

Articles

Comparative Notes on the Operation of Some Avoidance Provisions in a Cross-Border Context

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1 Introduction

1.1 General

In administering a bankrupt estate, the insolvency representative will examine transactions in which the debtor was involved before the onset of bankruptcy, to ascertain whether any of the debtor's property or assets that should be available for distribution among all creditors were disposed of improperly. These transactions may usually be contested with the aim of reclaiming those assets from the recipient or beneficiary for the benefit of the creditors as a group – hence the notion of claw-back provisions or the swelling of the assets of the estate.

In this article, it is therefore intended to provide a general comparison of the law that regulates transactions entered into prior to bankruptcy in a number of jurisdictions. This is an appropriate study for several reasons. In the first place, the issue of the avoidance of pre-bankruptcy transactions is often central to problems involving cross-border issues: eg, a bankrupt may have disposed of property in countries other than the one in which he became bankrupt, and so considering how the different countries involved deal with the matter of pre-bankruptcy transactions can be helpful. Second, the legal systems of countries are not identical, and it is instructive to see how different systems, some traditional common law and others civil law, deal with the issue at hand. Third, the global context that has become a part of modern commercial law, and in particular bankruptcy law, may need to be reformed to deal with these matters more effectively. Finally, the fight against commercial fraud is also growing in importance.¹

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¹ See the agenda of the United Nations Commission on International Trade Law (UNCITRAL) Working Group V of 29 July 2008.

The jurisdictions that will be considered in this article include England² and the United States of America representing the common-law approach, the Netherlands and Germany as civil-law jurisdictions, and South Africa and India, both two former British colonies, representing developing countries with expanding economies. South Africa has a mixed legal system with its roots in both civil law as well as common law, while India follows the common-law approach.

The article will thus first provide a basic theoretical framework regarding the notion of voidable transactions, followed by some comparative notes on the basic elements for avoiding certain transactions in the jurisdictions mentioned above. This comparison will be followed by a discussion of this topic within the context of cross-border insolvency, and then some final remarks regarding the way forward will conclude the article.

All the jurisdictions included in the study provide a number of remedies to deal with voidable transactions. However, it must be stressed that because of limitations of space this article will concentrate on the avoidance of the traditional core or main pre-bankruptcy transactions. The article therefore does not purport to present a comprehensive discussion of all the possible avoidable transactions provided for by each one of the jurisdictions included.

These core or main transactions are fraudulent conveyances (of which the transaction at an undervalue is a species) and preferential transactions or preferences. Both the fraudulent conveyance transaction and the transaction at an undervalue relate to the situation in which the debtor disposes of an asset either without receiving value in return or without receiving adequate value. Whether a transaction becomes fraudulent or merely remains a transaction at an undervalue usually turns on the knowledge of the debtor's dire financial situation and the concomitant subjective intention to prejudice creditors by putting assets beyond their reach for the purposes of judicial execution. In the case of a fraudulent transaction of this kind, there is thus usually an actual intention to defraud, whilst there is not necessarily such an intention in the case of the mere transaction at an undervalue. Fraudulent conveyance provisions usually apply in bankruptcy as well as in the individual debt-collecting procedure. The reason for such provisions is that these transactions will cause the debtor to dissipate the estate assets to the detriment of his creditors when he already cannot pay all his debts in full.

In the case of a preferential transaction, an existing creditor receives a benefit either in the form of a pre-bankruptcy settlement of the debt in full or by an improvement in his status as a creditor in that he is elevated from being an unsecured creditor to the rank of a secured creditor on the eve of bankruptcy, thus escaping the ordinary queue provided for payment in bankruptcy. Many systems limit the setting aside of this kind of provision to

² Although England is referred to, this is actually a reference to both England and Wales.

bankruptcy, but some make it available outside bankruptcy as well.³ In essence, preference law is aimed at maintaining equality among the creditors as far as possible.

Since there may be different dispensations for individuals and corporate debtors in this regard, the article will also be limited to the position of corporate debtors in liquidation; in other words, under formal bankruptcy.

1.2 Preliminary Remarks Regarding Avoidance Rules and Terminology

When analysing a topic in an international framework, it is important to consider and establish the requisite terminology.⁴ In the context of bankruptcy law there are different approaches in various countries. In many instances, principles dealing with certain aspects are more or less the same, but the terminology used will differ – even among English-speaking countries steeped in the common-law tradition. In some instances, there are also differences in approach with regard to the treatment of debtors who are natural persons (individuals) and debtors that are corporate debtors. Some systems have unified bankruptcy legislation that deals with the various categories of debtors, while other systems have separate legislation for the different categories of debtors.⁵ It is also important to note that lately much effort is being put into the ideal of establishing international norms – both for the purposes of cross-border insolvency rules and to harmonise domestic insolvency laws.⁶

Many terms are used to refer to avoidance provisions in general, such as voidable or impeachable transactions, or dispositions, or claw-back provisions; but the terms ‘avoidance provisions’ or ‘avoidable transactions’ will be used here to refer to those legal transactions that occurred before the effective or relevant date of bankruptcy and that may be set aside or otherwise be rendered ineffective.

Avoidance provisions in bankruptcy usually relate to an effective or relevant date established by statute, or a judicial ruling that indicates the formal commencement of bankruptcy proceedings. The effective date is extremely important in order to calculate relevant time periods for the

³ See, eg, s 3 of the amended German Gesetz über die Anfechtung von Rechtshandlungen eines Schuldners außerhalb des Insolvenzverfahrens, the Anfechtungsgesetz (‘the AnfG’).

⁴ See Jay Lawrence Westbrook ‘Choice of Avoidance Law in Global Insolvencies’ (1991) 17 *Brooklyn Journal of International Law* 499 at 504 ff, where the author established a framework to analyse various legal systems in this regard. This system is also acknowledged and used as a point of departure for this article. See also Philip R Wood *Principles of International Insolvency Law* 2 ed (2007) at 458 ff.

⁵ On these and other differences, see Bob Wessels ‘Insolvency Law’ in: Jan M Smits (ed) *Elgar Encyclopedia of Comparative Law* (2006) at 294 ff.

⁶ The UNCITRAL Legislative Guide on Insolvency Law 2004 (http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html) and the World Bank Principles and Guidelines for Effective Insolvency and Creditors Rights 2001 and 2005 (<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/LAWANDJUSTICE/GILD/0,,contentMDK:20196839~menuPK:146205~pagePK:64065425~piPK:162156~theSitePK:215006,00.html>) may be mentioned as two prime documents in this regard.

purposes of avoidance provisions. Usually this date is set as the date of formal bankruptcy, but it is sometimes set as the earlier date on which the petition to apply for formal bankruptcy is filed.

The term 'bankruptcy' will also be used to refer to the situation in which a company or corporate debtor is in liquidation; in other words, under formal bankruptcy.⁷ In this regard, it must be noted that the date of filing for bankruptcy usually precedes the actual advent of formal bankruptcy. Both these moments (ie, the date of filing or formal bankruptcy) may be relevant for calculating the time periods that are in many instances prescribed as elements of avoidable transactions. Many systems also provide for the setting aside of these transactions in the case of corporate rescue, but this topic also falls outside the scope of this article.

By way of introduction, it should also be mentioned that relevant legislation usually defines important elements of avoidable provisions such as estate assets or property, what amounts to a transaction or disposition, and sometimes presumptions regarding the state of insolvency of a debtor. These transactions become relevant from the point of view of avoidance if they are entered into when the debtor is also already insolvent, or if they cause the debtor's insolvency. The term 'insolvency' may also mean factual (ie, balance-sheet insolvency) or commercial insolvency (ie, cash-flow insolvency). Systems also differ with regard to this element and its relevance for avoidance provisions. The main avoidance provisions traditionally cover fraudulent conveyances, transactions at an undervalue, and preferences.

It is noticeable that several elements apply in almost all the systems, but that they differ in a number of ways. A standard requirement for avoiding a transaction is the prescribed time periods during which the transaction must have occurred. Some systems prescribe longer periods where the debtor and the recipient are related or connected persons as defined. Some avoidable transactions require the subjective intent to prejudice creditors with a particular transaction as an element and/or the more objective ordinary course of business. The onus of proof regarding the core elements for avoiding is usually on the insolvency representative. In some systems these elements previously mentioned and/or the state of insolvency are presumed when the transaction occurred within a so-called suspect time period, in which instances the recipient will have to rebut those presumptions in order to save the transaction. Some systems provide statutory defences to the recipient or beneficiary that could also prevent the transaction from being avoided.

As indicated above, this article will concentrate on the mainstream avoidance provisions: fraudulent conveyances and preferences. In many systems, there are related remedies in that specific avoidance provisions are developed to deal with pertinent issues such as voiding the granting of

⁷ However, it must be noted that avoidable transactions are in many instances also available in cases of formal business rescue procedures.

securities,⁸ extortionate credit transactions in England,⁹ and the avoidance of leveraged buyouts in the United States of America.¹⁰ Set-off is also viewed as some form of preference that may be ignored in certain circumstances.

Some systems also protect transactions emanating from the formal financial markets that would otherwise be avoidable.¹¹ The rights of bona fide third-party recipients of the assets initially disposed of are in many instances protected.¹² Then the insolvency representative may claim the monetary value of such an asset from the first recipient.¹³ The recipient who has given consideration in return for the benefit received from the debtor may also enjoy some protection with regard to such consideration.¹⁴

The legal procedure to attack a transaction will often entail a formal legal action in a court of law, but in some instances, other bodies, such as an insolvency regulator, may decide on the fate of a particular transaction. There are also various dispensations available to finance such legal actions. Some systems also have special limitation provisions that apply to the periods in which to invoke these remedies.

When a transaction is set aside, the consequence is usually that the beneficiary must return the benefit received from the debtor, or, if it is no longer available, its market value at the time of the transaction. In some instances, and usually where the parties have colluded, the recipient must also pay damages over and above the return of the asset or its market value to the estate. Sometimes in such a case, the transaction may also attract criminal liability.

2 A Theoretical Framework for the Doctrine of Avoidable Transactions

2.1 The Historical Development of Avoidable Transactions

Rules designed to avoid certain transactions that are to the detriment of creditors developed concomitantly with execution (debt-collecting) procedures of property. These procedures can be classified as individual debt-collection devices when creditors use their individual rights, by way of judgment and execution, to realise their debts from their debtors' assets. By contrast, these rights become collective when the debtor becomes insolvent

⁸ See, eg, s 245 of the (English) Insolvency Act 1986 (c. 45) and s 534 of the (Indian) Companies Act 1 of 1956 that deal with the avoidance of floating charges.

⁹ See s 244 of the (English) Insolvency Act 1986 that deals with extortionate credit transactions.

¹⁰ In other words, where the management of a failing company causes the company to borrow against its assets and to use this loan to buy the stock of the management at inflated prices.

¹¹ See, eg, s 165 of the (English) Companies Act 1989 (c. 40) and ss 35A and 35B of the (South African) Insolvency Act 24 of 1936.

¹² See, eg, s 32(3) of the (South African) Insolvency Act 1936.

¹³ See, eg, s 33(2) of the (South African) Insolvency Act 1936.

