

**United Nations Day Speech 2019**

**25 Years of Cross Border Insolvency Reform**

**Tim D. Castle, Barrister**

It is a great pleasure to return to address you today in Hobart as we celebrate United Nations Day. As I mentioned in my speech here last year, my involvement with the laws and policies of the United Nations began in 1978 at a Model UN Conference in Hobart at the Friends' School.

In the past 41 years, I have been fortunate to witness great changes in the way the world works; specifically with the globalisation of world trade, and revolutions in transport and communications, which create connections between people and places that we could never have imagined back in 1978. I often wonder what the next 20 to 40 years holds in store for us, in terms of how we work, do business, and interact with one another.

It is fitting to reflect on the early days of the colony here in Van Dieman's Land, founded in the late 1700s, as we look out at Salamanca Place. This English Settlement was part of what I might call Globalisation 1.0 which grew gradually out of the Renaissance and stretched right through the reign of Queen Victoria until the end of the 19<sup>th</sup> century. Well before that, of course, there is evidence of significant trade occurring in ancient times, including recent anthropological evidence of trading occurring between the indigenous peoples of Australia and South-East Asia.

One of the most significant breakthroughs in the growth of world trade in modern times has been the creation of the limited liability company. At the time of Australia's founding, companies were formed as charter companies by virtue of the Royal Prerogative. Last time I travelled through Northern Tasmania, I noted the continued existence of one such company, the Van Diemen's Land Company based in Smithton, and believed to be the last remaining Charter Company still operating in Australia.<sup>1</sup> Another notable example of such a company was the East India Company that many of you may know from films such as the Pirates of the Caribbean series.

---

<sup>1</sup> Phillips, Valmai, *Enterprising Australians*, (1984, Bay Books) 22.

An early development in terms of limited liability was triggered by a company known as the South Sea ‘Bubble’ Company. That company raised a significant sum of money in a joint public-private partnership to consolidate and reduce national debt in the UK.<sup>2</sup> The company expanded quickly, before collapsing dramatically in 1720.<sup>3</sup> The financial fallout associated with the collapse of the South Sea Company revealed otherwise unheard of vulnerabilities in modern commerce, which triggered a parliamentary inquiry and various regulatory reforms in the UK, including the requirement that all joint stock companies could only be created with approval from Parliament or the Crown.

Some of you will recognise the names of other speculative companies from the 19<sup>th</sup> century which typically involved ambitious projects to extract minerals or even Peruvian Guano from exotic overseas destinations (at least, exotic from the perspectives of English investors). Many of you might recognise the name Peruvian Guano from the famous English case about the scope of discovery in *Compagnie Financiere du Pacifique v Peruvian Guano Co* (1882) 11 QBD 55.

As the law developed, three features became implicit in the formation of a company. First, capital is contributed by the issue of shares to investors. Secondly, credit is advanced by suppliers and lenders. Thirdly, the day-to-day operations of the company are controlled by management on behalf of the investors, which is unlike partnerships, where the managers and owners are one and the same.

By granting a company limited liability status, the government provides the company with the ability to take risk, and therefore drive economic growth and prosperity, in such a way that if the venture fails, the investors are not ruined. Rather the losses of investors are limited to the amount of money they have invested. Equally, the losses to the creditors are limited to the outstanding amount owed to them from time to time by the company.

English law developed from as early as 1844, a dedicated system of company liquidation. The associated processes allowed for distribution of money from the

---

<sup>2</sup> Helen J Paul, ‘The “South Sea Bubble”, 1720’, (2015) *European History Online*.

<sup>3</sup> *Ibid.*

wreckage of a company to claimants in order of the risks undertaken by them.<sup>4</sup> Impressively, the NSW Supreme Court was actually ahead of the UK in developing such a system, with the passage of the *Debtors' Estates Distribution Act 1830* (NSW).<sup>5</sup>

In simple terms, investors or equity holders were paid last, because they took the greatest risk. Creditors were paid first, because their only reward was the repayment of debts and not any share of the profit.

