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JUDICIAL REFLECTIONS ON INSURANCE INSOLVENCY

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Insurance looms large in the discourse of cross border insolvency for two reasons: the propensity of insurers to operate through foreign branches rather than subsidiaries; and the protections and preferences conferred on insurers' creditors by domestic law.

Australia is among the countries that have taken the significant step of making the UNCITRAL Model Law on Cross Border Insolvency part of their own statute law. But adoption of the Model Law by Australia in 2008[2] was on the basis that domestic general insurance companies were to be kept beyond its reach[3]. As a result, if an Australian general insurer is subject to insolvency administrations both in Australia and elsewhere, the Model Law, as part of the law of Australia, will not assist in rationalising or harmonising approaches to the two administrations; nor will the provisions about seeking assistance in another country apply.

Australia is not alone in this. Governments and legislatures have generally set their own insurance companies apart from any adoption of the Model Law. In the United States, domestic insurance companies are not caught by chapter 15 of the Bankruptcy Code[4]; and in the United Kingdom, the Cross Border Insolvency Regulations 2006 do not apply to an entity authorised under the Financial Services and Markets Act to effect or carry out contracts of insurance[5].

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[1] A Judge of the Supreme Court of New South Wales
[2] Cross-Border Insolvency Act 2008 (Cth)
[3] Cross-Border Insolvency Regulations 2008, regulation 4 and item 2 of schedule 1
[4] Section 109(b) of the Bankruptcy Code excludes railroads, regulated financial institutions and domestic insurance companies.
[5] Schedule 1, paragraph 2(i)

The general attitude is that the court of a country that has enacted the Model Law can entertain an application for recognition of a foreign insolvency proceeding affecting a foreign insurer but is not free, at least under the enacted Model Law, to facilitate recognition elsewhere of the liquidation of one of its own insurers or co-operate with a foreign court in relation to such a liquidation.

The reasons for this deliberate isolationism may readily be accepted. Insurance policies allow us to sleep soundly at night untroubled by worries about liability to someone we might injure through negligent driving, the risk that our employers may not be able to pay compensation if we are injured at work or the risk that the contractor building our new house will fail before completing it and not be able to perform post-completion warranties.

In Australia, all these forms of insurance play an important role in every day life. In countries without a government subsidised health system, one would no doubt add health insurance to the list. The key social purpose of certain insurances is emphasised by measures under which government bodies exist to underwrite from the public purse losses that would have been met by an insolvent insurer had it remained financially viable. The three particular kinds of cover I have mentioned – third party motor vehicle, workers compensation and home builder – are, in Australia, backed by government protection that operates in the event of an insurer's insolvency. I know that other countries have similar arrangements.

When these government bodies fill the place of the failed insurer, there is the question of recourse to proceeds of reinsurance that the failed insurer carried in respect of the relevant risk. A four-way contest may develop. Should the reinsurance proceeds reimburse the government fund or agency that has met the claims of unpaid policyholders? Should they benefit the holders of policies of the relevant type – so that if the reinsurance is in respect of workers compensation insurance, the reinsurance proceeds benefit only creditors claiming as workers compensation policyholders in the liquidation? Should it be the insurance creditors as a whole who enjoy the fruits of reinsurance? Should the proceeds perhaps form part of the assets applicable in the liquidation towards the claims of all creditors?

Policyholders unable to recover from an insolvent insurer – either at all or in full – do not mind whether it is a government agency or a reinsurer that makes them whole. But, of course, if it is a government agency that does so, it may be that that agency cannot access the failed insurer's reinsurance. Privity of contract rules will often protect the reinsurer from both direct claims by the insured and subrogation claims by the government agency. Cut-through clauses or principles allowing non-parties to sue on contracts made for their benefit may give the insured recourse against the reinsurer – subject to laws making voidable contracts that have the effect of depleting an insolvent estate.

Competition of this kind came to the surface at the three stages of the HIH liquidation in Australia – in 2003, 2005 and 2011. The result was ultimately an order of priority of entitlement to reinsurance proceeds effectively as follows:

- First, state government guarantee bodies which had covered unsatisfied claims by the insolvent insurer's motor accident, workers compensation and home building insureds were entitled under various state laws to first priority enjoyment of the proceeds of reinsurances backing those policies. That was the 2003 case which raised questions about the interaction of State and Federal laws.[6]
- Second, certain insureds carrying cover against liability for asbestos injury were expressly given by the court access to amounts received under reinsurance specifically backing their policies in circumstances where they, the insureds, had effectively paid for the reinsurance. That was the 2011 case[7] which involved exercise of a specific power the court has to give such access.
- Third, the general insolvency law provides that reinsurance proceeds are to be applied towards the claims of all creditors with debts under insurance contracts, not just those whose insurance might be regarded as backed by reinsurance. It was that provision and its susceptibly – or, as it turned out to

