C.I.C.A. (Civil) CACV013/2013
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IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS
ON APPEAL FROM THE GRAND COURT
FINANCIAL SERVICES DIVISION
FSD 61 of 2013 (AJJ)
FSD 60 of 2013 (AJJ)

BEFORE

The Rt Hon Sir John Chadwick, President
The Rt Hon Sir Anthony Campbell, Justice of Appeal
The Hon John Martin, Justice of Appeal

IN THE MATTER OF THE BANKRUPTCY LAW (1997 Revision)

BETWEEN

THE GOVERNMENT OF THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

Appellant

-and-

(1) WILLIAM H. MILLARD
(2) PATRICIA MILLARD

Respondents

James Corbett QC instructed by Rebecca Hume of Kobre & Kim appeared for the Appellant

Malcolm Davis-White QC instructed by Kyle Broadhurst of Broadhurst LLC appeared for the Respondents

Hearing: 1 April 2014
Delivered 15 April 2014

JUDGMENT

MARTIN J.A.

Introduction

1. On 29 May 2013 Jones J made absolute orders for bankruptcy in respect of each of the respondents, William Millard and Patricia Millard ("the Millards"), on their own petitions.

2. Section 9 of the Bankruptcy Law (1997 Revision) entitles a person aggrieved by an order to appeal to this Court. The appellant, the Government of the Commonwealth of the Northern Mariana Islands ("the Commonwealth"), is a judgment creditor of the Millards; but its judgments are in relation to unpaid tax, and are unenforceable in this jurisdiction. For reasons explained below, the Commonwealth nevertheless claims to have been prejudiced by the making of the bankruptcy orders, and it appeals against them.

Background

3. In brief summary, the relevant background is as follows. The Millards went to live in the Northern Mariana Islands, which are an overseas territory of the United States of America, in March 1986. They say that they were attracted by a tax incentive designed to encourage United States citizens to relocate to the Islands. In September 1987 they sold their interests in a computer business for US$76.8 million. They filed tax returns in respect of the year ending 31 December 1987, and paid approximately US$4.7 million in tax on the basis that the tax incentive applied. In 1989, they were notified that the Commonwealth considered that they had paid insufficient tax. They responded through their lawyers and, so they say but the Commonwealth disputes, the Commonwealth accepted their position. In 1990 they left the Islands, and since then they have been residents of the Cayman Islands. On 1 July 1994 the Commonwealth obtained judgments in default of defence against the Millards in amounts totalling US$36,636,094.21. The proceedings that led to those judgments were

not served personally on the Millards, but were served by advertisement in the New York Times and the Marianas Variety pursuant to orders to that effect made by the United States District Court for the District of the Northern Mariana Islands. It appears to be common ground that the judgments were not served on the Millards for many years; and the Millards say that they were not aware of the judgments, or of the proceedings that led to them, until some time in 2011. The Commonwealth says that the Millards were taking steps to conceal the whereabouts of themselves and their assets, and that it was unable to locate the Millards until late 2010. In the course of 2011, the Commonwealth registered the judgments in US District Courts in New York and Florida. By that time, the judgment debts had grown very substantially through the addition of interest; indeed, by January 2013 they had increased to a total of over US$123 million. The Millards have taken steps to challenge the default judgments in both New York and Florida; they say that the costs of doing so, and resisting enforcement proceedings in Belgium and Switzerland, places great strain on their resources.

Procedural history

4. The Commonwealth's first complaint (grounds 1-3 of the Grounds of Appeal) is that the way in which Jones J dealt with the hearing on 29 May 2013 amounted to a serious procedural irregularity. It is accordingly necessary to set out the relevant procedural history.

5. The Millards presented petitions for their own bankruptcies on 10 May 2013.

6. On 14 May 2013 Henderson J declined to make a summary order on the petitions. He ordered the Millards to serve the documents filed in the proceedings on all creditors of US$50,000 or more, including creditors whose claims were disputed; and he adjourned the petitions until seven days after service on the last such creditor. The

Commonwealth notified the Court of its interest on 16 May and asked for a sight of the evidence filed in support of the petitions. On 21 May Jones J's personal assistant emailed to say that the evidence could be collected from the court office, and on the same day the Commonwealth's attorneys said they would do so on 23 May.

7. A hearing of the petitions was provisionally fixed for 5 June 2013 before Jones J. On 22 May his secretary emailed the Commonwealth's attorneys, saying:

> *June 10th is not a "concrete" date for the hearing of the Petition; however Summons for Directions will be heard on Wednesday, 29th May…. During the hearing of this Summons the Hon Judge will advise the hearing date for the Petition.*

8. On 28 May the Cause List for the following day was published. It showed the petitions as listed for a "Directions hearing".