Within the total group of creditors, distinctions were then drawn between secured creditors - such as, banks – which provided the main funding for the enterprise, unsecured creditors, and priority creditors such as employees and the government, to whom salary and taxes may be owed.

This basic scheme is set out today in Chapter 5 of the *Corporations Act 2001* (Cth), and owes its origin to the English *Companies Acts*, which served as a model for company law throughout the common-law world, and I suspect also the civil law world.

Within 'Globalisation 1.0', cross-border insolvency was not a concept that caused much difficulty, because there was an unequal distribution of economic power between the world's leading economies, such as Great Britain and the United States of America, and the places where investments took place. To the extent that any problems did arise, those problems were solved by reliance on general principles of comity between jurisdictions. This was something specifically embodied, for example, in section 581 of the *Corporations Act* and its predecessors in Australia.<sup>6</sup> That did, however, mean there were separate insolvency administrations in each jurisdiction, which were subject to the laws of that jurisdiction.

As the title of tonight's talk indicates, 25 years ago something happened to change this landscape.

That something was a pivotal meeting between UNCITRAL and INSOL International in April 1994 to discuss the possibility of an international text being developed by

---

<sup>4</sup> *Joint Stock Companies Winding Up Act 1844* (UK).

<sup>5</sup> T F Bathurst, 'The Historical Development of Insolvency Law', speech presented at Francis Forbes Society for Australian Legal History in Sydney (3 September 2014).

<sup>6</sup> *Corporations Act 2001* (Cth) s 124(1).

UNCITRAL to deal with the emerging problems of cross-border insolvency.<sup>7</sup> In other words, the two organisations sought to create a regime which had a greater degree of certainty and predictability than existing reliance on *ad hoc* appeals to judicial comity.

The genesis of this meeting can be traced back several years earlier, to the 1987 Wall Street collapse, also known as ‘Black Monday’. I remember that era well, as I had only just commenced work as a solicitor in the Insolvency Litigation Department at Mallesons Stephen Jaques. The specific context of that collapse was a major change during the 1980s in relation to banking liberalisation. By that I mean, many leading economies, including Australia, had moved to a floating exchange rate and there was a growth in what are now termed ‘global capital markets’. Banks, which had previously operated only in individual countries, were now operating throughout the world. In fact, I could probably give an entire lecture purely on the changes to the banking landscape at that time. From insolvency point of view, however, the globalisation of the banking industry meant, of course, the globalisation of credit, which in-turn meant the globalisation of credit *risk*.

The term ‘legal risk’ is often used to refer to uncertainty in terms of how courts might react, or what laws might apply, if things go wrong. Putting this in purely commercial terms, to the extent the global expansion of credit involved an element of ‘legal risk’, bankers will price the loans that they make with an additional margin to address that ‘legal risk’. In other words, credit becomes more expensive to the borrower, because of the uncertainty associated with the recovery of loans made in a cross-border context, with the result that the impulse to lend money is reduced and global trade is thereby affected.

If I could just interpolate here, one of the functions of law, whether statute or case law, is to provide advance guidance to actors in the community about the consequences that may follow in the future, should a specific circumstance arise. The higher the level of certainty about a future response to a given scenario, the lower the level of risk premium that needs to be built into the transaction costs. This is a key rationale for all the work done by UNCITRAL in addressing problems associated with global trade and commerce.

---

<sup>7</sup> INSOL International, ‘INSOL Partners: UNCITRAL’ (Web Page) <<https://www.insol.org/un-profile>>.

All of the texts developed through UNCITRAL have this common feature, namely reducing the legal risks associated with international trade by creating a set of common rules that apply in participating states. This can be put by reference to a simple analogy (which is more a feature of the mainland than Tasmania), of having a single railway gauge between neighbouring states rather than having different trains running on different tracks that mean people having to change trains at the border to get from point A to point B.

In the last 25 years, UNCITRAL has taken up the challenge of addressing such cross-border insolvency problems incrementally.