¹⁴ See, eg, s 548(c) of the US Bankruptcy Code of 1978; s 33(1) of the (South African) Insolvency Act 1936.

and the assets have to be distributed equally among the creditors.¹⁵ It is thus said that the advent of formal bankruptcy sets the collective debt-collecting procedure in motion, and that it would be highly inequitable to disregard what occurred with regard to the disposal of estate assets prior to the granting of such an order.¹⁶

This problem was realised centuries ago within the ambit of individual debt-collecting procedures.¹⁷ Legal systems therefore developed rules to discourage debtors from putting their assets beyond the reach of their creditors. These rules were designed to avoid otherwise perfectly valid transactions entered into before bankruptcy. This produced a doctrine of avoidable transactions that forms an integral part of the collecting devices in execution law.

Avoidable or voidable transactions par excellence are divided into two distinct categories, ie, 'fraudulent conveyance law' and 'preference law'. Glenn¹⁸ states that both fraudulent conveyance law and preference law are within the field of creditors' rights. He refers to both as 'that body of doctrine which bears the name of creditors' rights'.

2.2 Fraudulent Conveyance Law

Fraudulent conveyance law originally developed within the ambit of rudimentary debt-collecting procedures. This began as individual execution, but in its developed form also became operative within the ambit of collective debt procedures, ie, bankruptcy. As this fraudulent conveyance law infringes creditors' rights in both these instances, it should be studied in the light of judgment and execution (being the general law, also referred to as non-bankruptcy law), as well as its operation within bankruptcy law.¹⁹ Fraudulent conveyance law is thus not restricted to bankruptcy law.

Fraudulent conveyance law is intended to strike down actions designed to hinder, delay or defraud creditors, or such dispositions made by an insolvent debtor for less than, or without, a fair consideration.²⁰ Such acts by the debtor have a direct bearing on his financial state of solvency or insolvency, ie, his inability to pay his creditors fully. The beneficiary may be a creditor or any other person.

¹⁵ HG Bauer *The Bankrupt's Estate: A Study of Individual and Collective Rights of Creditors under Roman and Early English Bankruptcy Laws* (unpublished LLM dissertation, Southern Methodist School of Law (1980)) at 44-5.

¹⁶ See Charles Seligson 'The Code and the Bankruptcy Act: Three Views on Preferences and After-Acquired Property' (1967) 42 *New York University LR* 292:

'[T]o do so would encourage a race among creditors; engender favoritism by the debtor; and result in inequality of distribution. At bankruptcy the bankrupt would be left . . . with only tag ends and remnants of unencumbered assets.'

See also Garrard Glenn *Fraudulent Conveyances and Preferences* vol 1 (1940) at 1-7; Bauer op cit note 15 at 45.

¹⁷ See Bauer op cit note 15 in general.

¹⁸ Glenn op cit note 16 at 1.

¹⁹ *Ibid.*

²⁰ Thomas H Jackson *The Logic and Limits of Bankruptcy Law* (1986) at 69.

Fraudulent transactions or dispositions made by a debtor diminish his assets available for execution in general. These actions therefore harm the rights of the creditors vis-à-vis the debtor. A creditor or creditors who suffered loss because of the disposition is or are usually entitled to avoid the transaction. After the debtor's bankruptcy, however, the remedy will be invoked by the insolvency representative in favour of the body of creditors.

2.3 Preference Law

Preference law deals with the transfer of money or some assets of the debtor to a creditor to settle a pre-existing debt or to improve a particular creditor's position by, eg, granting him real security, thereby improving his position on the ladder of payments.

The preferential transaction or disposition benefits the favoured creditor to the prejudice of other creditors in that he receives a greater share of the debtor's assets than he would otherwise enjoy under the distributional rules of bankruptcy.²¹

Traditionally, preference law is restricted to bankruptcy law, the collective debt-collection procedure, because it adjusts the rights of creditors vis-à-vis other creditors.²² As indicated above, though, some systems also prescribe avoidance rules to be applied in this regard in the general law.

The beneficiary is always a creditor who stands in an existing relationship of debt with the insolvent debtor. This is the real distinction between a preference and a fraudulent conveyance in the form of a transaction at an undervalue, since in the case of the preferential transaction there is a lawful pre-existing obligation to pay the creditor. The obvious benefit that the payer receives in return for such payment is a discharge from his liability to pay. This payment decreases his assets but simultaneously diminishes his liabilities, and such a discharge from liability would amount to value in return for the payment made by the debtor.²³

In conclusion, preferences differ from fraudulent conveyances discussed thus far because preference law deals with the settling of a pre-existing debt, whereas the law providing for the avoidance of preferences seeks to prevent the giving of preferences by the debtor, and aims at adjusting rights among the creditors.²⁴ The rationale for a law permitting the avoidance of preferences is to promote the *pari passu* principle that in bankruptcy there should be an equal distribution of the property of the estate among creditors in general.²⁵

²¹ Robert Weisberg 'Commercial Morality, the Merchant Character, and the History of the Voidable Preference' (1986) 39 *Stanford LR* 3. Catherine Smith *The Law of Insolvency* 3 ed (1988) at 125 states that preference law is 'aimed at securing that a distribution will take place with a prescribed legal order of preference in the distribution'.

²² Glenn op cit note 16 at 1; Jackson op cit note 20 at 69.

²³ *Estate Jager v Whittaker* 1944 AD 246 at 250 per Watermeyer CJ.

²⁴ Jackson op cit note 20 at 68-9.

²⁵ Charles Jordan Tabb 'Rethinking Preferences' (1992) 43 *South Carolina LR* 981 at 987; Andrew Keay 'In Pursuit of the Rationale Behind the Avoidance of Pre-Liquidation Transactions' (1996) 18 *Sydney LR* 55.

3 Fraudulent Transactions and Preferences in the Common-law Jurisdictions

3.1 Introduction

Both Roman and English law first developed rules directed against fraudulent conveyances, dispositions, transfers, or transactions within the framework of individual property execution procedures, ie, the remedy of the general law.²⁶

To some extent, preference law stems from fraudulent conveyance law, but the settlement of an existing debt was not seen as a wrong at first.²⁷

3.2 England

3.2.1 General

The Insolvency Act 1986 that applies in England and Wales provides for the adjustment of prior transactions, including transactions at an undervalue,²⁸ fraudulent conveyances and preferences.²⁹ It must also be noted that this statute deals with both corporate and individual insolvency matters but in many instances provides separate but in some instances almost identical provisions for the various categories of debtors.³⁰ Depending on the relevant bankruptcy procedure, the insolvency representative may be a trustee, liquidator or administrator of a company under administration, but he has standing and may approach the court with a view to avoiding certain transactions.³¹

²⁶ Bauer op cit note 15 at 11 ff, 44 ff; Johan Albert Ankum *De Geschiedenis der actio Pauliana* (1962) at 25-6.

²⁷ See Glenn op cit note 16 at 654:

‘Now, the Romans thought that a preference was quite different from a fraudulent conveyance. . . The Romans . . . “did not regard a payment made in the ordinary course of business where there was no guilty intent on the part of either debtor or creditor” . . . [t]he question was one of fairness, and it was not unfair for a debtor arbitrarily to select a creditor for payment, although it left him the less able to take care of others. . . Now, as to the English system which we inherited, the preference was slow of penetration.’

Further, Weisberg op cit note 21 at 39:

‘Early English law barely apprehended the concept of the preferential transfer. Unlike the fraudulent conveyance, the preference was not illegal at common law.’

See also I Treiman *A History of the English Law of Bankruptcy: with Special Reference to the Origins, Continental Sources, and Early Development of the Principal Features of the Law* (unpublished DPhil thesis, University of Oxford (1927)); Howard Leoner Oleck *Debtor-Creditor Law* (1953) at 82; Bauer op cit note 15 at 27.

²⁸ In the case of company debtors, see ss 238-41 of the Insolvency Act 1986, and in the case of individuals, ss 339-42 of the Insolvency Act 1986.

²⁹ Section 240 (corporate debtors).

³⁰ The Insolvency Act 1986 resulted from an intensive review of the insolvency law by Sir Kenneth Cork during the 1980s, published as the *Insolvency and Practice Report of the Review Committee* Cmnd 8558 (1982). The Insolvency Act 1986 was amended by the Insolvency Act 2000 (c. 39) and the Enterprise Act 2002 (c. 40). For a full discussion, see Ian F Fletcher *The Law of Insolvency* 3 ed (2002); and LS Sealy & David Milman *Annotated Guide to the Insolvency Legislation* 10 ed (2007) for a comprehensive discussion of English bankruptcy law.

³¹ Where an insolvency practitioner from the private sector is not in office, the official receiver may act as trustee or liquidator.

3.2.2 Fraudulent Conveyances under the General Law

Although earlier legislation did deal with fraudulent conveyances to some extent,³² the famous Statute of Elizabeth, enacted in 1571,³³ formed the basis of the modern law of fraudulent conveyances.³⁴

The 1571 Act provided

'[f]or the avoiding and abolishing of feigned covinous and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments and executions, as well of lands and of tenements and chattels, . . . Devised and contrived of malice, fraud, covin, collusion, or guile, to the end, purpose and intent, to delay, hinder or defraud creditors and others . . . [they] . . . shall be utterly void, . . . and of no effect. . .'.³⁵

This statute did, however, protect those transfers effected in return for good consideration made lawfully and bona fide, and thus without knowledge of the fraud.

This Act formed part of the general law. A creditor could thus recover his claim by impeaching a fraudulent conveyance. The insolvency representative could similarly impeach such a transfer for the benefit of the creditors as a group in insolvency. Bankruptcy legislation, however, also introduced remedies that could be invoked only after the debtor had been declared bankrupt.³⁶ The latter form of statutory remedies covered what have become known as transfers at an undervalue or transfers without any or adequate consideration received in return, but these remedies clearly remain a species of fraudulent conveyance law.

Until January 1926, the 1571 Act remained the principal remedy in England that applied whether the debtor was declared bankrupt or not. The 1571 Act also remained the backbone of this species of avoidable dispositions in other common-law jurisdictions. This Act was repealed in England by the combined effect of the Law of Property Acts of 1922, 1924 and 1925, and its principles were then embodied in s 172 of the Law of Property Act 1925. In essence, this section made the conveyance of property with the intent to defraud creditors voidable at the instance of any prejudiced person.³⁷ Yet conveyances of property for valuable or good consideration and in good faith to any person who, at the time of the conveyance, had no notice of the intent to defraud creditors were protected.³⁸ In addition, various other pieces of bankruptcy

³² See Bauer op cit note 15 at 46: 'Although the now famous Act of 13 Elizabeth, c. 5 (1571) was the first English statute to be denominated a statute of "fraudulent conveyances," it is apparent that English legislation had dealt with the problem of fraudulent conveyances for two hundred years prior to the enactment of that statute.'

³³ Stat 13 Eliz c 5, 6 Stat at Large (Pick) 268 (1571).

³⁴ Oleck op cit note 27 at 83.

³⁵ This statute had a distinct penal character because of the clause giving the Crown half the recovery. The courts, however, developed it into the prime remedial measure available to creditors aggrieved by their debtor's fraudulent dispositions. See Glenn op cit note 16 at 79 ff; Frank R Kennedy 'Involuntary Fraudulent Transfers' (1987) 9 *Cardozo LR* 531 at 537.