9. A few minutes before the hearing on 29 May was due to start, the judge's personal assistant handed the parties' counsel a draft "Agency Agreement". By the terms of that agreement, the Clerk to the Court as Trustee in Bankruptcy pursuant to an "absolute order for bankruptcy" in respect of the Millards made "on 29 May 2013" appointed two named persons as the Trustee's Agents.

10. Soon after entering court, the judge stated that he "thought this was a substantive hearing" (according to the Commonwealth's note) or "was proceeding on the basis this was to be a substantive hearing" (according to the Millards' note). Despite submissions by the Commonwealth's counsel as to the basis on which it had been led to believe that the hearing was for directions only, and a description in general terms of the matters which the Commonwealth would wish to place in evidence and on which it would make submissions, the judge proceeded to make the absolute bankruptcy orders and authorise the

Trustee in Bankruptcy to appoint agents "subject to obtaining the Court's prior approval to the terms of a written agency agreement".

The Commonwealth's first complaint

11. In these circumstances, the Commonwealth complains that it was misled into believing that the hearing on 29 May 2013 would be a directions hearing only; and that the way in which the judge dealt with the matter deprived the Commonwealth of a chance to adduce evidence it wished to adduce and to develop its submissions properly in the light of that evidence.

12. I accept the Commonwealth's submissions on this point. The clear impression given by the email dated 22 May from the judge's personal assistant and the Cause List was that the hearing on 29 May would not itself be the substantive hearing, but would instead be confined to giving the directions necessary to prepare for a later substantive hearing. It was clear that the Commonwealth had relied upon that impression, and in my view it was entitled to do so. The evident purpose of the order made by Henderson J on 14 May was that substantial creditors should have an opportunity to support or oppose the petitions, and they were entitled to a proper opportunity to express their attitude to the court. The course taken by the judge deprived the Commonwealth of that opportunity. Although it is the case that a bankruptcy order, once made, relates back to the date of presentation of the petition, giving rise to a period of potential uncertainty which should not be unnecessarily prolonged, there was not sufficient urgency in this case to warrant depriving the Commonwealth of an opportunity to present its case in an orderly fashion. Moreover, as the judge himself remarked, personal bankruptcy petitions are rare in the Cayman Islands, and it was possible that the Millards' petitions were the first petitions ever presented by debtors seeking their own bankruptcies. In those circumstances, it would have been sensible for the judge to have had

the benefit of proper research into the law and full argument for and against the making of the bankruptcy orders. Yet further, the production of the draft agency agreement by the judge's personal assistant immediately before the commencement of the hearing, and the judge's statement to the effect that he expected the hearing to be the substantive hearing, gave the appearance that he had pre-judged the outcome of the hearing.

13. The Commonwealth has applied to us for leave to adduce further evidence. That evidence consists of the matters which it would have put before the Grand Court had it been given the opportunity to do so. Its intention is primarily to dispute the version of events put forward by the Millards; and it may very well be that it would not have made a difference to the outcome of the petitions even if it had been before the judge. I would nevertheless give the Commonwealth leave to adduce the evidence, on the ground that – but for the way in which the judge dealt with matters – it would have been before us in any event.

14. In a Respondents' Notice, the Millards contend that the effect of the judge's decision to proceed to deal with the petition was a refusal by him to adjourn the matter to allow further evidence to be adduced. On that basis, it is said that the decision was a case management decision which, on conventional grounds, this Court should be slow to interfere with. It is also said that the Commonwealth has a remedy for what occurred in its ability to apply for the review, recission or variation of the orders under section 8 of the Bankruptcy Law or the annulment of the orders under section 170 of the Law. As to the first point, it does not seem to me that the judge's method of dealing with matters at the hearing on 29 May can properly be characterised as a case management decision. As the Commonwealth says, it amounted to a departure from the stated purpose of the hearing, without warning and without a fair opportunity for the Commonwealth to prepare for a substantive hearing. That departure was not justified by any

exceptional urgency. Nor did the judge identify what, if any, considerations made it appropriate to turn what was stated to be a directions hearing into a substantive hearing; and, absent such identification, it is impossible to say that he exercised such discretion as he had on a sound basis. As to the second point, the short answer is that the Commonwealth was entitled to have its position considered before bankruptcy orders were made at all; it should not be forced into a situation where it has to try to deal with a *fait accompli*.