[6] HIH Casualty and General Insurance Ltd v Building Insurers' Guarantee Corporation [2003] NSWSC 1083

[7] Amaca Pty Ltd v McGrath & Anor as liquidators of HIH Underwriting and Insurance (Australia) Pty Ltd [2011] NSWSC 90

be, imperviousness - to modification by scheme of arrangement that was the subject of the 2005 case.[8]

The 2005 case also dealt with the impact of specific insurance legislation requiring that, in the insolvent liquidation of an Australian insurer, assets in Australia be applied first towards liabilities in Australia. That legislation has to be obeyed along with the rules about the order of application of assets, including the several variants concerning reinsurance receipts.

The result of all of this is a convoluted set of rules defining the manner of application of assets in the winding up, with departures of various kinds from any rule of proportionate equality of participation by creditors – including departures to the detriment of foreign creditors.

It was this distorted version of rateable participation that came to be considered by the courts in England when they were asked whether the assets of HIH under the control of United Kingdom provisional liquidators should be kept there to be administered under the United Kingdom system or sent to Australia to be dealt with under the Australian regime.

The matter came before the English courts on application made by the English provisional liquidators[9]. The English court was also in receipt of a letter of request from the Supreme Court of New South Wales[10] asking that the proceeding be decided since, in effect, the decision would assist the due administration of assets in Australia.

Ultimately, of course, the matter reached the House of Lords where, in the McGrath v Riddell case[11], the result was, although not unanimously, endorsement of the principle of modified universalism strongly supported by Lord Hoffmann and also by Lord Walker – the principle that insolvency proceedings are collective, dealing

[8] Re HIH Casualty and General Insurance Ltd [2005] NSWSC 240
[9] Re HIH Casualty and General Insurance Ltd; McMahon v McGrath [2005] EWHC 2125 (Ch); Re HIH Casualty and General Insurance Ltd [2006] EWCA Civ 732
[10] Re HIH Casualty and General Insurance Ltd [2005] NSWSC 536
[11] Re HIH Casualty and General Insurance Ltd; McGrath v Riddell [2008] UKHL 21

with all assets for all stakeholders, and should be administered on a world-wide basis but with jurisdictional differences not being altogether ignored so that the local court can pay some attention to the fairness of the basis of administration in the principal jurisdiction.

Clearly part of this is a view that is by no means new and was stated more than 100 years ago[12] - that one administration can be and will be ancillary or secondary to another which takes the lead; the same kind of thinking, at least in general terms, as one sees reflected in the model law provisions.

Lord Hoffmann had already supported a principle of this kind in the Navigator decision in the Privy Council[13] which I must say I consider more radical than McGrath v Riddell and to which I shall return.

The fact remains that, in the English courts, the prevailing approach is one that entails recognition of and assistance in implementing a foreign insolvency administration according to the foreign rules governing it; and this is without any operation of the UNCITRAL Model Law but might perhaps be withheld by reference to some local principle of public policy.

The McGrath v Riddell and Navigator cases were soon being cited in Australia in support of applications to request assistance of a foreign court in relation to insolvencies with cross-border aspects. In my own court, there were applications in the HIH administration for letters of request directed to foreign courts in the United Kingdom[14] and Hong Kong[15]. The requests were for assistance by way of compelling persons within the foreign jurisdiction to attend for examination on matters on which the liquidators needed to obtain information for the purposes of their administration. There had been earlier such

[12] Re English Scottish and Australian Chartered Bank [1893] 3 Ch 385
[13] Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings plc [2006] UKPC 26
[14] McGrath & Anor as liquidators of HIH Insurance Ltd [2008] NSWSC 881
[15] McGrath & Anor as liquidators of HIH Insurance Ltd [2008] NSWSC 780

applications[16], but they had been dealt with under "act in aid" statutory provisions[17].

The liquidator of another Australian insurer, New Cap[18], made an application in 2009 for a similar letter of request, but in more financially significant circumstances. The liquidator had been successful in obtaining judgment in the Australian court against participants in the London insurance market. The judgment was on a wholly statutory cause of action for the claw-back by a liquidator of certain kinds of preferential payments. The liquidator, armed with that judgment, looked for ways of enforcing it in the United Kingdom. Because the cause of action was statutory, UK legislation concerning the enforcement of foreign judgments would not be applicable; nor was the case one in which an action could be brought on the foreign judgment at common law. The Australian court was asked to request the assistance of the English court in enforcing the Australian money judgment.