³⁶ Cf ss 42-5 of the Bankruptcy Act 1914 (4 & 5 Geo. 5, c. 59).

³⁷ Section 172(1) of the Law of Property Act 1925 (15 Geo. 5, c. 20.).

³⁸ Section 172(3).

legislation provided for the setting aside of prior transactions including voidable settlements of property, ie, a settlement without valuable consideration.³⁹

Section 172 of the Law of Property Act 1925 was replaced by ss 423 to 425 of the Insolvency Act 1986, which introduced a new set of rules governing transactions intended to defeat and delay creditors. Although contained in the Insolvency Act, this is the remedy of the general law, because formal bankruptcy is not a prerequisite. The two preconditions for invoking these rules are a transaction at an undervalue and the purpose of the transaction being either to put assets beyond the reach of persons (creditors) making a claim against the transferor, or otherwise to prejudice the interests of such persons. Although s 423 is headed 'transaction defrauding creditors', fraud is not expressly mentioned as an element in respect of these rules. Yet it is accepted that the subjective purpose of the transaction must have been the consequential prejudice to a creditors or creditors.⁴⁰ It is accepted that these provisions have replaced the former fraudulent conveyance provisions, and that the transactions at an undervalue contained in ss 238 and 239 of the Insolvency Act 1986 are members of the same family, ie, fraudulent transactions.⁴¹ A transaction that falls within the ambit of this remedy may be set aside at the instance of either the insolvency representative or the victim of the transaction himself.⁴²

Although s 423 of the Insolvency Act 1986 has a great deal in common with the sections dealing exclusively with transactions at an undervalue in bankruptcy, it differs in the following respects. It does not require the inability to pay debts at the time of the transaction; does not impose any time limits during which the transaction must have taken place; and allows a wider range of people to apply it.⁴³

3.2.3 Transactions at an Undervalue in Terms of Bankruptcy Law

Section 238 of the Insolvency Act 1986 deals with transactions at an undervalue. It provides for the setting aside of such transactions entered into at an 'undervalue'⁴⁴ during the prescribed 'relevant time'.⁴⁵

A transaction is at an undervalue if the company makes a gift to another person or otherwise enters into a transaction with that person on such terms that the company receives no consideration, or receives consideration in

³⁹ See, eg, ss 42-5 of the Bankruptcy Act 1914.

⁴⁰ John Armour 'Transactions Defrauding Creditors' in: Howard Bennett & John Armour (general editors) *Vulnerable Transactions in Corporate Insolvency* (2003) 95 at 109.

⁴¹ John Armour 'Transactions at an Undervalue' in: Howard Bennett & John Armour (general editors) *Vulnerable Transactions in Corporate Insolvency* (2003) 37 at 39.

⁴² Section 424, and see transactions at an undervalue below.

⁴³ Rebecca Parry *Transaction Avoidance in Insolvencies* (2001) at 245-6; Harry Rajak *Company Liquidations* (1988) at 291-2.

⁴⁴ Section 238(4) and see s 339(3).

⁴⁵ The relevant time is defined in s 240; see also s 341.

money or money's worth that is significantly less than the consideration in money or money's worth that the company provided.⁴⁶

The relevant time refers to a time period as well as the financial condition of the company at that relevant time. The period is in principle two years prior to the onset of insolvency proceedings as described in s 240(3) of the Insolvency Act 1986, and the company must have been unable to pay its debts⁴⁷ or the transaction must have caused this dire financial state of affairs.⁴⁸ Transactions with 'associates' – ie, persons connected to the company⁴⁹ – create presumptions in respect of the debtor's state of insolvency during the relevant period, with the result that, in order to save the transaction, the connected person must prove that the company was in fact able to pay its debts when it entered into the transaction.⁵⁰

In general, the recipient has certain statutory defences in that he may rely on the fact that the transaction was entered into in good faith and for the purpose of carrying on the debtor's business in the belief that it would be to the benefit of the debtor company.⁵¹

3.2.4 Preferences in Terms of Bankruptcy Law

As regards preferences provided for by the Insolvency Act 1986, s 239 states that a preferential transaction must have occurred, in that the debtor must have placed a creditor, surety or guarantor in a better position than that which the person would have been in if the transaction had not taken place.⁵²

The preference must also have been made during the relevant time, which, as in the case of s 238, refers to both a prescribed period and the fact that the company was insolvent at that time.

In general, the period regarding the transaction is six months prior to the onset of insolvency that is described in s 240(1)(b). Where the creditor is connected to the company, the period is extended to two years.⁵³

The debtor must have been influenced by a desire to prefer the beneficiary.⁵⁴ Where the beneficiary is connected to the debtor, this desire is presumed and, in order to save the transaction, the beneficiary must show that the debtor was not influenced by such a desire to prefer.⁵⁵

⁴⁶ See s 238(4).

⁴⁷ In terms of s 123 both cash-flow insolvency as well as balance-sheet insolvency will suffice.

⁴⁸ Section 240(1)(a) and (2). Depending on the particular insolvency proceeding at hand, s 240(3) prescribes different periods with regard to the relevant moment for calculating the applicable period.

⁴⁹ See ss 249 and 435 regarding connected persons and associates.

⁵⁰ See s 240(2).

⁵¹ Section 238(5). In the case of individuals, s 339 prescribes a five-year period ending with the date of presentation of the bankruptcy petition on which the individual is adjudged bankrupt.

⁵² Section 239(4).

⁵³ Section 240(1)(a).

⁵⁴ Section 239(5) read with s 239(4)(b). In the important decision in *Re MC Bacon Ltd* [1990] BCC 78 at 87, the Court held that the former dominant intention to prefer has been replaced with the desire to improve the beneficiaries' position in bankruptcy. Such a desire will not be present where the company was influenced by proper commercial considerations.

⁵⁵ Section 239(6). See s 340 for a similar provision regarding individuals.

3.3 The United States of America

3.3.1 General

The current federal bankruptcy statute in the United States of America is the United States Bankruptcy Reform Act of 1978 (the ‘Bankruptcy Code’), an example of a truly unified piece of legislation in that it deals with both corporate and individual bankruptcy.⁵⁶ Bankruptcy legislation is a federal matter in the United States, while legislation such as the Uniform Fraudulent Transfer Act (‘the UFTA’) forms part of the general law that can be dealt with at state level.⁵⁷ Particular provisions concerning the avoidance of certain prior transactions were enacted in various bankruptcy statutes.⁵⁸ But these rules did not exclude the state law on fraudulent conveyances. They are treated as part of the avoidance powers of the insolvency representative, a trustee in terms of United States law.

3.3.2 Fraudulent Conveyances under the General Law

Initially the Statute of Elizabeth of 1571 was recognised in virtually every state in the United States either as part of the common law or enacted in local state legislation.⁵⁹ The Uniform Fraudulent Conveyance Act (‘the UFCA’) was promulgated in 1920 in an attempt to unify this branch of the law in all the states.⁶⁰ However, it was accepted in only twenty-six states. The draftsmen attempted to make fraudulent conveyance law more definite by defining various combinations of circumstances constituting fraudulent transfers – even when lacking the intent to hinder, delay or defraud.⁶¹ The UFCA therefore defined particular core terms, ie, ‘assets’, ‘conveyances’, ‘creditor’, ‘debt’, ‘insolvency’ and ‘fair consideration’.⁶² The purpose of the UFCA was to codify the decisions and body of law that had developed under the Statute of Elizabeth of 1571.

In 1984 the Commissioners on the Uniform Laws promulgated the Uniform Fraudulent Transfer Act (the ‘UFTA’), which was intended to replace the

⁵⁶ The Bankruptcy Code of 1978 (Title 11 of the US Code) came about as a result of the *Report of the Commission on the Bankruptcy Laws of the United States* HR Doc no 137 93d Congress session 1973. The Bankruptcy Code was further amended in 2005 by the Bankruptcy Abuse, Prevention and Consumer Protection Act of 2005. For an exposition of the current legislation, see Jeffrey Thomas Ferriell & Edward J Janger *Understanding Bankruptcy* 2 ed (2007).

⁵⁷ Ferriell & Janger *ibid* note 56 at vii and 582.

⁵⁸ See, eg, ss 67 and 70 of the former Bankruptcy Act of 1898.

⁵⁹ Douglas G Baird & Thomas H Jackson *Cases, Problems and Materials on Bankruptcy* 2 ed (1990) at 247.

⁶⁰ Louis J Vener ‘Transfers in Fraud of Creditors Under the Uniform Acts and the Bankruptcy Code’ (1987) 92 *Commercial LJ* 218 at 221-2.

⁶¹ Elizabeth Warren & Jay Lawrence Westbrook *The Law of Debtors and Creditors: Text, Cases, and Problems* (1986) at 122 submit that the most important aspect of the UFCA was that it added to fraudulent conveyance law the concept of ‘constructive fraud’ which permits the avoidance of certain transactions that can be regarded as unfairly disadvantageous to a transferor’s creditors, regardless of the intent of the parties involved.

⁶² *Idem* at 123 ff.

UFCA. By far the majority of states have since adopted the UFTA.⁶³ Its s 1 defines certain terms that are largely in accordance with similar terms found in the present Bankruptcy Code.⁶⁴ An interesting feature of the UFTA is that it does not deal only with the avoidability of fraudulent transfers,⁶⁵ but also makes a preferential transfer in favour of an insider in order to settle an antecedent debt voidable if the insider had reasonable cause to believe that the debtor was insolvent.⁶⁶

Section 544(b) of the Bankruptcy Code empowers the insolvency representative to avoid any pre-bankruptcy transfer that is voidable under applicable law by a creditor holding an unsecured claim that is allowable. It thus incorporates state fraudulent conveyance law, state law based on the Act of Elizabeth 1571, the UFCA or the UFTA into the Bankruptcy Code, thereby making it available as a remedy to the insolvency representative as well.

3.3.3 Transactions at an Undervalue in Terms of Bankruptcy Law

Section 548 of the Bankruptcy Code of 1978 now deals with fraudulent transfers in insolvency.⁶⁷ Based on s 7 of the UFCA, s 548(a)(1)(A) of the Bankruptcy Code grants the trustee the power to invalidate transfers made or obligations incurred by the debtor that were made or incurred on, or within two years before the filing of the bankruptcy petition, made voluntarily or involuntarily with the actual intent to hinder, delay or defraud creditors. Section 548 denounces transfers as defined in s 101(54) made with actual, ie, subjective, intent to defraud existing or future creditors, as well as constructively fraudulent transfers.⁶⁸

Section 548(a)(1)(B) in particular resembles ss 4 to 7 of the UFCA. It provides in principle for the avoidance of constructively fraudulent transfers where the debtor

- (a) received less than a 'reasonably equivalent value';
- (b) was insolvent or became insolvent as a result of this; or
- (c) was engaged in business or was about to engage in a business transaction for which his remaining property was deemed to be unreasonably small capital; or

⁶³ See Douglas G Baird & Thomas H Jackson 'Fraudulent Conveyance Law and Its Proper Domain' (1985) 38 *Vanderbilt LR* 833.