15. Taken together, the matters I have described amount in my judgment to a substantial denial to the Commonwealth of a fair hearing. Were it not for the fact that I consider that the bankruptcy orders were wrong in principle, I would have allowed the appeal on this ground and considered – in the light of the new evidence filed by the Commonwealth, and in the light of further evidence of matters occurring after the date of the bankruptcy orders which I would allow the Millards to adduce – whether bankruptcy orders should now be made.

The Commonwealth's second complaint

16. The remainder of the Commonwealth's grounds of appeal take issue with the judge's substantive decision that it was appropriate in the circumstances to make bankruptcy orders. In particular, it is said that the judge was wrong to hold that the Millards were not required to prove that they were insolvent (ground 4); that he was wrong to reject the Commonwealth's contention that the petitions were presented for an improper purpose, namely to obtain the benefit of a stay of the Commonwealth's enforcement proceedings under Chapter 15 of the United States Bankruptcy Code (ground 5); that he was wrong to reject the Commonwealth's contention that bankruptcy orders would serve no purpose (ground 6); and that he was wrong to make bankruptcy orders in circumstances where the Millards had self-declared net assets in excess of US $46 million each (ground 7).

17. The context for these contentions is as follows. The Commonwealth's judgment debts are based on tax liabilities. They are enforceable in the United States, because the liability arose in a United States overseas territory; but they are not enforceable in the Cayman Islands, which follows the policy adopted by many, if not most, nations of refusing to permit enforcement of a foreign revenue debt. The leading authority to that effect is the well-known case of *Government of India v Taylor* [1955] AC 491, in which it was held that an Indian income tax liability could not be proved in the liquidation of a company registered in England. It is accordingly common ground that the Commonwealth cannot prove for its debts in the Millards' bankruptcies. The Millards nevertheless included the Commonwealth's judgment debts as liabilities in their Statements of Affairs made in connection with their petitions. The result of doing so was that their liabilities exceeded their assets by about US $32 million. If the judgment debts had been excluded (as they should have been if the Statement of Affairs had been in the form prescribed by the Bankruptcy Rules), their assets would have exceeded their liabilities by about US $86 million.

18. It might be thought that the fact that the Millards are bankrupt in the Cayman Islands would be of little concern to the Commonwealth. The judgment debts cannot be proved in the bankruptcies, but there is on the face of it nothing to stop the Commonwealth pursuing the Millards through the United States courts. The reason that the Commonwealth claims to have been prejudiced by the bankruptcy orders, however, is that those orders have provided the trigger for the making in the United States of orders under Chapter 15 of the Bankruptcy Code staying all proceedings in the United States. Chapter 15 is the mechanism in the United States for giving effect to the UNCITRAL Model Law on Cross-Border Insolvency, and it depends upon the existence of a "foreign main proceeding", that is to say an insolvency proceeding in a country outside the United States. The Millards'

Cayman Islands bankruptcies are foreign main proceedings for the purposes of Chapter 15. On 16 May 2013, six days after presentation of the Millards' petitions, the Millards' representatives filed petitions in the Bankruptcy Court of the Southern District of New York seeking Chapter 15 recognition of the Cayman bankruptcy proceedings; and on 20 May 2013 a Judge of that Court granted provisional relief staying enforcement proceedings by the Commonwealth against the Millards in the United States. On 4 November 2013, the same Judge granted recognition of the bankruptcy orders pursuant to Chapter 15. It is clear from his written decision that the grounds on which recognition could be refused were limited; and his conclusion was that:

> *The express provisions of chapter 15, and the purposes underlying it, authorise and contemplate providing support to the Cayman Bankruptcy Proceeding; protecting U. S. assets from being grabbed (even without a bond); and allowing an opportunity to come into the U. S. courts*.

The "opportunity to come into the US courts" is an opportunity for the Trustee in Bankruptcy's agents to challenge the making of the default judgments. Thus the position is that the Commonwealth is, by virtue of the making of the bankruptcy orders, prevented from taking enforcement action in the United States without having any opportunity to take any steps in the bankruptcies themselves.

19. The Commonwealth was able to put forward its arguments against the making of the bankruptcy orders at the hearing before Jones J on 29 May 2013 (although, as I have mentioned, not as fully as it would have wished). In essence, those arguments were that it was necessary for a debtor seeking his own bankruptcy to establish that he was insolvent; that the Millards' assets exceeded their liabilities in this jurisdiction, so that they were not insolvent; that the purpose of a bankruptcy was to achieve an orderly realisation of assets and their distribution among known creditors, which purpose would not be achieved if the

Millards were made bankrupt; and that the petitions were presented for the improper collateral purpose of obtaining a Chapter 15 stay. I deal with these arguments in turn.