The first and foundational text is the *Model Law on Cross-Border Insolvency (1997)* which has formed the basis of cross-border insolvency legislation in at least 46 states, including Australia.<sup>8</sup> This *Model Law* is elegant in its simplicity. The underlying rationale is that creditors should not be advantaged or disadvantaged by their geographical status.<sup>9</sup> To take a simple example, if a company operates through subsidiaries in Country A and Country B, and has assets and creditors in both countries, the aim of the *Model Law* is to ensure that the assets of the company are placed in a single pool and distributed equally between the creditors in Company A and Company B, as part of a single liquidation. Most people would think that this is fair, and eliminates what might otherwise be an arbitrary geographical border.

Unfortunately, lawyers don't necessarily see the problem that simply. Country A and Country B might have completely different legal systems – think Australia and Indonesia for example, rather than Australia and New Zealand.

What if all of the assets are in Country A and most of the creditors are in Country B? For example, if the company goes into liquidation with \$100 in a bank account in Country A, \$100 worth of creditors in Country A, and \$100 dollars worth of creditors in Country B. The fair solution would be to pay all creditors \$0.50 in the dollar. However, the lawyers in country A might say, 'Well these assets are in our country, so our

---

<sup>8</sup> UNCITRAL, 'Status: UNCITRAL Model Law on Cross-Border Insolvency (1997)' (Web Page) <[https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border\\_insolvency/status](https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency/status)>.

creditors should get paid 100 cents on the dollar; we're not concerned that the creditors in Country B get nothing'.

The *Model Law* thus operates to create, in effect, a pooling of the assets, designating one country as the central place of liquidation. The designated place is known as the 'centre of main interests', or 'COMI' for short. The COMI is supposed to be the place where the management of the company was located prior to liquidation round the company.

In principle, this make sense, because the liquidator at the COMI should have access to most of the books, records and key staff of the company, to conduct the most efficient liquidation of it. Under the *Model Law*, once the COMI is identified, the intention is that the courts in all other countries should give recognition to that COMI, and allow any assets located in their jurisdiction to be paid into the central liquidation account at the COMI. Equally, creditors of the company (wherever they happen to be) should be entitled to make claims on that central account at the COMI and receive the appropriate distribution. This is achieved by Article 13 of the *Model Law* which puts foreign creditors on the same footing as local creditors, which is of course subject to the insolvency laws of the COMI.

If we think about this, for a moment, it is remarkable 'leap of faith' by countries who have adopted the *Model Law*, to give up control of property in their own country, and hand it to a person who is an official of a court in another country, trusting them to distribute the assets to creditors around the world, and to do so in a manner which is consistent with the laws of another country (where for example the order of payment of creditors may differ from their own country). That leap of faith is very much a matter of having an internationalist perspective, rather than a purely 'national' perspective. Further, the trust associated with such cooperation can only be explained on a rational basis by recognising that increased world trade benefits the individual country more than the benefit which may be gained by refusing to distribute assets according to the worldwide scheme.

Now of course, no scheme devised by lawyers ever operates quite the way that one might expect. One of the more interesting problems which the *Model Law* has thrown up is the fact that not every jurisdiction treats all creditors in the same way. This is graphically illustrated by an Australian case that went to the Full Federal Court in *Akers*

*v Saad Investments*,<sup>10</sup> where the COMI was located in the British Virgin Islands, a tax haven, and the liquidator was not required to pay any attention to tax debts. That company had assets in Australia which the liquidator sought to have repatriated to the British Virgin Islands. The Australian Tax Office argued that it would be excluded from the worldwide pooling, even though it would otherwise be entitled to claim those funds if the liquidation took place solely in Australia. The Full Federal Court solved this problem by ordering that only part of the money should be repatriated to the British Virgin Islands, to enable the monies which were retained in Australia to be paid to the tax office on a *pro rata* basis, thereby giving it the same dividend as the other creditors. This was permissible under the *Model Law* because the Australian Court retained the discretion to refuse to hand over proceeds on ‘public interest’ grounds.