⁶⁴ *Ibid.*

⁶⁵ See ss 4 and 5(a) of the UFTA.

⁶⁶ See s 5(b) of the UFTA.

⁶⁷ See in general Ferriell & Janger op cit note 56 at 581-602.

⁶⁸ Constructive fraud refers to the transaction at an undervalue where the debtor does not receive reasonably equivalent value in return. In other words, no actual fraudulent intent is present in this instance (see Ferriell & Janger op cit note 56 at 585).

- (d) intended to incur or believed that he would incur debts beyond his ability to pay, or⁶⁹
- (e) made such transfer to, or for the benefit of an insider, or incurred such obligation to, or for the benefit of an insider under an employment contract and not in the ordinary course of business.

The most important difference between s 548 and state law is that the former applies only to transfers that took place within two years prior to the filing of the bankruptcy petition.

3.3.4 Preferences in Terms of Bankruptcy Law

In terms of s 547(b) of the Bankruptcy Code, the insolvency representative may avoid any transfer of an interest of the debtor in property when such transfer is –

- (a) to or for the benefit of a creditor;
- (b) for or on account of an antecedent debt owed by the debtor before transfer was made;
- (c) made while the debtor was insolvent;
- (d) made during the prescribed period that is usually 90 days before the date of the filing of the petition, or between 90 days and one year before the date of the filing of the petition, if the creditor at the time of such transfer was an insider;⁷⁰ and

the transfer enabled such a creditor to receive more than the latter would have received under a ch 7 proceeding.

Section 547(c) contains defences against an attack on such a transfer, of which the following may be mentioned:

- Section 547(c)(1) protects the transfer to the extent that it was intended by the debtor and creditor to be a contemporaneous exchange for new value.
- Section 547(c)(2) protects the transfer if the debt was incurred in the ordinary course of business or financial affairs of the debtor and the transferee; *and* either the transfer was made:
 - in the ordinary course of business or financial affairs of the debtor and the transferee; or
 - according to ordinary business terms.⁷¹
- Section 547(c)(9) protects transfers of less than \$5,000 because such small transfers have little effect and cannot be recovered in a cost-effective way.

⁶⁹ Note that s 548 of the Bankruptcy Code differs from the UFCA in that it applies to transfers of both exempt and non-exempt property. The test in the amended s 548(a)(1)(B) is 'reasonably equivalent value' whilst the term used in ss 4-7 of the UFCA is 'fair consideration'.

⁷⁰ See s 101(31) for a definition of the term 'insider'.

⁷¹ The 2005 amendments eased the burden for the recipient to ward off an avoidance claim by allowing him to prove either the elements listed in the text above in (b)(i) or (b)(ii): see ss 547(c)(2)(A), 547(c)(2)(B) and Ferriell & Janger op cit note 56 at 566-76.

Under s 547(f), the debtor is presumed to have been insolvent on, and during the 90 days immediately preceding, the date of the filing of the petition. The estate representative has the burden of proving the avoidability of a transfer under subs (b) and the creditor or party in interest against whom recovery or avoidance is sought carries the burden of proving the non-avoidability of a transfer under subs (c) of this section in order to prevent the transaction from being set aside.⁷²

4 Fraudulent Transactions and Preferences in Some Civil-law Jurisdictions

4.1 The Historical Development

Two praetorian remedies of Roman law – the *restitutio in integrum* and *interdictum fraudatorium* – were initially available to recover property fraudulently transferred by the debtor.⁷³ These earlier remedies caused the eventual embodiment of the well-known *actio Pauliana*, which clearly stems from the codification of Justinian, much earlier than the Act of Elizabeth of 1571.⁷⁴ Roman law, like early statutes in English law, first directed its attention to dispositions that were fraudulent.⁷⁵

The essential elements for successfully invoking the *actio Pauliana* against the recipient are that there was a fraudulent disposition of his property by a debtor; the disposition must have caused or increased the alienator's insolvency; and the recipient must have participated in the fraud. If the property was obtained by a lucrative title (eg, a donation), the fraudulent intention of the debtor would suffice.⁷⁶

As early as the fifteenth century, in conjunction with the development of bankruptcy law, certain statutory adjustments were made to the *actio Pauliana* of the Roman law, especially in Italian and French law. In the law of insolvency, presumptions concerning insolvency and fraud and so-called suspect periods were introduced in Italian law.⁷⁷ Rules were also introduced in France that related the date of formal bankruptcy back to the date of the cessation of payments by the debtor.⁷⁸ Similar developments emerged in other

⁷² See s 547(g) of the Code.

⁷³ Anjum op cit note 26 at 17, 52 ff.

⁷⁴ Dig 42.8 and C 7.75. See in general Otto Lenel 'Die Anfechtung von Rechtshandlungen des Schuldners im klassischen römischen Recht' in: *Festschrift zu August Sigmund Schultzes siebenzigstem Geburtstag* (1903) at 23.

⁷⁵ Kennedy op cit note 35 at 535.

⁷⁶ See Dig 42.8: Quae in fraudem creditorum facta sunt, ut restituantur. Max Radin 'Fraudulent Conveyances at Roman Law' (1931) 18 *Virginia LR* 109 at 111 points out that the term 'fraus' in Latin does not mean 'fraud' in the sense of deceit. The word for that is 'dolus'. 'Fraus' means 'prejudice' or 'disadvantage'.

⁷⁷ See in general Walter Gerhardt *Die systematische Einordnung der Gläubigeranfechtung* (1969) at 77.

⁷⁸ JH Dalhuizen *Dalhuizen on International Insolvency and Bankruptcy* (1986) vol 1 in par 2.34 n34 and par 3.327 n30.

civil-law countries as well, and these statutory amendments became known as the improved actio Pauliana provisions.

Principles concerning the actio Pauliana that evolved in Roman law were also adopted in the later Roman-Dutch law. Great lawyers of the time systemised the principles,⁷⁹ but they remained in essence the rules that evolved in Roman law and that were subsequently codified in the Code of Justinian.⁸⁰

A development similar to that in English law took place in the Netherlands.⁸¹ For some time the actio Pauliana remained the general law on the subject. But insolvency laws introduced provisions dealing with fraudulent conveyances in insolvency.⁸² The actio Pauliana remained the remedy of the general law until the codification of the Dutch law.⁸³

In conclusion, one may say that, just as the Act of Elizabeth of 1571 was important for the development of avoidance transactions in common-law jurisdictions, so the actio Pauliana became the backbone of this important part of the law in the civil-law jurisdictions.

4.2 Current Dutch Law

4.2.1 General

The Faillissementswet of 1897 (the 'Fw') is still the main bankruptcy statute in the Netherlands.⁸⁴ This Act deals with three types of bankruptcy: liquidations, suspensions of payments, and debt restructuring for individuals. It also empowers the insolvency representative, termed a 'curator' in Dutch law, to attack the prescribed avoidable transactions.

4.2.2 Fraudulent Conveyances under the General Law

'De Pauliana', as it is referred to in modern Dutch law, is dealt with in ss 3.45 to 3.48 of the Nieuw Burgerlijk Wetboek (NBW).⁸⁵ This is the remedy of the general law.

In principle, this remedy entails a rechtshandeling (ie, a legal act or transaction whereby property is disposed of, either without value or for

⁷⁹ See Robert J Pothier *Commentarius ad Pandectas* ad Dig 42.8; Johannes Voet *Commentarius ad Pandectas* ad Dig 42.8 containing the Paulian provisions of the 17th-century Roman-Dutch law.

⁸⁰ Largely codified in Dig 42.8.

⁸¹ Although French law did influence Dutch law in this respect.

⁸² See, eg, s 3 of the Ewige Edik of Karel V of 4 October 1540; s 12 of the Ordinance of Amsterdam of 1777.

⁸³ Cf s 1377 of the Burgerlijk-Wetboek of 1898, which section was replaced by ss 3.45-48 of the Nieuw Burgerlijk Wetboek 1992. See AS De Blecourt-Fischer *Kort Begrip van het Oud Nederlands Burgerlijk Recht* (1967) for a discussion of the historical development of the Dutch Civil Code.

⁸⁴ See Peter JM Declercq *The Netherlands Bankruptcy Act and the Most Important Legal Concepts* (2002) for a comprehensive discussion of Dutch bankruptcy law. It must also be noted that the Netherlands is reviewing its rather outdated laws in this regard. It is, however, not clear when a new law will be introduced: see Bob Wessels 'International Insolvency Law in the Netherlands: The Pre-Draft of Title 10' (2008) 17 *International Insolvency Review* 143.

⁸⁵ The 'New Civil Code', referred to as the NBW. See RJK Klomp et al *Burgerlijk Wetboek* (1991).

insufficient value in return). The further requirements for successfully invoking this remedy are:

- Onverplicht verricht: ie, a voluntary disposition made where no contractual or statutory legal obligation thereto exists;
- Benadeling: ie, the creditors or even only one creditor should be prejudiced by the disposition in that it caused or increased the debtor's insolvency; and
- Wetenschap: ie, the debtor and the recipient must have been aware that the disposition would cause prejudice to creditors. (If the debtor received no value in return for the disposition, his knowledge in this regard will suffice.)

4.2.3 Transactions at an Undervalue in Terms of Bankruptcy Law

The faillissementspauliana, being the remedy in bankruptcy, is enacted in ss 42 to 51 of the Fw.⁸⁶ These sections, however, regulate both fraudulent conveyances and preferences. Section 42 is important because it deals with fraudulent conveyances in bankruptcy.

The requirements for invoking s 42 are largely similar to those prescribed in s 3.45 NBW.⁸⁷ When bankruptcy is imminent, the required knowledge concerning prejudice is in general assumed.⁸⁸ But a formal statutory presumption regarding knowledge will apply when a transaction at an undervalue is effected within one year prior to bankruptcy, or where the parties involved are associates.⁸⁹

4.2.4 Preferences in Terms of Bankruptcy Law

Section 47 of the Fw refers to transactions that amount to preferences. Although the settlement of an existing debt is in principle valid, such a payment may be set aside in two circumstances: where it is proved either that the person receiving the payment knew that the bankruptcy application of the debtor had already been filed, or that the payment was arranged between the debtor and the creditor with the intention of preferring that creditor above other creditors.⁹⁰ These provisions have been criticised recently.⁹¹

⁸⁶ The proposed new provisions for the 'pauliana' in bankruptcy have been criticised with comparative notes regarding German and English law by RJ de Weijs 'De pauliana in het Voorontwerp: over het verschil tussen één- en tweerichtingsverkeer op de valreep' (2008) 15 *Tijdschrift voor Insolventierecht* 245.

⁸⁷ Compare the text of s 42 of the FW with s 3.45 NBW.

⁸⁸ See Gijs van Dijck 'Comparing Empirical Results of Transaction Avoidance Rules Studies' (2008) 17 *International Insolvency Review* 123 at 130.

⁸⁹ See ss 43 and 45 of the Fw.

⁹⁰ See Reinout D Vriesendorp & Frans P van Koppen 'Transactional Avoidance in the Netherlands' (2000) 9 *International Insolvency Review* 47.