Is insolvency essential to a debtor's petition?

20. Section 15 of the Bankruptcy Law provides that a debtor may present a bankruptcy petition against himself without alleging any grounds. This contrasts with section 14, which specifies twelve different grounds on which a creditor may petition.

21. Section 17(1) of the Bankruptcy Law is in the following terms:

> *Every petition presented by a debtor shall be accompanied by a statement verified in the prescribed manner of the debtor's property, his debts and liabilities, his creditors, and of the value and dates of the securities held by them, and of the dates when such securities were actually given, together with a general statement of the profits, losses and expenses of any business in which he may have been engaged during the twelve months preceding the presentation of the petition, and a memorandum explanatory of the causes of his insolvency.*

22. In paragraph 8 of his judgment, Jones J held that, by contrast with the statutory provisions in England (where a debtor may petition only on the ground of inability to pay his debts), the effect of section 15 was that it was not necessary for a debtor to assert his own insolvency:

> *If a debtor is not required to allege insolvency, it seems to me that he should not be required to prove insolvency*.

He then considered section 17, and said this:

> *The requirement that a debtor must file a memorandum explaining the causes of his insolvency assumes that a person will not present a bankruptcy petition against himself unless he believes that he is insolvent in some sense, but a requirement to explain the causes of his perceived insolvency is not the same thing as requiring that he*

must allege and prove that he is insolvent by reference to the narrow test.

By the narrow test, the judge meant the Commonwealth's contention that in computing assets and liabilities it was permissible to take into account only assets located in the Cayman Islands and liabilities enforceable in the Cayman Islands. Finally, he said this, at paragraph 9 of his judgment:

I think that the combined effect of sections 15 and 17 is that a petitioning debtor must explain his financial position and show cause why a bankruptcy order should be made. I do not see any reason to interpret these provisions to mean that he must prove insolvency in the narrow sense that the realisable value of his Cayman assets is less than the amount of those liabilities which are enforceable against him in this jurisdiction.

23. In my view, the judge's conclusion about the need to establish insolvency is wrong. The assumption underlying the whole of the Bankruptcy Law and the rules made under it is that it is dealing with insolvency. This is implicit in section 14, where all the grounds on which a creditor may petition are indications of an inability to pay debts. It is implicit also in the concluding words of section 17(1) ("a memorandum explanatory of the causes of his insolvency"). Further examples are section 39, which imposes a duty on the debtor to the utmost of his power to aid in the realisation of his property and the distribution of the proceeds among his creditors; and section 67, which makes it a precondition of discharge from bankruptcy that the debtor's assets are of a value equal to 50% of the amount of his unsecured liabilities. Again, it is implicit in the form of statement of affairs prescribed by the Bankruptcy Rules, which requires the debtor to state how much of the liabilities are expected to rank for dividend (thereby assuming that they may not be paid in full). It is to be noted that the Commonwealth's judgment debts were included in the Statements of Affairs made by the Millards notwithstanding that they

were ineligible to rank for dividend at all. All of this accords with the common understanding that bankruptcy is a state of affairs involving insolvency. It follows that, although a debtor's petition need not allege any grounds, it is nevertheless necessary that the material supporting it must establish a credible case of insolvency. It is, of course, possible that a debtor will turn out not to have been insolvent at all (in which case the adjudication is likely to be rescinded under section 8 or annulled under section 170); but that possibility does not mean that a debtor need not establish at least a prima facie case of insolvency at the outset.

What assets and liabilities may be taken into account?

24. What, then, are the assets and liabilities that may be taken into account for the purpose of establishing whether or not a debtor can establish a credible case of insolvency so as to permit him to petition for his own bankruptcy?

25. The Commonwealth's argument (the narrow test rejected by the judge) was that the only assets to be taken into account were assets located in the Cayman Islands, and the only liabilities were liabilities enforceable in the Cayman Islands.

