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In re Stanford International Bank Limited [2009] EWHC 1441 (Ch)

Adam Al-Attar, Barrister, 3-4 South Square, London, UK, and **Michael D. Good**, Managing Principal, South Bay Law Firm, Torrance, California, USA

Overview

If a company used to perpetrate a fraud (Ponzi, Madoff, Stanford) should fail, how should its centre of main interests (COMI) be determined?

The question is without an easy answer because, on one view, COMI should only ever be a question of fact whereas, on another view, the meaning of COMI not settled and may require refinement in the context of Council Regulation 1346/2000 on insolvency proceedings (the 'Insolvency Regulation'), and in the different context of the Cross Border Insolvency Regulation 2006 (the 'Cross Border Regulation'), to accommodate cases of fraudulent failure.

COMI is a question of fact (or more accurately a question of application) if it is treated as having a tolerably clear legal meaning derived from the legislative text and relevant legislative background. The Court must identify a company's 'interests', identify from those 'interests' which are 'main' and which are not, and, in relation to the former, locate their 'centre'. In applying each component to the facts found, the Court is entitled to exercise discretion in reaching its conclusion. Such discretion is permissible because it is unavoidable in making a judgement as to the proper application of a legal concept. On this view, there is no need to sharpen the legal meaning of COMI to reach a right answer consistent with the legislative intent and, significantly, there is no basis on which to do so.

There is no practical obstacle on this view, the broad view, to accommodating cases of fraudulent failure within the same framework as cases of non-fraudulent failure. COMI is to be determined at the point proceedings are opened, or at which recognition is sought, and that enquiry may take into account facts revealed post failure which would not have been apparent to creditors and other third parties (including, for example, financial regulators) in dealing with the company prior to its failure and the revelation of the fraud.

COMI is, alternatively, a concept that has a much more precise legal meaning. It is to be determined by reference to objective factors ascertainable to third parties which either confirm or rebut the presumption that a company's COMI is at the place of its registered office. The components of COMI outlined above are on this view, the narrow view, subject to a rule which regulates the factors which the Court can take into account in determining COMI.

The narrow view does create a practical obstacle to accommodating fraudulent and non-fraudulent failure within the same framework. The same test can, of course, be applied in *all* cases, but in cases of fraudulent failure it is deeply unattractive that the opening and recognition of main insolvency proceedings should turn on the façade apparent to third parties and not the facts. For example, the mastermind of a fraud might organise the head office functions of his front company in Jurisdiction A because of its lack of effective regulatory oversight in order to facilitate a fraud on investors in Jurisdiction B. The matter is complicated if the assets acquired are diverted to Jurisdiction C. In such cases, it is difficult to see the practical value of protecting creditors' and others' reliance on the façade created. What is important is the getting in and distribution of the assets (and their substitutes) that still exist. For the most part, this will turn on a thorough investigation of the fraud itself, but secondary considerations include the effectiveness of the claims handling and distribution process to be put in place.

In re Stanford International Bank [2009] EWHC 1441 (Ch), Mr Justice Lewison considered himself bound to adopt the narrow view in the context of the Cross Border Regulation, having regard to the recitals to and the case law in connection with the Insolvency Regulation.

This case note summarises the facts and reasoning underlying the decision in *Stanford* and asks whether the broad view might sensibly be adopted as the test for COMI under the Cross Border Regulation and the Insolvency Regulation.

Facts

A receiver appointed by the Securities and Exchange Commission in the United States ('SEC'), and a liquidator appointed by the Financial Services Regulatory Commission ('FSRC') in Antigua, in relation to Stanford International Bank ('SIB') applied for recognition in the United Kingdom under the Cross Border Regulation. The practical reason for recognition was to gain control of bank accounts in London.

SIB was a bank incorporated in Antigua where it had its registered office. In the course of its business, it issued certificates of deposit to customers resident in countries other than Antigua and to customers in the United States through financial advisers in that country, being the country in which the majority of its assets were managed under contract.