⁹¹ See LJ van Eeghen *Het schemergebied vóór faillissement: Een onderzoek naar de wenselijke verdeling van verhaalsrisico's van de onderneming vóór faillissement* (published doctoral thesis, Tilburg, 2006) (2006), who submits that s 47 is unjustified; and G van Dijck *De faillissementspauliana: revisie van een relic* (doctoral thesis, Tilburg, 2006), who submits that the development of remedies of

4.3 German Law

4.3.1 General

Germany reformed its bankruptcy laws during the 1990s, and the Insolvenzordnung ('the InsO'), which came into operation on 1 January 1999, is the current bankruptcy code.⁹² Although the InsO is another example of unified legislation that deals with the bankruptcy of both corporations and individuals, the avoiding provisions of the general law in Germany, like those of the UFTA in the United States of America, are contained in a separate Act, the Gesetz über die Anfechtung von Rechtshandlungen eines Schuldners außerhalb des Insolvenzverfahrens, the Anfechtungsgesetz ('the AnfG'). The AnfG was amended and updated by the Einführungsgesetz zur Insolvenzordnung ('the EGIInsO'), which introduced the current InsO.

Briefly, the position is that the InsO contains avoidance provisions in Part Three, Chapter Three ss 129 to 146 that apply in bankruptcy, and the AnfG contains those provisions that apply outside bankruptcy. Under s 129 of the InsO, the insolvency representative, the Insolvenzverwalter, will have the right to contest pre-bankruptcy transactions that amount to avoidable transactions in terms of the relevant provisions (ss 130 to 146) of the InsO. Section 146 also prescribes a general requirement for the avoidable transactions in terms of the InsO, in that they must be to the disadvantage of the creditors of the bankruptcy proceeding.

Since Germany is a civil-law jurisdiction, its law on avoiding transactions, named Anfechtungsrecht (avoidance provisions), also developed from the Paulian action.⁹³

4.3.2 Fraudulent Conveyances under the General Law

Article 1 of the EGIInsO contains the amended provisions of the AnfG. It must be noted that these provisions are broader than the traditional fraudulent conveyance law in the other systems included in this article. Like the UFTA in the United States, the AnfG also seems to include an anti-preference provision.⁹⁴ These provisions are available to creditors,⁹⁵ but s 6(1) states that the insolvency representative may continue with such action initiated by a creditor if bankruptcy intervenes.

The general rule is stated in s 1 of the AnfG: transactions by a debtor that prejudice the creditors may be subject to avoidance proceedings as provided for in the AnfG.

private law in general prevents the practical problems in applying ss 42-51 Fw. For a full overview, see B Wessels 'Gevolgens van faillietverklaring' (2) *Series Wessels Insolventierecht* vol III (2007) at 9-231.

⁹² See Charles E Stewart *Insolvency Code, Act Introducing the Insolvency Code* (1997); Eberhard Braun *Commentary on the German Insolvency Code* (2006) for an English copy of the InsO and commentary on the InsO.

⁹³ WW McBryde, A Fressner & SCJJ Kortmann (eds) *Principles of European Insolvency Law* (2003) at 349-50.

⁹⁴ Sections 3 and 6.

⁹⁵ Section 2.

Section 4 resembles a provision on fraudulent conveyances in that it makes a transaction by the debtor without receiving (proper) consideration in return avoidable unless such transaction was effected more than four years prior to the avoidance action. But an occasional gift of minimal value is excused.⁹⁶

The AnfG also deals with transactions that amount to intentional prejudice of the creditors' rights.⁹⁷ These seem to be actions that may amount to either fraudulent conveyances or even preferences. The intention of the beneficiary or the relationship between the debtor and the beneficiary is also relevant in these instances. This provision seems to be aimed at collusive transactions between the debtor and the beneficiary. Sections 5 and 6 of the AnfG also contain avoidable provisions regarding transactions by heirs and loans in lieu of capital.

There are further elaborate provisions such as those dealing with the calculation of relevant time periods; prayers for relief; the legal consequences of avoidance and avoidance provisions against successors in title.⁹⁸ Most importantly, s 19 states that where facts contain a foreign element, the law to which the effects of the transactions are subject shall determine the avoidability of such transaction.

4.3.3 Transactions at an Undervalue in Terms of Bankruptcy Law

Section 134 of the InsO allows the insolvency representative to contest pre-bankruptcy transactions that amount to dispositions without consideration. The requirements are almost identical to s 4 of the AnfG in that the provision does not affect such transactions effected more than four years prior to the commencement of the bankruptcy proceeding. An occasional gift of minimal value is also excused.

4.3.4 Preferences in Terms of Bankruptcy Law

In terms of ss 130 and 131 of the InsO, a transaction whereby the debtor granted a creditor a security interest or satisfied the claim within three months prior to the petition for bankruptcy will in principle be contestable under the following conditions. A distinction must be drawn between so-called 'congruent coverage', where the creditor had an actual claim against the debtor, and 'incongruent coverage', where the creditor either had no claim at all or the claim was not feasible because of the manner in which it was made, or the timing thereof.

Section 131 states that incongruent coverage that was given during the month prior to the bankruptcy filing or after the filing will be contestable. Such actions that occur two or three months prior to filing may also be contestable if the debtor is unable to pay the other creditors at the time of the

⁹⁶ Section 4(2).

⁹⁷ Section 3.

⁹⁸ Sections 7, 8, 13 and 15.

act, or if the preferred creditor has known that such an act would defeat the payment of other creditors.

Congruent coverage that occurred within three months prior to the filing or even after the filing may be contestable if the debtor is unable to pay the other creditors at the time of the act and the preferred creditor was aware of this fact.⁹⁹

5 Fraudulent Transactions and Preferences in the Jurisdictions of Two Developing Countries

5.1 South African Law

5.1.1 General

South Africa has a mixed legal system because of the huge influence of both Roman-Dutch law and English law following a succession of colonisation by the Dutch and later the British. The Insolvency Act 24 of 1936 is the main bankruptcy statute and resembles earlier English law.¹⁰⁰ This Act is not a unified insolvency act, though, and especially corporate bankruptcy is largely regulated by the Companies Act 61 of 1973, whilst certain uncodified Roman-Dutch law principles still apply as well.¹⁰¹ Statutory avoidable dispositions are prescribed by the Insolvency Act, and these provisions will also apply to bankrupt companies.¹⁰² These statutory remedies are only available once formal bankruptcy of the debtor has commenced.

The uncodified principles of the *actio Pauliana* as they applied in seventeenth-century Roman-Dutch law remain the remedy of the general law that applies inside and outside formal bankruptcy. The insolvency representative is known as a trustee in the case of sequestration in terms of the

⁹⁹ Section 130 of the InsO.

¹⁰⁰ For current texts on South African insolvency law, see *Mars The Law of Insolvency in South Africa* 9 ed (2008) by Eberhard Bertelsmann, Roger G Evans, Adam Harris, Michelle Kelly-Louw, Anneli Loubser, Melanie Roestoff, Alastair Smith, Leonie Stander & Lee Steyn; *Meskin Insolvency Law and its operation in winding-up* (1990-; loose-leaf) edited by PAM Magid, André Boraine, Jennifer A Kunst & David A Burdette; and Robert Sharrock, Kathleen van der Linde & Alastair Smith *Hockly's Insolvency Law* 8 ed (2007).

¹⁰¹ A new Companies Act 71 of 2008 was assented to by the President on 9 April 2009 but it is not due to come into operation in 2009. This Act contains a new business rescue procedure but in terms of its Schedule 5, the Transitional Arrangements, ch 14 of the Companies Act 61 of 1973 will continue to regulate the winding up of insolvent companies pending new (insolvency) legislation. Such legislation may well deal with the insolvency of both individuals as well as companies. (Regarding insolvency law reform, see in general *South African Law Commission Report* (Project 63) *Review of the Law of Insolvency (Volume 1) and (Volume 2) Draft Bill* (2000), available at http://www.doj.gov.za/salrc/reports/r_prj63_insolv_2000apr.pdf).

¹⁰² The Companies Act 1973 does not contain its own avoidance provisions, but its s 339 read with s 340 make the statutory avoidance remedies provided by the Insolvency Act 1936 as well as the *actio Pauliana* available to the insolvency representative.

Insolvency Act 1936 and as a liquidator in the case of a company wound up in terms of the provisions of the Companies Act 1973.

5.1.2 Fraudulent Conveyances under the General Law

As stated above, the *actio Pauliana* of the Roman-Dutch law still applies in its original form in South African law.¹⁰³ This remedy can be invoked by a creditor who enforces a debt against a debtor whose estate has not yet formally been declared bankrupt, as well as by the insolvency representative in formal bankruptcy. To void a fraudulent conveyance under the *actio Pauliana*, the following must be proved:¹⁰⁴

- (a) the alienation must have diminished the debtor's assets;
- (b) the recipient must not have received his own property;
- (c) the debtor-alienator must have had the intention to defraud his creditors, but if value was received, the recipient must have been aware of such an intention to defraud;
- (d) the fraud must have caused the detrimental consequences for the creditors.

Unlike the position in many civil-law jurisdictions such as the Netherlands and Germany, the *actio Pauliana* has thus not yet been codified in South African law, and it is remarkable to see modern pleadings still based on this action and South African courts setting precedents on it.¹⁰⁵

5.1.3 Transactions at an Undervalue in Terms of Bankruptcy Law

In terms of the Insolvency Act, any disposition not made for value by the insolvent can be set aside by the court if the insolvency representative can prove, in instances where the disposition was made more than two years before the date of sequestration, that immediately after the disposition was made, the person disposing of the property was insolvent (in other words, that the liabilities exceeded the assets).¹⁰⁶ If the disposition was made less than two years prior to sequestration, the court can set it aside if the person who benefited by the disposition cannot prove that the assets of the insolvent exceeded his liabilities immediately after the disposition was made.

Where it is proved that at any time after such a disposition has been made, the insolvent's liabilities exceeded his assets by less than the amount of the

¹⁰³ See, eg, *Hockey NO v Rixom NO and Smith* 1939 SR 107; Mars op cit note 100 in par 13.26.

¹⁰⁴ South African courts place much reliance on the construction of Pothier ad Dig 42.8 regarding the principles of the *actio Pauliana* (see *Hockey NO v Rixom NO and Smith* supra at 118). Dig 42.8.6.14 prescribes a one-year prescription period for the institution of the action, and this period is calculated as from the date of the sale of the assets of the debtor.

¹⁰⁵ For a plea to improve this remedy in South African law, see André Boraine 'Towards Codifying the *actio Pauliana*' (1996) 8 *SA Merc LJ* 213.

¹⁰⁶ Section 26(1) of the Insolvency Act.

disposition, the extent to which it can be set aside is limited to the amount of such excess.¹⁰⁷

Section 26 of the Insolvency Act requires the insolvency representative to prove that the disposition was not made for value. The expression ‘without value’ in s 26 is not defined in the Insolvency Act. As it has no technical meaning, it should be interpreted in the ordinary sense of the word: without reasonable value or for inadequate value.¹⁰⁸ The word ‘value’ has been described, for instance, as the price that the disposed property will demand in the market.¹⁰⁹

5.1.4 Preferences in Terms of Bankruptcy Law

A disposition by a debtor may be set aside as a voidable preference in terms of s 29(1) of the Insolvency Act if it appears that the debtor, because of a dire financial situation, was unable to pay all his creditors fully but favoured a particular creditor, for instance, by making full payment of pre-existing debts. The insolvency representative must prove that:

- (a) a disposition was made by the insolvent within six months prior to sequestration;
- (b) the effect of the disposition was to prefer one creditor above the others; and
- (c) immediately after the making of such disposition the debtor’s liabilities exceeded the value of his assets (ie, the value at the date of the disposition).