I should observe here that one of the adjustment mechanisms which is frequently used in UNCITRAL instruments is to allow courts to apply a ‘public interest’ test to prevent the text or Model Law from operating in an unintended way in novel circumstances.

There is a lot more detail I could go into in relation to the *Model Law*, but its essential internationalist nature is the main point that I wish to highlight today. As problems and circumstances have been identified in the last 25 years, there have been a range of additional texts which have been developed to create what is becoming an effective international framework for dealing with cross-border insolvency.

These instruments have been developed through the ongoing work of UNCTRAL Working Group V, which has been occupied full-time for most of the last 25 years in addressing problems and solutions in relation to Cross-Border Insolvency in its meetings which take place twice a year in Vienna and New York respectively. Australia has been a very active contributor to these discussions, and a number of our colleagues from UNCCA have attended and made significant contributions to those discussions.

If I could return briefly to the question of the adoption of the *Model Law* and related texts, this process has been a somewhat uneven one. As a rule of thumb, there have generally been global economic downturn’s or recessions every 10 to 15 years, of more or less severity and significance. To take the case of Australia, the model law was

---

<sup>10</sup> *Akers (as Joint Foreign Representative) v Saad Investments Co Ltd (in Official Liquidation)* (2010)190 FCR 285.

finalised in 1997, but not adopted here until 2008,<sup>11</sup> in response to the global financial crisis or GFC. There has, since that time, been a fair number of cases considering aspects of the *Model Law*, including, for example, the *Akers* case that I mentioned earlier.<sup>12</sup>

Cross-border insolvency is not a matter which comes up in practice every day, however the existence and utility of the *Model Law* is something that can and should be taken into account by traders and companies which operate internationally, as well as the lawyers that work for them.

I would like to finish by reflecting on one of the biggest cross-border insolvencies to have occurred in the GFC, which was the collapse of Lehman Bros. This Company – or more accurately, conglomerate – was the fourth-largest investment bank in the United States, employing over 26,000 staff in various jurisdictions including the US, Australia, Hong Kong, Japan, Europe and the Middle East.

In this context, Lehman Brothers took full advantage of the modern world's trading conditions. To give one example, Lehman Brothers had adopted a practice of 'Sweeping' the cash holdings in its European bank accounts every Friday and sending the money to the US. Lehman Brothers put itself into a 'Chapter 11 Administration' in the US on Monday 15 September 2008.<sup>13</sup> Yet, the Friday before initiating liquidation procedures, it had transferred £5 billion from the London subsidiary to the head office subsidiary in the US, arriving in the US just as the liquidation (or bankruptcy as it is termed there) began. So, you can immediately see the sorts of tricky problems that needed to be addressed, considering the company had both European and US creditors, and suddenly there was £5 billion less in Europe to be paid out to the European creditors. There were also significant creditors in Asia and Australia. Fortunately, the

---

<sup>11</sup> UNCITRAL, 'Status: UNCITRAL Model Law on Cross-Border Insolvency (1997)' (Web Page) <[https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border\\_insolvency/status](https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency/status)>.

<sup>12</sup> *Akers (as Joint Foreign Representative) v Saad Investments Co Ltd (in Official Liquidation)* (2010) 190 FCR 285.

<sup>13</sup> Monique Wise on behalf of Lehman Brothers, 'Leeman Brothers Holdings Inc. Announces it Intends to File Chapter 11 Bankruptcy Petition' (Press Release, 15 September 2008) available at <[http://www.lehman.com/press/pdf\\_2008/091508\\_lbhi\\_chapter11\\_announce.pdf](http://www.lehman.com/press/pdf_2008/091508_lbhi_chapter11_announce.pdf)>.

UNCITRAL *Model Law* helped facilitate proceedings in a variety of countries which had adopted the *Model Law*,<sup>14</sup> including Australia,<sup>15</sup> and Japan,<sup>16</sup> for example.