The receiver was appointed pursuant to an SEC complaint which did not allege that SIB was insolvent but which sought to prevent waste and dissipation of assets to the detriment of investors, although the receiver might have applied to the US Court at a later stage to sanction a distribution plan.

The liquidator was appointed pursuant to a petition which alleged actual or imminent balance sheet insolvency and which was verified by an affidavit confirming insolvency, although the winding up order was expressed in just and equitable terms and on the basis of a statute in which insolvency did not feature as a ground.

Held

Against this background, Lewison J was required to decide –

(1) whether the receiver, or the liquidator, was a foreign representative? And

(2) whether the foreign proceedings were foreign main proceedings?

The judge's reasoning on the second issue can be summarised as follows:

(1) COMI is a concept common to the Cross Border Regulation (derived from the UNCITRAL Model Law) and the Insolvency Regulation, and, having regard to the legislative history, it is reasonable to infer an intention that COMI in the Cross Border Regulation has the same meaning as in the Insolvency Regulation (paragraph 45).

(2) Recital 13 to the Insolvency Regulation provides:

> 'The centre of main interest should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is *therefore* ascertainable by third parties' (emphasis added).

(3) On this interpretation, the recital 'is really an assumption of fact' (paragraph 55). It assumes that because a debtor administers his interest from a place on a regular basis that that place will be ascertainable by third parties (but that assumption may not be true on some facts).

(4) The Court in determining a company's COMI is not, however, thereby justified in putting to one side how third parties perceive matters; on the contrary, because insolvency is a foreseeable risk 'transparency and objective ascertainability' are important (paragraphs 55 and 61).

(5) A two stage approach is required (paragraph 63):

  (a) The Court must first identify a set of objective and ascertainable factors.

  (b) The Court must then determine from that set of factors where a company's head office functions are carried out in order to confirm or to rebut the presumption that its COMI is at the place of its registered office.

(6) In this context, ascertainable by a third party refers to 'what was in the public domain and what a typical third party would learn as a result of dealing with the company' (paragraph 62). It does not extend to facts which would have been revealed by an honest answer to a question had it been asked.

Comment

In so holding, Lewison J considered that he was required to depart from the reasoning (but not the result) in his own recent decision *In re Lennox Holdings Ltd* [2009] BCC 155. This twist is surprising because Lewison J referred to same passages of the Court of Justice decision in *Eurofood* in *Lennox* as he did in *Stanford*, but a close comparison of *Stanford* and *Lennox* does reveal an appreciable difference in approach.

Lennox concerned a company that supplied UK food products to UK expatriates and holidaymakers in Spain and which had a number of major UK suppliers. In holding that the company had its COMI in the UK, Lewison J had regard to the following facts summarised in the evidence:

(1) The directors lived and worked in England.

(2) The board of directors and management conducted meetings from offices in London.

(3) The company's accounts were prepared by accounts in England.

(4) A substantial number of the company's creditors were located in England and a number had contacted the board of directors and management in response to the deterioration in its finances apparent from a fall in its share price listed on AIM.

By contrast, in *Stanford* Lewison J discarded factors that were not objective and ascertainable and only analysed those that were in terms of their relevance and as pointing to or away from Antigua, for example (paragraph 98):

(1) The location of the directors (the principal movers of the fraud) was irrelevant as it was not ascertainable by third parties.

(2) The marketing of certificates of deposit through financial advisers in the United States was irrelevant because, on the facts, an investor would not have considered a financial adviser as acting for SIB.

(3) The fact that the purchasers of certificates of deposit were located outside Antigua was irrelevant as it pointed to no state other than Antigua.

(4) The locations of assets outside Antigua, mostly in the United States, may have been ascertainable but, on analysis, was irrelevant because those assets were managed by other entities under contractual arrangements with SIB.

The approach in *Stanford* is, therefore, narrower than that applied in *Lennox*, but no practical difference is immediately obvious in the ordinary run of cases. There is no example of a case which would have been decided differently had the approach in *Stanford* been applied. The factors which carried the most weight in *Lennox* were funding and day-to-day management in connection with creditors, which would have been accounted for on the *Stanford* approach as objective and ascertainable factors.