If the insolvency representative succeeds in proving the above-mentioned facts, the beneficiary may raise a statutory defence that will, if successful, prevent the transaction from being set aside. The beneficiary will thus be able to avoid the setting aside of the disposition by proving, first, that the disposition was made in the ordinary course of business and second, that it was not intended thereby to prefer one creditor above another.¹¹⁰ In order to determine the ‘ordinary course of business’ the courts apply an objective test, whilst in the case of the second part of the defence, the test applied is a subjective one and is concerned with the subjective intention of the debtor, which often, in the absence of direct evidence, has to be inferred from the surrounding circumstances.¹¹¹

Section 30 of the Insolvency Act also prescribes the requirements for an undue preference. This type of preference involves a disposition of assets to a

¹⁰⁷ Ibid.

¹⁰⁸ *Estate Wege v Strauss* 1932 AD 76.

¹⁰⁹ *Bloom’s Trustee v Fourie* 1921 TPD 599.

¹¹⁰ Section 29(1).

¹¹¹ These concepts have been the subject of many judgments, as will be clear from *Cooper & Another NNO v Merchant Trade Finance Ltd* 2000 (3) SA 1009 (SCA).

creditor, made at any time before sequestration and while the liabilities of the debtor exceeded his assets, with the intention of preferring one creditor above others.

5.2 India

5.2.1 General

The current position in India resembles elements of South African law. The insolvency laws of both jurisdictions have their roots in English law and reflect the older English model that provided different legislation for companies and personal bankruptcy respectively. So there is no unified insolvency legislation.¹¹² The Companies Act 1956, as amended, contains provisions dealing with the winding up of companies. The Companies Bill of 2008 was tabled in Parliament in August 2009 and referred to the Parliamentary Standing Committee to invite comments from the public and trade bodies.¹¹³ There are two other pieces of legislation to deal with personal insolvency: the Presidency Towns Insolvency Act 1909, which applies in the provinces of Mumbai (Bombay), Chennai (Madras) and Kolkata (Calcutta); and the Provincial Insolvency Act 1920, which applies to the rest of India.¹¹⁴

Being a former English colony, India has commercial laws based largely on English law, thus English common law. As in South Africa, the Companies Act 1956 prescribes the winding-up provisions for companies, but s 529 imports certain provisions of the insolvency laws that will apply in prescribed instances.¹¹⁵ In the case of an insolvent company that has been declared bankrupt, the Companies Act, unlike the South African statute, has its own provisions to deal with undervalue and preferential transactions.

5.2.2 Fraudulent Conveyances under the General Law

The most pertinent fraudulent conveyance remedy outside bankruptcy that resembles a classical fraudulent conveyance claim is to be found in the Transfer of Property Act 1882. In the first place, it seems that the Act of Elizabeth 1571 did apply in India in days past but that it was repealed by the Transfer of Property Act.¹¹⁶ Secondly, the pertinent provision that deals with fraudulent conveyances (transfers) in the 1882 Act is s 53, but it limits its application to immovable property.¹¹⁷ This section was clearly inspired by the

¹¹² See R Puliani *Bharat's Manual of Companies Act & Corporate Laws* (2007) and PS Narayana *Law of Insolvency* (2007) in general.

¹¹³ It is to be noted that the 2008 Companies Bill contains new provisions on winding-up as well as provisions on a consolidation of business rescue.

¹¹⁴ Against the backdrop of India's constitutional make-up consisting of states and union territories, Wood op cit note 4 at 116 indicates that the winding up of corporations is a matter for central government, whilst individual bankruptcy is both a central and a state matter.

¹¹⁵ Individual bankruptcy rules that are imported include proof by secured creditors, insolvency set-off, interest on debts and the ranking of debts (see Wood op cit note 4 at 116).

¹¹⁶ See the Schedule to the Transfer of Property Act 1882.

¹¹⁷ This provision is also analogous to ss 172 (repealed) and 173 of the later (English) Law of Property Act 1925, which Act replaced the Act of Elizabeth of 1571 in England.

Elizabethan Act since it makes the transfer of immovable property with intent to defeat or delay the creditors of the transferor voidable at the option of any creditor so defeated or delayed. Yet the rights of a transferee in good faith and for consideration are protected. Where a creditor institutes such a suit, the section states that it will be on behalf of, or for the benefit of, all the creditors. It is assumed that an insolvency representative may also invoke this provision in bankruptcy. Section 53 seems to imply that this provision will otherwise not impair any avoidable provisions in bankruptcy since it states that this section will not affect any law in force relating to insolvency.

Although not strictly a fraudulent conveyance provision, it is interesting to note that s 128 of the 1882 Act states that where a donor donates all his property, the donee who accepts such a gift becomes personally liable for all the debts due by, and liabilities of, the donor at the time of the gift. The amount of the liability, however, seems to be limited to the value of the donated property.

5.2.3 Transactions At An Undervalue in Terms of Bankruptcy Law

Section 531A of the Companies Act allows for the avoidance of voluntary transfers of movable or immovable property, or any delivery of goods, made by a company within a period of one year prior to formal bankruptcy. However, this section stipulates that such a transfer or delivery is only void if it is made outside the ordinary course of its business, or in favour of a purchaser or encumbrancer but not in good faith, and not for valuable consideration.

5.2.4 Preferences in Terms of Bankruptcy Law

In terms of s 531 of the Companies Act 1956, a fraudulent preference by the company debtor may be set aside. Any transfer of movable or immovable property, a delivery of goods, payment, execution or other act relating to property made, taken or done by, or against a company within six months before the commencement of its winding up, will be deemed to be a fraudulent preference. If the company is wound up, this fraudulent preference is deemed invalid.¹¹⁸

To constitute a preference that is fraudulent, the transaction must be made voluntarily. So a transaction made under pressure by the creditor is not a fraudulent preference.¹¹⁹

The mere fact that some preferential treatment was shown to a particular creditor will not suffice: it must thus be proved that it was one 'with a view' to

¹¹⁸ The insolvency representative carries the burden of proof (*Jayanthi Rai v Popular Bank Ltd* (1966) 36 Comp. Cas. 854).

¹¹⁹ *Monark Enterprises v Kishan Tulpule* 1992 (74) Comp. Cas. 89 (Bom).

giving such a creditor favoured treatment.¹²⁰ To constitute a fraudulent preference, the dominant motive in the mind of the company as represented by its directors should be to prefer a particular creditor. Where the transaction is made in favour of a creditor solely with a view to avoiding civil or criminal proceedings, the transaction will not be viewed as a fraudulent preference.

6 Cross-border Implications of Avoidable Transactions

6.1 General

In modern commerce, more than one jurisdiction may be involved in a bankruptcy matter. In many such instances the company debtor may own assets in various jurisdictions and may have entered into transactions that may be avoidable in some jurisdictions but not in others. In spite of a variety of legal models and a body of principles of private international law, uncertainty still prevails in many areas in the cross-border situation.¹²¹

The position with regard to avoidable transactions will be affected to some extent by the bankruptcy proceedings that are taking place in a particular case. For instance, if a company has a presence and an estate in each one of the jurisdictions included in this article and thus qualifies for bankruptcy, a separate bankruptcy proceeding may in principle be opened in each one of the jurisdictions in terms of their respective bankruptcy laws. In such an instance there will then be a number of concurrent bankruptcy proceedings, and in principle, each one of the jurisdictions will apply its own avoidance provisions to those transactions that occurred within the respective jurisdictions. If, eg, the insolvency representative from England wishes to become part of the concurrent insolvency proceeding in South Africa, he will at least have to qualify for ancillary relief in terms of South African law in order to join the South African proceeding with a view to lodging claims on behalf of the English creditors against the South African estate. The South African insolvency representative will be in charge of the South African proceeding, however, and as stated before, South African insolvency law will largely be used to attack voidable dispositions that took place within this jurisdiction.

Where there is only one (main) proceeding, eg, an English bankruptcy order, the English insolvency representative (being the foreign insolvency representative in the other jurisdictions) will have to approach each of the other jurisdictions with an ancillary proceeding, with a view to having the English bankruptcy order and his appointment as such recognised in the foreign jurisdictions. The position of a foreign insolvency representative regarding his recognition and powers to

¹²⁰ The dominant motive by making the transaction has to be ascertained, and if it is tainted with an element of dishonesty, the question of fraud arises (*Official Liquidator v Victory Hire-Purchasing Co. (P.) Ltd.* 1982 (52) Comp. Cas. 88 (Ker)).

¹²¹ See in general PJ Omar 'The Landscape of International Insolvency Law' (2002) 11 *International Insolvency Review* 173; Ian F Fletcher *Insolvency in Private International Law: National and International Approaches* 2 ed (2005).

deal with assets and related matters such as avoidable transactions in the particular foreign jurisdiction will depend on the rules of the foreign jurisdiction that may well differ from country to country.

Usually, the cross-border rules of a specific jurisdiction will be contained in local legislation, a treaty or convention that might exist between the relevant jurisdictions, supra-national legislation that applies in regions such as the European Union, or they may be based on common-law principles derived from concepts of international law such as comity that may prompt a foreign court to assist the foreign insolvency representative in this regard. Sometimes, and depending on the countries involved, a particular jurisdiction may offer more than one option for the purposes of recognition and so on.¹²²

To illustrate the complexity of the problem from the point of view of recognition, it must first be noted that a foreign insolvency representative who, eg, wishes to be recognised as such in England will have to consider whether he may qualify for the relevant recognition by utilising s 426 of the English Insolvency Act 1986. This section grants foreign insolvency representatives from certain designated ‘relevant countries’ a relative easy route to be recognised as such. Since England has also adopted its own version of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency 1997 – the Cross-Border Insolvency Regulations of 2006 – such an insolvency representative may also be able to apply for recognition in terms of this structure. Where the jurisdictions involved are European Union Member States, except Denmark, the European Union Regulation on Insolvency Proceedings of 2000 (the ‘EU Insolvency Regulation’) will apply.

The position of an insolvency representative with regard to avoidable dispositions that took place in foreign jurisdictions will raise a number of questions, such as which law will apply in such an instance and whether the representative will have the required standing to attack such a transaction in the foreign jurisdiction. The position on this aspect might be clear and well regulated in some countries but less clear and even totally unregulated in others.

Clearly, where a well-developed system is in place, an insolvency representative will have the benefit of using those procedures. But where there are no certain rules in place, the fall-back position will usually be to use the principles of private international law as they apply in such a foreign jurisdiction in order to work out which rules to apply.

