings as such have as yet been instituted.

German insolvency law was described as characterising these payments out as gratuitous payments

under Article 134 of the German Insolvency Act. The measure of loss was the difference between the amount deposited and the subsequent payment out. There is a four year clawback time period in relation to German law. The administrator wanted the additional benefit and comfort of reserving the right if necessary and if so advised to resort to the provisions of English insolvency law, in particular the usual provisions regarding transactions at an undervalue to recover losses arising by virtue of the fictitious accounts.

No reliance could be placed upon the recent UNCITRAL Model Law recently incorporated into English law by virtue of the Cross-Border Insolvency Regulations 2006. This is because the four year period referred to above predated the implementation of the Regulation into English law which only applies to transactions for present purposes after the date of its incorporation into English law. Nor could the EC Insolvency Regulation be relied on since Phoenix was an investment undertaking within the meaning of that expression as expressed and contained in Article 1(2) of the Regulation and thus was not addressed in the Registrar's judgment.

However, many of the practical requirements introduced by the Cross-Border Regulations, eg the need for proper certified copies of the applicant's appointment and those canvassed by Mr Registrar Nicholls in *Re Rajapakse* [2007] BPIR 99 were regarded by the administrator as being applicable by analogy, eg a consideration of whether and if so to what extent the foreign court had made any order or direction permitting the English application to be made.

The Registrar in the present case gave a short judgment in acceding to the application. He noted that the German administrator was conscious of what some eminent commentators had pointed out as being a failing, if not at least some confusion, with regard to the proper distinction that existed between on the one hand recognition and on the other judicial assistance. The former technically refers to giving effect directly to the foreign law whilst the second notion reflects the use of local law to assist the foreign proceedings. On any view the *Cambridge Gas* decision as well as the Phoenix application dealt with the latter principle.

The administrator also drew the relatively self evident parallel with the way in which English courts have in the past recognised the appointment of a foreign court appointed receiver. There is no question but that the same principles still obtain even now with regard to such appointees. The abiding requirement lies in the English court being satisfied that the foreign court was jurisdictionally competent. In *Schemmer v Property Resources Limited* [1975] Ch 273 especially at 287 the principle had been put in terms of the need to demonstrate a 'sufficient connection' between in that case the target company, ie the company over which the foreign receivers were appointed and the jurisdiction in which the foreign appointee was appointed. There is much discussion in the text books and elsewhere about the possible difficulties which arise when an appointment was made in a state which was not the state of incorporation but the same did not need to trouble the court in the Phoenix application. Phoenix was itself the subject of an administration order in its own State of incorporation.

However, in the present case the Registrar also went on to note that the potential UK defendants had themselves a sufficient connection with Phoenix but it may be thought with respect that he had no need to go that far even though he was apparently satisfied that they owned assets here as well as resided here on the basis of the evidence he saw. The common law regime which was being discussed here and which was being applied cannot on any basis be dependent upon the connection, if any, between potential defendants who may well be outside the jurisdiction and the jurisdictional basis on which the original appointment abroad was made.

The German administrator also addressed the view often expressed that reciprocity per se will not be a ground for recognition by adducing expert evidence from his German lawyers that a German court would apply English law and in the process receive expert evidence on that topic.

Of far greater significance, however, was the need to show that even if the appointing court had the necessary jurisdictional competence, generally well accepted conflict of law principles were also being respected. In *Schemmer,* the foreign receiver was a US court appointed receiver but one appointed under what was effectively a penal provision. In the circumstances the English court held that the American appointment was unenforceable in the English court. No such impediment existed in the *Phoenix* application.

Finally, the applicant argued again by way of analogy with the receivership cases that judicial assistance should be afforded as long as there was no prejudice to any creditors and as long as the provisions of English insolvency law were respected and satisfied. This is a point which was raised and discussed by the Privy Council in paragraph 26 of the *Cambridge Gas* decision. The German administrator provided formal evidence and confirmed through his German lawyers that there was no intention of taking any formal insolvency process in English law such as the institution of formal winding up proceedings in this country.

The Registrar stated that he regarded the *Cambridge Gas* decision as 'of very great persuasive authority' even though it was not strictly binding on him. He expressed himself entirely satisfied that on the evidence before him and on the basis that various authorities cited to him, the principal ones of which being set out in this note, the application was wholly justified and that the German administrator was entitled to 'all possible assistance' that the English court was able to give in circumstances such as those which pertained in the case before him.

The case is a welcome one on any basis: indeed it is difficult to see how it offends any principle of common-sense let alone any established legal principles.

If nothing else the case serves as an indirect warning to American courts that quite apart from the strict letter of the law contained in the Model Law as implemented in that jurisdiction the English courts are happy to have resort where necessary to discretionary common law principles. The US courts have so far refused to take such a discretionary basis into account in considering whether or not there should be a main proceeding in the United States in addition to a main proceeding in an off shore jurisdiction so as to be able to address the case on a case by case basis with the appropriate relief attached. The problem has, of course, arisen vividly in the case of the *Bear Stearns* decision as well as in a case which has come to be called the *Basis Yield* case. It does admittedly seem odd that this country is prepared to be more flexible in exercising its common law jurisdiction where circumstances allow, a reality which apparently our American cousins are for the moment reluctant to recognise.

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