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# Lack of direction: flaws in the Model Law

**KEY POINTS**

- The absence of a mechanism for co-operation and communication between courts regarding the determination and application of foreign law in avoidance actions fails to implement the stated goals of the Model Law and adds expense, delay, and uncertainty to proceedings.
- This article considers how the US courts have had to try to develop their own solutions to realise the stated goals of the Model Law with varied success. It suggests some solutions on how the US courts could approach the problem.

## INTRODUCTION

The stated goals of the UNCITRAL Model Law on Cross-Border Insolvency include fostering communication and co-operation among foreign courts. Nonetheless, the Model Law contains no formal mechanism for a court overseeing a non-main proceeding to communicate with or obtain determinations from the court overseeing the main proceeding with respect to the avoidance laws of that state. In the absence of such directives, US courts have been forced to develop their own solutions, which vary significantly and have, thus far, failed to fully realise the goals of the Model Law. Recent cases pending in New York and the British Virgin Islands arising from the collapse of three Madoff feeder funds highlight these limitations and the potential conflicts. One potential solution – certifying questions of law to the foreign court – has not yet been adopted by any US court, but potentially minimises the failings of other approaches while best serving the goals of the Model Law.

## FOREIGN-LAW AVOIDANCE ACTIONS IN CHAPTER 15

The legislative history of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) indicates that the question of whether or not to permit foreign representatives to prosecute avoidance actions in non-main proceedings was one of vigorous debate. Certain members of the Working Group were concerned that this complex issue "would not lend itself well to a harmonized solution within the framework of the [Model Law]" (UN Doc A/CN.9/435 62–63 (19 February 1997)). Nonetheless, the view prevailed that such a provision was necessary, leading to the inclusion of Art 23, which permits each enacting state to determine whether and to what extent a foreign representative has standing to pursue avoidance actions.

Although the Working Group acknowledged the complexity of this issue and the difficulty of providing a harmonised solution, "the question of the applicable law to determine the requirements and other substantive rules for the commencement of those actions [was] left to the rules on the conflict of laws of the enacting State" (UN Doc A/CN.9/435, 64). Reliance on existing conflict of law principles, however, ignores the very purpose of the Model Law: to facilitate co-operation and harmonise existing, territorialistic insolvency regimes in an age where the insolvency of multinational corporations increasingly implicates assets spread among multiple jurisdictions.

The US's codification of the Model Law as Ch 15 of title 11 (the Bankruptcy Code) of the US Code, explicitly prohibits foreign representatives from prosecuting avoidance actions under US law in a case under Ch 15. Thus, a foreign representative may only prosecute avoidance actions under US avoidance law by instituting a full bankruptcy case under another chapter of the Bankruptcy Code.

Initially, it was unclear whether this bar extended to avoidance actions based on foreign law. However, in *Tacon v Petroquest Res Inc (In re Condor Ins Ltd.)*, 601 F.3d 319 (5th Cir 2010), the US Court of Appeals for the Fifth Circuit – the first appellate court to address the issue – held that, although foreign representatives were prohibited from bringing avoidance actions under US law in a case under Ch 15, there was no such proscription on avoidance actions based on foreign law. No court has since held otherwise and, several bankruptcy courts have expressed approval of *Condor's* reasoning.

## FAIRFIELD REDEEMER ACTIONS

One recent example of the potential for conflict that arises from the lack of guidance regarding avoidance actions based on foreign law can be seen in the claw-back litigation arising from the Fairfield Funds – Fairfield Sentry Limited, Fairfield Lambda Limited, and Fairfield Sigma Limited (collectively, the "Funds"), which were the largest feeders to Bernard L Madoff Investment Securities LLC (BLMIS) before its collapse. Following the collapse of BLMIS, the Funds were placed into liquidation (the BVI Insolvency Proceedings) in the British Virgin Islands (the BVI) before the Commercial Division of the Eastern Caribbean High Court of Justice, British Virgin Islands (the BVI Court), and liquidators were appointed to represent each Fund (the Liquidators). The Liquidators, as foreign representatives, obtained recognition from the Bankruptcy Court of the BVI Insolvency Proceedings as foreign main proceedings under Ch 15. The liquidators have since commenced numerous avoidance actions in three jurisdictions – the BVI Court, US Bankruptcy Court for the Southern District of New York (the Bankruptcy Court), and the Supreme Court of the State of New York (the New York State Court) – seeking to avoid substantially identical payments made to former shareholders in respect of redemptions (the Fairfield Redeemer Actions).