Terminology that will apply in this section is the Centre of Main Interest (‘the COMI’), referring to the jurisdiction in which the debtor has been incorporated and has its head office and/or main place of business. The *lex concursus* is the law of the country in which the main bankruptcy proceeding

¹²² In general, see Bob Wessels *International Insolvency Law* (2006) for a discussion of various cross-border dispensations.

is initiated, usually where the COMI of the debtor is deemed to be. The law of the country in which a particular transaction takes place is referred to as the *lex causae*.

6.2 Hypothetical Case Study: Main Proceeding Scenario

With reference to the countries discussed in this article, a hypothetical practical problem can be raised regarding the operation of a cross-border insolvency matter. For example, the company has been incorporated in and has its main place of business and head office in England; but through branch offices, it also operates in all the jurisdictions discussed in this article, by means of local branches established in each.¹²³ If only a main bankruptcy proceeding is opened with regard to the ‘mother’ company in England where the COMI is deemed to be for the purposes of this discussion, the English insolvency representative will attempt to trace assets of the company within these other jurisdictions as well.

The first steps to take in this regard, and under circumstances in which only a main proceeding is in place, will be to approach all the various jurisdictions where the company operates through its established branches. The first aim would be to establish whether the English insolvency representative could gain recognition based on the foreign main bankruptcy order by way of an ancillary proceeding within those jurisdictions. The further aim would be to trace and attach the relevant assets for the benefit of the English creditors. Such recognition will firstly be subject to the cross-border dispensation that will apply between England and each particular jurisdiction. If such recognition can be obtained, a second question will be the extent to which the foreign jurisdiction will allow the English insolvency representative to examine and attack possible avoidable transactions. If the English insolvency representative is allowed to do so, the real question will ultimately be which legal system to apply in order to determine whether certain pre-bankruptcy transactions that have been carried out, either by the mother company or by any of its branches, are avoidable in order to reclaim the assets disposed of by such transactions.

It will thus become imperative for the English insolvency representative to consider his position with regard to the applicability of English law (the local law of the home country) or the local law of the other relevant jurisdiction. A quick glance at the various principles that apply in the various jurisdictions included in this article is sufficient to highlight the difficulties that may arise. In some jurisdictions, the same kind of disposition will not be avoidable because of different time periods or a different interpretation of core elements.

¹²³ It is to be noted that this example does not entail a group of companies since it is the same company that is operating through branches in the various jurisdictions. In a group situation, each group member remains a distinct juristic person. Clearly, the group concept also poses many difficulties from an insolvency point of view (see, eg, UNCITRAL Legislative Guide on Insolvency Law op cit note 6 in pars 82-92).

The various dispensations will also allow the English insolvency representative to apply either the home country's law or English law, which may further complicate matters.

For the purposes of the jurisdictions under review, however, it is important to note that the EU Insolvency Regulation will apply to the EU Member States in our example, ie, England, the Netherlands and Germany. Accepting that there is only a main proceeding where the court of COMI has granted the main bankruptcy order, the law of that jurisdiction (the *lex concursus*; English law in this example) will in terms of art 4(2)(m) of the EU Insolvency Regulation also regulate the avoidance of transactions that took place in the other Member States. Article 13 of the EU Insolvency Regulation, however, grants the recipient or beneficiary of such an avoidable transaction a special defence, in that he may rely on the fact that a transaction that is avoidable in the *lex concursus* would not amount to an avoidable transaction in the *lex loci*. It is notable that the EU Insolvency Regulation amounts to supra-national legislation, and in the absence of such a dispensation or a convention between non-member states, the legal positions might be less clear, as will appear below.

Where the English insolvency representative wishes to approach a court in the United States for recognition, ch 15 of the United States Bankruptcy Code, being the adopted version of the UNCITRAL Model Law, will apply. If the English insolvency representative obtains recognition for the English main proceeding in the United States, s 522(a) in ch 15 of the Bankruptcy Code grants the English insolvency representative standing to apply certain avoidable provisions of that Code.¹²⁴ When a foreign proceeding is, however, a foreign non-main proceeding, the United States court must in terms of s 522(b) be satisfied that an avoidance action relates to assets that, under United States law, should be administered in the foreign non-main proceeding.¹²⁵

In general, there is no statutory dispensation regarding cross-border insolvency matters between the Netherlands and non-EU Member states. Where such a foreign insolvency representative, eg, applies for recognition in the Netherlands, principles of Dutch private international law will apply. Assistance granted by Dutch courts in such instances in the past appears to be limited.¹²⁶ Since the Netherlands is an EU Member State, though, the EU Insolvency Regulation will apply with regard to the English bankruptcy order. English bankruptcy law, as the *lex concursus* in this instance, will thus apply,

¹²⁴ Prior to ch 15, s 304 of the Bankruptcy Code, now repealed, regulated cross-border matters. Although the provision was hailed as a progressive embracement of universality, it did not deal with all related issues such as the treatment of avoidable dispositions in a cross-border situation. See Jay Lawrence Westbrook 'Avoidance of Pre-Bankruptcy Transactions in Multinational Bankruptcy Cases' (2007) 42 *Texas International LJ* 899 for case studies as well.

¹²⁵ This section is in line with the UNCITRAL Model Law on Cross-Border Insolvency.

¹²⁶ See *Gustafsen q.q. /Mosk 24* (Supreme Court, October 1997, NJ 1999, 316) referred to in *Insol International Cross-Border Insolvency: A Guide to Recognition and Enforcement* (2003) at 161, where the Dutch court allowed the *lex concursus* to be applied in a case of an avoidable transaction but on the basis that the foreign law basically agreed with the *lex causae*, ie, Dutch law in that instance.

and therefore English avoidance provisions will in principle govern voidable transactions that took place in the Netherlands.

Braun¹²⁷ indicates that Germany has various international (or cross-border) insolvency systems that will apply, depending on the other country involved. The EU Insolvency Regulation will apply in a cross-country bankruptcy matter if Germany and any other EU Member State, except Denmark, is involved. With regard to other non-EU Member States, Part Eleven, Chapter One, ss 335 to 338 of the InsO, which is to some extent modelled on the EU Insolvency Regulation, will apply. In terms of s 335 of the InsO, the effects of an insolvency proceeding opened in another country will in principle be subject to the local laws of the home country where the debtor has its COMI. In this sense, Germany adopts the approach of universality in that it deems its bankruptcy proceedings to operate outside its borders, but simultaneously recognises foreign bankruptcy orders. In terms of s 339 a transaction may be contested by a foreign insolvency representative in Germany in accordance with the local law of the opening country (the *lex concursus* being applicable). But the beneficiary or recipient may try to save the transaction in his favour by proving that the law of another state is relevant for the purposes of the transaction and that the transaction is not contestable in terms of that particular law. In this instance, and if it is accepted that the COMI is in England, English law may be applied to attack transactions that were effected in Germany, subject to the statutory defence as explained.

Although South Africa has adopted the UNCITRAL Model Law on Cross-Border Insolvency in the form of the Cross-Border Insolvency Act 42 of 2000, this option is not yet available to any foreign insolvency representative, since the South African version includes a designation clause that makes the Act applicable only to designated countries, and no country has yet been designated.¹²⁸ Thus, in the absence of any enforceable legislative dispensation in South Africa, local common-law principles that have evolved by precedent over time will currently be applicable. So the English insolvency representative will in the first place have to approach a South African High Court to apply for recognition. As part of such a recognition order, the foreign insolvency representative will have to request the court to grant him the necessary powers that will enable him to trace and execute on local assets. His position will rest squarely on the discretion of the court, where territoriality is still largely the norm. In theory, he may ask to be allowed to attack local transactions in terms of English avoidance provisions, but the chances are good that the South African court will at best allow him to deal with such transaction in terms of South African bankruptcy law. The position is

¹²⁷ Braun *op cit* note 92 at 561.

¹²⁸ As from the moment of the first designation, South Africa will have a dual cross-border system in that designated countries will have the benefit of the Cross-Border Insolvency Act 2000, but non-designated countries will still be subject to the less predictable current uncodified system. See Alastair Smith & André Boraine 'Crossing Borders Into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law' (2002) 10 *American Bankruptcy Institute LR* 135.

nevertheless not clear, especially since the time periods in the statutory provisions are calculated as from the date of formal bankruptcy. In the absence of a statutory rule, a South African court may argue that the ancillary order in the format of a recognition order does not amount to a bankruptcy order for this purpose.¹²⁹

India at present has no specific statutory regime that deals with cross-border insolvency matters, but it is said that Indian courts nevertheless 'have a well-developed and predictable approach to issues of foreign claims, creditors and judgments including those involving cross-border insolvency issues'.¹³⁰ It seems that this jurisdiction will recognise foreign bankruptcy orders, but it is not clear to what extent, if at all, its courts will allow a foreign insolvency representative to attack transactions that occurred in India in terms of the *lex concursus*. In *National Textiles Workers' Union v P.R. Ramakrishnan*¹³¹ a constitutional bench of the Supreme Court held that foreign decisions could be followed, unless they are opposed to Indian ethics, traditions, or jurisprudence or are otherwise unsuitable. In view of judgments such as this, a case to apply the *lex concursus* could certainly be argued, but it is quite conceivable that, if the foreign avoidance provision is not provided for by Indian law, the Indian court may refuse to apply the foreign law in such an instance.

Except for the jurisdictions regulated by the EU Insolvency Regulation, the other dispensations will more or less allow the English foreign insolvency representative, after recognition, to apply the principles of the *lex causae* in an attempt to avoid certain avoidable transactions that were carried out in their respective jurisdictions, except where a pertinent legal rule applies in that country that would allow the insolvency representative to apply the *lex concursus*, ie, English law, in this regard.¹³² It is to be noted that with the exception of the EU Insolvency Regulation and the German dispensation that deal with substantive issues such as the treatment of avoidable dispositions in bankruptcy as well, the other models are largely concerned with procedural issues regarding the recognition of a foreign insolvency representative or the bankruptcy order as such. The effect of such recognition on substantive issues such as which law to apply with regard to avoidable dispositions must then be considered in view of principles of private international law, in particular choice of law rules that apply in the particular country. It may thus also happen that both the local law and the law of the *lex concursus* will apply, but in many jurisdictions, this is somewhat unpredictable in the absence of clear provisions in this regard. It is, however, safe to say that in many instances the avoidable provisions of the country where the transaction took place (the '*lex*

¹²⁹ Section 23 of the Cross-Border Insolvency Act 2000, however, follows the proposal in the UNCITRAL Model Law on Cross-Border Insolvency by granting a foreign insolvency representative standing to attack transactions in South Africa in terms of local insolvency laws.

¹³⁰ See *Insol International* op cit note 126 at 127.

¹³¹ AIR 1983 SC 75, referred to in *Insol International* op cit note 126 at 127.