One immediate question on all these applications for the issue of letters of request was whether there were reasonable prospects that the request, if made, would be acceded to. The Australian court was not about to make a futile request. The assessment in the later cases, with the aid of foreign law opinions based heavily on McGrath v Riddell and Navigator, was that there were reasonable prospects of success. In the New Cap case, the letter of request was issued on the footing that, whatever might be the position under "act in aid" legislation, modified universalism would very likely cause the English court to recognise and give effect to the aspect of the insolvency administration in Australia consisting of the right, established by the Australian judgment, to recover money from the London market participants.

The New Cap circumstances are similar to those that arose in relation to the enforcement in the United Kingdom of money judgements of the United States Bankruptcy Court in the Eurofinance case[19]. The concluding part of the July 2010

[16] for example, Re HIH Insurance Ltd (In Liquidation) and Ors [2004] NSWSC 454
[17] Corporations Act 2001 (Cth), s 581 the terms of which are similar to those of the Insolvency Act 1986 (UK), s 426
[18] New Cap Reinsurance Corporation Ltd v A E Grant and Ors, Lloyd's Syndicate No 991 [2009] NSWSC 662
[19] Rubin v Eurofinance SA [2010] EWCA Civ 895

judgment of the English Court of Appeal in that case strongly supports the principle that the local court should give effect to a foreign insolvency regime by deploying its own jurisdiction in support. Of particular interest is the fact that the UK version of the UNCITRAL Model Law had been found insufficient to ground that part of the relief sought in aid of the US bankruptcy.

There is an important point here. The general law concepts of comity and modified universalism are not constrained by the existence of statutory analogues. That was the real point of difference in the House of Lords in McGrath v Riddell. Two of their Lordships emphasised the existence of UK statutory provisions (predating, I might say, that country's adoption of the Model Law) that regulated the matter of assistance by English courts to foreign courts on matters of insolvency[20]. Lord Neuberger went so far as to say, in effect, that he would have agreed with Lord Hoffmann's strong approval of modified universalism had it not been for the existence of the statutory "act in aid" provisions. It is not without significance for the future development of this aspect of the common law that, in a speech at the Insolvency Law Dinner in London in November 2009[21], Lord Neuberger said that, on revisiting McGrath v Riddell in the course of preparing that speech, he had concluded that there is "considerable attraction" in the view that had been preferred by Lord Hoffmann and Lord Walker.

I have spoken of the local court deploying its own jurisdiction in aid of the foreign insolvency administration. There is no conceptual difficulty with the idea that, in the Eurofinance case, the English court will enforce the US money judgment or that in the New Cap case the English court might enforce the Australian money judgment[22]. Ordering people to pay money is something that courts do every day. A money judgment is part of the standard judicial armoury – a deployment of the local court's established jurisdiction.

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[20] The "act in aid" provisions of the Insolvency Act 1986 referred to at note 17 above.

[21] "Insolvency, Internationalism and Supreme Court Judgments" viewed at http://www.judiciary.gov.uk - "Media" – "Speeches"

[22] A few days after this paper was presented, the High Court of Justice, Chancery Division (Lewison J), ordered the defendants to pay the amount of the judgment obtained by the New Cap liquidator in Australia. Leave to appeal to the Court of Appeal was granted and the appeal is to be expedited.

The Navigator case arguably went further. The foreign administration there was a plan of reorganization under chapter 11 of the United States Bankruptcy Code. It affected not only the rights of the creditors of Navigator but also the rights of shareholders. And it was the part stripping shareholders of their shares and vesting them in a creditors' committee to which the Privy Council said the local court should give effect on the basis of comity. The reason was that the local court could have dispossessed the shareholders under its own statute law as part of a scheme approved by both a meeting of creditors and the court itself. The Privy Council's decision tells us that if a foreign law insolvency process produces effects upon or in relation to the insolvent company extending beyond its creditors and there is some analogue by which the local court might have done the same, then resort to the analogue is permissible to assist the foreign law process. So, while the common law concept of modified universalism is, as I said earlier, not constrained by statutory analogues, it may itself feed off statutory analogues.