To further complicate matters, the Liquidators have also asserted various avoidance claims under the BVI Insolvency Act of 2003 (the BVI Statutory Claims), but only in the Bankruptcy Court in the US. No BVI court has applied the relevant provisions of the BVI Insolvency Act to the facts presented in these cases. Consequently,

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numerous issues of first impression under BVI law must be decided by the Bankruptcy Court in order to adjudicate the BVI Statutory Claims. Such a scenario is arguably offensive to the British Virgin Islands' interest in having its laws interpreted by its domestic courts. Furthermore, because a decision of the Bankruptcy Court would likely not be binding in a subsequent case before the BVI Court there is a danger that defendants could be subject to different results depending on forum, thereby creating incentives to forum shop.

## EXISTING AND POTENTIAL SOLUTIONS

Where a US court assumes jurisdiction of an issue governed by foreign law, r 44.1 of the Federal Rules of Civil Procedure permits the court to consider "any relevant material or source" in determining foreign law, whether or not it is submitted by one of the parties or would otherwise be admissible under the Federal Rules of Evidence. Thus, litigants routinely rely various sources including expert witnesses to prove foreign law and courts can and do perform independent research.

Although this procedure may be practical where the foreign law is clear and well settled, it does not account for issues of first impression or questions of law on which there is disagreement in the home state. There are several other drawbacks. First, litigants may be deprived of the opportunity to appeal an adverse ruling to the court of the governing law, creating the potential for conflicting rulings and forum shopping. Additionally, proving foreign law, particularly through the use of experts, can add significant expense, complexity, and delay to litigation. Finally, proof of foreign law without input from the courts of that jurisdiction simply ignores the goals of communication and cooperation that the Model Law was intended to facilitate.

A second alternative is to defer to the foreign court without directly communicating, either through abstention or a stay of litigation pending resolution of new or novel issues of law by the foreign court. For example, in *Maxwell Commun Corp PLC v Société Générale (In re Maxwell Commun Corp PLC)*, 186 BR 807 (SDNY 1995), the bankruptcy court held that the presumption against extraterritoriality and principles of comity precluded application of US avoidance law to transfers that occurred entirely overseas. The court, therefore, dismissed an adversary proceeding to recover those transfers. While abstention limits the incentives for forum shopping and minimises the risk of inconsistent decisions, it fails to effectuate the goals of communication and co-operation and precludes a foreign court from providing assistance to the home court where avoidance actions may be necessary to recover assets of the estate.

The Bankruptcy Court in the Fairfield Redeemer actions has taken a hybrid approach. At this time, the court has issued a stay of the Redeemer Actions before it, in light of pending appeals of a ruling by the BVI Court that may affect the claims before the Bankruptcy Court as well as appeals of rulings of the Bankruptcy Court regarding its jurisdiction to hear the Redeemer Actions in the first instance. This wait-and-see approach does diminish the risk for inconsistent rulings and respects the BVI court's prerogative in deciding issues of its domestic law. However, the pending appeals may not be dispositive of the issues of BVI law before the Bankruptcy Court and, after considerable delay, the court and the litigants may be in no better position.

The court in *In re Int'l Banking Corp BSC*, 439 BR 614 (Bankr SDNY 2010), adopted a third approach, in which it ordered the parties to submit to the jurisdiction of a Bahraini court to seek a determination of Bahraini law and invited "the prevailing party to return to th[e] Court and ask that comity be afforded to the Bahraini court's decision." *Id* at 629. In the event that the Bahraini court declined to exercise jurisdiction, the court indicated that it would decide the dispute based on its authority to do so under *Condor*. Thus, despite the lack of a formal procedure governing application of foreign law in cross-border insolvencies, the bankruptcy court crafted and implemented a solution that harmonised the competing interests. Once again, this approach does not involve communication or cooperation among foreign courts, and it is entirely dependent on the foreign court assuming jurisdiction, which, absent formal mechanisms in the Model Law, may be limited by domestic standing rules. Additionally, the necessity to commence two separate proceedings potentially adds expense and delay.

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## CERTIFICATION

One potential solution involves certification of questions to a foreign court regarding issues of its domestic law. US federal courts often certify questions of US state law to the highest court of that state. However, no such procedure exists for questions of foreign law, and the practice is unprecedented in US courts. Certification offers several advantages to the approaches discussed above. First, it accords the greatest deference to the foreign court's interest in having its law decided by its domestic courts. Second, certification can involve communication between both courts in formulating the questions. Third, a formal certification procedure could minimise the potential time, cost, and uncertainty of instituting completely separate proceedings. Finally, allowing the foreign court to rule on issues of its domestic laws preserves the ability to appeal such a ruling within that jurisdiction.

## IMPLICATIONS AND TAKEAWAYS

In the absence of formalised procedures governing application of foreign avoidance law in cross-border insolvencies, US courts have been forced to formulate their own approaches. The results have varied greatly and each has significant flaws. Certification or a similar mechanism to seek guidance from a foreign court is one potential solution that reduces the flaws of other approaches, while embracing the goals of the Model Law. ■