¹³² In this regard, the German InsO does contain a provision that emulates the position in the EU Insolvency Regulation.

causae') and where the assets that were the object of such transaction are situated will apply. The outcome will necessarily be influenced by the discretion of a local court and especially the view that the court holds regarding a universality or territoriality approach.¹³³

Although England has issued the main bankruptcy proceeding in our example, it should be mentioned that the position of a foreign insolvency representative who wishes to operate as such in England would depend on the specific English statutory measure that applies in the particular instance. Clearly, if a foreign insolvency representative comes from another EU Member State, the EU Insolvency Regulation will apply. Where the Cross-Border Insolvency Regulations of 2006 apply, a foreign insolvency representative will in terms of art 23 at least have the standing to attack avoidable transactions but in terms of the prescribed sections of the English Insolvency Act 1986. Foreign insolvency representatives from relevant and designated countries who rely on s 426 of the Insolvency Act 1986 will to some extent be in the hands of the courts. In this last dispensation, however, it seems that an English court will apply principles of private international law that may allow the court to prescribe either English law or the substantive law from the foreign jurisdiction.¹³⁴

6.3 A Special Case Study: Concurrent Proceedings

In this instance, at least two bankruptcy proceedings with regard to the same debtor are opened in different countries. The country where the COMI of the company is deemed to exist will operate the so-called main bankruptcy proceeding, whilst the other country where the debtor has a presence will regulate the concurrent bankruptcy proceedings. In principle, in such an instance, the bankruptcy provisions of the respective jurisdictions will be applied with regard to assets situated in each country, but clearly a foreign insolvency representative may apply for recognition in order to prove claims and participate in the other bankruptcy proceeding, though in accordance with the law of the relevant country. In the absence of a firm legal principle that may apply, it is improbable that a foreign insolvency representative will be allowed to apply his home-country avoidance provisions in such an instance.

However, estate representatives must always be mindful of all the legal avenues open to them when dealing with a cross-border situation. In an extraordinary South African case, a foreign company incorporated in Namibia opened a branch in South Africa that was properly registered in terms of South African company law as an external company.¹³⁵ The Namibian-based company contracted the services of a South African company but because of

¹³³ See Westbrook op cit note 124 at 914.

¹³⁴ Section 426(1) of the (English) Insolvency Act 1986. See also *Hughes v Hannover-Ruckversicherungs AG* [1997] BCC 921.

¹³⁵ *Sackstein NO v Proudfoot SA Pty (Ltd)* 2006 (6) SA (SCA) at 358 and the preceding judgments in the same matter reported in *Sackstein NO v Proudfoot SA (Pty) Ltd* 2003 (4) SA 348 (SCA) and *Sackstein NO v Proudfoot SA (Pty) Ltd* [2005] JOL 14088 (W).

its dire financial situation failed to pay its debts. Then, prior to its liquidation, the Namibian company paid the South African creditor by way of a money transfer from its Namibian bank account to the creditor's South African bank account. Meanwhile, the South African branch of the Namibian company was also liquidated in South Africa. As a result, there was a concurrent bankruptcy proceeding that makes the situation a bit different from the hypothetical case study above where there is clearly only a main proceeding in operation. The South African insolvency representative acting on behalf of the liquidated South African branch could also have approached the Namibian Court for a recognition order with a view to invoking Namibian avoidance provisions, but he elected to contest the aforementioned payment by the Namibian company in accordance with South African avoidance provisions. (Coincidentally, the relevant Namibian provisions are virtually identical to their South African counterparts.) While the South African insolvency representative attempted to establish his standing to attack this payment in a South African court, the Namibian court granted an order based on a compromise that rescinded the Namibian liquidation order of the mother company. The South African branch remained under liquidation in terms of South African law. The South African insolvency representative, seeking to claim the payment that had emanated from Namibia, relied on the fact that the mother branch in Namibia and its daughter branch in South Africa were one and the same entity, but he then looked to South African courts and bankruptcy law in order to contest the transaction in South Africa because the money was within the boundaries of South Africa.

In the end, and after some years of litigation in this regard, the South African Supreme Court of Appeal ruled that the South African insolvency representative's claim could not proceed because of the effect of the Namibian court order. This judgment thus foiled the territorial approach adopted by the South African insolvency representative, and the South African court used the 'one company' concept against the insolvency representative in the end. However, from the court's point of view it did acknowledge what had happened in Namibia. (It must be noted that this was not a group of companies where each company kept its separate corporate identity. Suffice to say that avoidable transactions that occurred within a group of companies will pose another set of difficulties that fall outside the scope of this article.)

7 A Futuristic View

Despite the fact that the various jurisdictions considered for the purposes of this article are based on either the common law, the civil law, or a blend of these legal systems, the avoidable transactions as provided for in each jurisdiction share certain core characteristics.¹³⁶

¹³⁶ See pars 3-5 *supra*.

In order to assist countries that are in the process of reforming their local bankruptcy laws, various international instruments emanating from important bodies, such as UNCITRAL and the World Bank, contain principles and guidelines designed to assist such countries when conducting the actual reform.¹³⁷ On the one hand, the aim of these guidelines is to try to set minimum standards regarding the bankruptcy principles that should apply in all jurisdictions, while, on the other hand, their implementation may also lead towards more harmonised local bankruptcy laws on a global scale.

With regard to avoidance provisions in cross-border matters, UNCITRAL followed a cautionary approach by indicating that this is one of the difficult areas to manage in a cross-border scenario.¹³⁸ The UNCITRAL Model Law on Cross-Border Insolvency, which has in the meantime been incorporated into the UNCITRAL Legislative Guide on Insolvency Law 2004, proposes in art 23 that a foreign insolvency representative must have standing to bring an action to contest avoidable dispositions. However, the matter is otherwise left open to the adopting countries to provide the particulars, such as the substantive principles relating to avoidance provisions to be applied in a particular cross-border case.¹³⁹

At the same time, an extensive debate continues about the setting of norms and standards regarding avoidance provisions in general.¹⁴⁰ Some researchers are conducting surveys to fathom the cost-effectiveness of the various provisions in this regard.¹⁴¹ In general, it may be stated that where elements are prescribed that call for extensive judicial inquiry, such as subjective intentions or ordinary course of business requirements, the more expensive the litigation to attack such provisions may become. A strict rule that allows for minimum defences and is based more on objective criteria will be more certain and more cost-effective to apply, but it may in some ways hamper economically desirable transactions. In this regard the UNCITRAL Legislative Guide on Insolvency Law states in par 154 that the design of avoidance provisions requires a balance to be reached between competing social benefits such as, on the one hand, the need for strong powers to maximise the value of the estate for the benefit of all creditors and, on the other, the possible undermining of contractual predictability and certainty. It may also require a balance to be reached between avoidance criteria that are easily proved and

¹³⁷ See the UNCITRAL Legislative Guide on Insolvency and the World Bank Principles and Guidelines for Effective Insolvency and Creditors Rights op cit note 6. For a comprehensive view of international instruments, see Bob Wessels *Cross-Border Insolvency Law: International Instruments and Commentary* (2007).

¹³⁸ Explanatory Memorandum to the implementation of the UNCITRAL Model Law on Cross-Border Insolvency.

¹³⁹ From the discussion supra, it is clear that those countries that have already adopted the UNCITRAL Model Law on Cross-Border Insolvency prefer to allow a foreign insolvency representative to use their avoidance provisions.

¹⁴⁰ Cf Tabb op cit note 25; Alastair Smith 'Presuming, Assuming, and Inferring an Intention to Prefer a Creditor in Impeachable Preferences' (2001) 13 *SA Merc LJ* 1; Thomas GW Telfer 'Voidable Preference Reform: A New Zealand Perspective on Standards and Goalposts' (2003) 12 *International Insolvency Review* 55.

¹⁴¹ See, eg, Van Dijk op cit note 88 at 141.

will result in a number of transactions being avoided, and narrower avoidance criteria that are difficult to prove but more restricted in the number of transactions that will be avoided successfully.

In view of the numerous problems faced by creditors and insolvency representatives in cross-border bankruptcy generally, initiatives have been launched in order to establish more predictable cross-border rules. Some countries have entered into treaties or conventions, either among themselves or on a wider regional basis.¹⁴² Supra-national legislation has been adopted among participating countries, of which the EU Insolvency Regulation is probably the best-known example at present.¹⁴³ The provision in the EU Insolvency Regulation that deals with the cross-border application of the *lex concursus*, also with regard to substantive issues such as avoidable transaction provisions, may serve as a suitable model for reform. In fact, Germany has already adopted a similar provision as part of its InsO that would apply in a cross-border situation between Germany and non-EU Member states.

A few countries have elaborate local legislation to deal with cross-border insolvency matters.¹⁴⁴ The UNCITRAL Model Law on Cross-Border Insolvency is a global initiative of the United Nations that serves as a model for reform or for establishing a local legislative framework on cross-border insolvency rules to the Member States of the United Nations. At present,¹⁴⁵ seventeen states have adopted this model law in one way or another in their respective local laws. Although the UNCITRAL Model Law on Cross-Border Insolvency is a giant leap forward in many respects, current drawbacks are the fact that relatively few countries have adopted it, it is largely limited to procedural issues, and in particular with regard to the application of avoidance rules there seems to be a tendency by such adopting states to apply their local avoidance rules in this regard. On the brighter side, these countries represent important economies, such as the United States, the United Kingdom, Mexico, Japan and Australia.

It is, however, to be noted that the UNCITRAL Legislative Guide on Insolvency Law 2004 firstly proposes minimum standards regarding the development or reform of local insolvency systems, including standards for

¹⁴² See, eg, the North American Free Trade Agreement (NAFTA) between the USA, Canada and Mexico, which envisaged a cross-border insolvency treaty among themselves. Within this context, the American Law Institute (ALI) has approved a set of principles and guidelines regarding its *Transnational Insolvency Project* (see Wessels op cit note 122 at 42-4). The ALI and the International Insolvency Institute (III) are the sponsors of a project to develop *Global Principles for Co-operation in International Insolvency Cases*, which includes recommendations regarding applicable legal principles. (The reporters are Professor Ian Fletcher (London) and Professor Bob Wessels (Leiden); for a status report, see 2008-07-doc3 ALI-III *Global Principles project well underway* (July 14th, 2008) at <http://bobwessels.nl/wordpress/?p=348>.)

¹⁴³ See also the initiative of the Organisation pour l'Harmonisation Afrique du Droits des Affaires (OHADA) in Western and Central Africa, which promotes co-operation on the harmonisation of business law among French-speaking African States. Sixteen member states have entered into a treaty that includes a harmonised bankruptcy legislative regime, together with cross-border insolvency rules that apply among the participating countries (Wessels op cit note 122 at 44-7).

¹⁴⁴ See, eg, Part 11 of the German InsO.

¹⁴⁵ See http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html (visited on 29 October 2009).

avoidance provisions. The Guide also proposes that UN Member States adopt the UNCITRAL Model Cross-Border Law on Insolvency. In theory, if these proposals were to be followed by a significant number of those states, it would set the scene among such participating countries to emulate the EU Insolvency Regulation to some extent.

In the end, bankruptcy law reform, particularly the operation of avoidable dispositions in an international context, remains an exciting evolutionary process necessitated by the realities of the twenty-first century. An eventual harmonisation of local bankruptcy laws linked to a uniform approach regarding cross-border insolvency matters will cause a natural acceptance and application of universalism in this area of the law. In spite of certain shortcomings, the UNCITRAL Model Law on Cross-Border Insolvency can thus be hailed as an important developmental model in this evolutionary chain, in that it serves as a bridge between foreign, and in some instances vastly differing, insolvency regimes.