But some foundation must still be found in what I have called the local court's standard judicial armoury. This was a problem that arose in a case concerning the English insurer, Independent Insurance[23]. The company was in the hands of provisional liquidators in the United Kingdom. As a result, the UK statute law precluded the bringing of actions against the company without the permission of the English court. An application was made ex parte under Australian "act in aid" legislation for an order prohibiting the bringing of actions against the company without the permission of the English court. There was no problem in recognising the regime imposed by the English court and accepting that it caused the provisional liquidators to be in office, so that all the statutory consequences that that involved in the foreign jurisdiction were in place there in relation to the English company. But when I looked around the judicial armoury as it existed in June 2005, I found no suitable weapon for the task of re-creating those consequences in Australia. The remedy of injunction was there, but its purpose was to restrain identified persons; and an injunction was ordered, at least on a permanent basis, only after the persons concerned had had an opportunity to be heard. The problem was that no particular person was threatening to bring litigation contrary to the stay in place in the United

[23] Re Independent Insurance Company Ltd [2005] NSWSC 587

Kingdom and no particular person was sought to be restrained. Had a particular person proposing to bring a particular action been targeted and made a party, an injunction would have been ordered in support of the English insolvency administration[24].

I note that the Supreme Court of Bermuda, in somewhat similar circumstances involving provisional liquidators appointed by the Cayman Islands court to a Cayman company, recently made ex parte an order addressed to the world prohibiting actions against the company in Bermuda except with the leave of the Bermuda court.[25] But the order was, it was said, made on terms that the provisional liquidators proposed to serve a copy of the order on all persons intended to be bound by the stay, apparently with the intent that a person was not restrained unless and until served and might then seek to have the order set aside or dissolved as it applied to the person.

Of course, had the Model Law been in force in Australia or Bermuda at the relevant time[26], an order recognising the UK or Cayman administration as a "foreign main proceeding" would have produced precisely the restraint sought; but this would have been the impact of the Model Law, as part of the law of Australia or Bermuda, not of any injunction ordered by the Australian or Bermudan court.

What does the future hold? There will, I think, be a strengthening of the principles of comity emphasised in the McGrath v Riddell and Navigator decisions. That will not be confined to insolvency cases. In the insurance field, we already have an example where the Court of Appeal of Ontario, in the Cavell case in 2006[27], upheld an order at first instance recognising an order of the English court for the convening of a meeting of creditors of a solvent insurer to consider a scheme of arrangement. A statutory basis in Canadian foreign judgments legislation was rejected. The decision was based on comity and comity alone; and although the decision related to only the first part of the two stage process by which a scheme of

[24] This is made clear at paragraph [54] of the judgment.
[25] Re Founding Partners Global Fund Ltd [2009] SC (Bda) 36 Com
[26] The Model Law has not been enacted in Bermuda. It became part of Australia's statute law as from 1 July 2008: see note 2 above.
[27] Re Cavell Insurance Co (2006) 269 DLR (4th) 679

arrangement becomes binding under English law, the Canadian court put in place mechanisms to ensure that subsequent stages of the English proceeding were brought back to it for what was effectively parallel recognition.[28]

The strengthening of the principles of comity (the outer limits of which will always be uncertain) will go hand in hand with the implementation of the Model Law where it is in force, with each likely to underwrite and strengthen the other.

I cannot leave these matters without referring to a recent judge-initiated innovation of significance. In June 2010, the Chief Justice of Singapore and the Chief Justice of New South Wales signed a memorandum of understanding[29] aimed at facilitating the determination in one country of questions of the law of the other country arising in the court of the first country. The Chief Justice of New South Wales and the Chief Judge of New York signed a similar memorandum of understanding in October 2010[30]. These protocols pave the way for parties to seek by consent a regime under which the court whose law is involved will act, at the request of the court where the question arises, to entertain and determine the question of law, thus avoiding the cumbersome and precarious process of proving foreign law by expert evidence.

Moves such as these emphasise the role that courts and judges themselves may usefully play in addressing the challenges of cross-border litigation quite apart from the confines of the particular cases that come before them. I quote, in conclusion, from the remarks of Chief Justice Spigelman of New South Wales at the signing of the New York protocol on 28 October 2010[31]:

> "Over recent decades an enhanced sense of international collegiality has developed amongst judges. There are many more opportunities for interaction at conferences and on visits by judicial delegations. This has

[28] In respect of its Australian business, Cavell resorted to local insurance company reorganisation legislation: Re Cavell Insurance Ltd [2008] FCA 1984

[29] http://www.lawlink.nsw.gov.au/practice_notes/nswsc_pc.nsf/6a64691105a54031ca256880000c25d7/33cfadb586532d46ca25779e00171f9a?OpenDocument

[30] http://www.lawlink.nsw.gov.au/practice_notes/nswsc_pc.nsf/pages/538

[31] http://www.lawlink.nsw.gov.au/lawlink/Supreme_Court/ll_sc.nsf/pages/SCO_speeches

considerably expanded the mutual understanding amongst judges of other legal systems. It has transformed the concept of judicial comity."

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