Ultimately however, the majority of the proceedings were conducted by the liquidators based in New York, under the supervision of the New York Federal Court.<sup>17</sup> In 2008 the presiding Judge stated that the hearing was ‘the most momentous bankruptcy I’ve ever say through. It can never be deemed precedent for future cases. It’s hard for me to imagine a similar emergency’.<sup>18</sup> The insolvency fees alone have totalled over US\$2 billion,<sup>19</sup> and as of 2016 Lehman Brothers had paid over US\$105 billion to its unsecured creditors.<sup>20</sup>

To my mind, the Lehman Bros example indicates the importance of having an internationalist cross-border insolvency regime which operates effectively and efficiently to finalise the affairs of a company that has collapsed, and to do so in a way which achieves fairness at the international level between competing creditors and claimants.

It is very interesting to see that Singapore, which is now well established as a hub for business, commerce, and international dispute resolution in Asia, adopted the *Cross-Border Insolvency Model Law* in 2017. Such a move is certainly evidence that governments and their business constituencies are continuing to recognise the benefits of having a clearly articulated regime for cross-border insolvency.

---

<sup>14</sup> Professor Rosaling Mason and John Martin, ‘Conflict and Consistency in Cross Border Insolvency Judgements’ <[https://www.uncitral.org/pdf/english/congress/Papers\\_for\\_Programme/46-MASON\\_and\\_MARTIN-Conflict\\_and\\_Consistency\\_in\\_Cross\\_border\\_Insolvency\\_Judgments.pdf](https://www.uncitral.org/pdf/english/congress/Papers_for_Programme/46-MASON_and_MARTIN-Conflict_and_Consistency_in_Cross_border_Insolvency_Judgments.pdf)>.

<sup>15</sup> *Parbery; in the matter of Lehman Brothers Australia Limited (in liq)* [2011] FCA 1449 (15 December 2011).

<sup>16</sup> *Debtor: Lehman Brothers Asia Holdings Ltd* (2009) Tokyo District Court (1 June 2009).

<sup>17</sup> *Lehman Brothers Inc. (SIPA Proceeding)*, New York Southern District (No 08-01420, Judge Shelly C Chapman) 19 September 2008.

<sup>18</sup> ‘Judge Approves \$1.3bn Lehman Deal’, *BBC News* (Web Page, 20 September 2008) <<http://news.bbc.co.uk/2/hi/business/7626624.stm>>.

<sup>19</sup> ‘Lehman Bankruptcy Fees Surpass \$2 Billion: Court Filing’, *Reuters* (Web Page, 1 February 2013) <<https://www.reuters.com/article/lehman-fees/lehman-bankruptcy-fees-surpass-2-billion-court-filing-idUSL1N0B0LR420130131>>.

<sup>20</sup> ‘JPMorgan to Pay \$1.42 Billion Cash to Settle Most Lehman Claims’, *Reuters* (Web Page, 26 January 2016) <<https://www.reuters.com/article/us-jpmorgan-lehman-idUSKCN0V4049>>.

No doubt, this work will continue in future years and decades. Australia will continue to contribute to this work as one of the world's leading (although not *largest*) trading nation. Though this might initially seem a far cry from the revolutionary issues and associated reforms brought about by the South Sea 'Bubble' Company, if we analyse Globalisation 1.0 and 2.0 closely, one finds some core common principles. That is, economic growth inherently requires the taking of risks, and while some risks cannot be eliminated, those associated with liquidation in the event of collapse can be significantly minimised through a cooperative international endeavour, based on an overall view of fairness that those who contributed to the operations of the company, wherever they may be, whilst it was alive and functioning should share equally in the proceeds after its demise, in accordance with generally accepted priority regimes. Accordingly, while today is primarily a day to reflect on the 25 years of UNCITRAL work on Cross-Border Insolvency, it is also an opportunity to look forward to the challenges, risks and opportunities that will no-doubt arise in the area, in the years to come.

23 October 2019

**Tim D. Castle, FCI Arb**

Barrister