The key question is whether the approach in *Stanford* is likely to make a practical difference outside the ordinary run of cases. In cases of fraudulent failure, there is likely to be a significant practical difference because the requirement that factors be ascertainable excludes matters which, by definition, are concealed prior to the revelation of the fraud following failure. Lewison J's understanding of what makes a factor ascertainable – that it is in the public domain – must be correct. To say that something is ascertainable because it would have been revealed by an honest answer to a question had it been asked deprives the requirement that factors be ascertainable of all content. The rigour with which this requirement might be applied however begs the question whether the legislature intended the determination of COMI to be regulated by a rule which excludes otherwise relevant factors.

In this respect, Lewison J is right to identify the factual assumption which underpins recital 13 to the Insolvency Regulation as key. If a debtor company regularly administers its affairs from a given place, it is reasonable to assume that that place will be ascertainable by third parties. It is also reasonable to infer from that assumption that the legislature intended creditors' perceptions to play a prominent role in weighting each relevant factor; however, it is leap of logic to move from recognising the importance to be given to creditors' perceptions (as a matter of weight) to the exclusion of matters which creditors cannot have perceived, especially in circumstances in which they, along with others, were deceived.

COMI, as first conceived, is a conceptual tool intended to give practical effect to the aims underlying the Insolvency Regulation. The primary aim of that regulation is to regulate the opening and recognition of insolvency proceedings in the Member States against the background of a single market. In that market, insolvency is a foreseeable risk and so the Court must give prominence to creditors' perceptions if the opening and recognition of insolvency proceedings is to align usefully with the perceptions of market actors. That primary aim cannot however sensibly be relied on as a justification for excluding factors not apparent to market actors in their dealings with the company. As victims, their reliance is not worth protecting. The legal certainty important to the market only has value if reliance is grounded in fact and not façade. To exclude as irrelevant factors which might enable a more effective insolvency proceeding is to compound victims' detrimental reliance.

Looked at in this way, the case of fraudulent failure is a reason for adopting the broad view in determining COMI under the Insolvency Regulation and the Cross Border Regulation. Cases in that run are likely to occur in the context of either regulation, and only in relation to the Insolvency Regulation is there a single market context which appears to pull towards the narrow approach. To give weight to that market context is however inappropriate in the case fraudulent failure because (just as reliance is not worth protecting) there are no underlying market expectations to protect.

A more difficult case is one in which a fraud is unravelled but the company carried on a substantial and genuine business as well. There is no obvious basis for giving the perceptions of one group priority. From their own point of view, the victims of the fraud relied in same way as the creditors for whom the company intended to and did perform, and vice versa. The broad view is that the Court must engage in a balancing exercising, taking into account all factors, and make an assessment of their relative importance in determining the company's COMI. By contrast, the narrow view would seemingly require the Court to ignore the fraud just as it does in the case of a fraudulent failure.

COMI analysis in the US-based SEC proceeding appears headed toward the broad view. Though, as of this writing, the parties have yet to complete their presentations before the US District Court in Texas, the specific questions on which Judge Godbey has requested briefing suggest a focus on the similarity of COMI to a debtor's 'principal place of business' as that concept is recognised under US law. Though not inconsistent with what creditors would have perceived about the debtor (i.e., the narrow view discussed above), the 'principal place of business' focuses more broadly on factors which, though objective, are not tied as closely to what the debtor held out to (or concealed from) specific parties. Instead, the debtor's 'principal place of business' views the totality of the debtor's operations (fraudulent or not) and, on the basis of these facts, determines the debtor's 'principal place of business.'

Stanford is subject to appeal and judgment is awaited. If the Court of Appeal is troubled by the case of fraudulent failure, it likely that the Judge's reasoning (but perhaps not his conclusion) will be modified to some extent to accommodate cases outside the ordinary run of things.

International Corporate Rescue

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