26. So far as liabilities are concerned, that argument appears to me to be correct. It is illogical to take into account, for the purpose of considering whether a debtor is insolvent and so able to petition for bankruptcy, a debt which is not itself provable in the resulting bankruptcy. That applies to liabilities which, by virtue of section 119 of the Bankruptcy Law, are not provable against a debtor's estate; and it applies also to debts, such as foreign revenue debts and gambling debts, which are unenforceable as a matter of law. To take such liabilities into account may result, as in the present case, in a situation in which the full range of bankruptcy procedures is deployed for the purpose of paying off a few relatively minor creditors, and returning a

substantial surplus to the debtor. I do not consider that to be the purpose of bankruptcy. That is not to say that the focus of a Cayman Islands bankruptcy is a purely domestic one. The debts that are capable of being taken into account do not have to be debts incurred in the Cayman Islands; they may be taken into account wherever in the world they were incurred, so long as they are enforceable in this jurisdiction. Similarly, assets may be taken into account wherever they may be situated; and to that extent I disagree with the Commonwealth's argument. Moreover, it seems to me that the ability to take into account foreign assets may, in some but not all cases, enable the existence of debts that are unenforceable in the Cayman Islands nevertheless to be taken into account as a matter of valuation. Thus, if it were the case that the Millards had substantial assets in the United States, or held shares in Cayman companies which had such assets, it would in my view be open to them to take into account when valuing such assets or shares that the Commonwealth's judgment debts were capable of being enforced against those assets or shares. In that way, the existence of the Commonwealth's debts could be indirectly recognised; but it was not, in my judgment, legitimate for them to be brought directly into account as liabilities for any purpose of the Millards' bankruptcies.

27. The Millards contend that, if they are prevented from bringing the Commonwealth's debts into account, they will be unable to take advantage of two legitimate purposes of bankruptcy: the ability to seek shelter from their creditors, and the ability to ensure that their available assets are distributed equitably among their creditors. As to the first, they say that they are being pursued relentlessly by the Commonwealth, and that the Chapter 15 stay – which is dependent upon the Cayman bankruptcy – represents their only chance of obtaining relief from the pursuit. They rely in particular on *Re Painter* [1894] 1 QB 85, in which it was held that it was not an abuse of process to present a petition whose primary object was the shielding

of a debtor against the remedies of his creditors. That was, however, a case in which the debtor was undoubtedly insolvent; and it does not seem to me to follow that, where relief from pressure is the sole object of a bankruptcy which would not otherwise occur, it is a sufficient reason on its own to make a bankruptcy order. Moreover, as the Millards themselves submitted, there is no evidence about their ability to seek bankruptcy in the United States, or otherwise take effective steps to challenge the judgment debts or their enforcement. As to the second point, the Millards say that a bankruptcy order is the only way to ensure that the Commonwealth is prevented from stealing a march on other creditors by enforcing directly against assets in the United States. They put the point in this way in their skeleton argument:

> *In the context of a worldwide insolvency, the engagement of available insolvency proceedings in another jurisdiction, so that both the Cayman and the US proceedings work towards the same aim of dealing with the worldwide insolvency, is not only not an abuse, it is a perfectly responsible and proper course to take*.

There are two things wrong with this contention. First, it has a considerable air of artificiality. The Millards' assets are said by them to consist very largely of shares in Cayman companies, and those companies very largely hold real estate in Cayman. The Millards and their companies appear to have few assets against which the Commonwealth can enforce their debts, so there is little prospect that the other creditors will be prejudiced. Although there may well be cases – such as *Re Thulin* [1995] 1 WLR 165, cited to us by the Millards - where it is desirable to make a bankruptcy order for the purpose of reaching overseas assets, this is not such a case. Secondly, and more fundamentally, the chapter 15 proceedings are ancillary to the Cayman Islands bankruptcy, and on the face of it any assets realised in the United States will be remitted to the Trustee in Bankruptcy in Cayman. If that occurs, the Commonwealth will be left without any means of enforcing its debts (except to the extent that it can do so in

other countries where the Millards have not taken steps to obtain recognition of the Cayman bankruptcy).

28. The Millards also contended that, even if they were not balance sheet insolvent, they were cash-flow insolvent, and that that was sufficient to justify the making of bankruptcy orders. A paragraph in their Respondents' Notice raised this point, since this was not the basis on which the judge dealt with the matter. However, given the very substantial surplus of assets over liabilities and the absence of any evidence of urgency or as to what steps if any the Millards were taking to realise or borrow against those assets, it seems to me that it would have been wrong to make bankruptcy orders on this basis. To do so would have meant merely that somebody else would have been charged with effecting such realisations or borrowings, and the end result would still have been that there was a substantial surplus to be distributed to the Millards. In any event, by the time the matter came before us, it was clear that the Millards were no longer cash-flow insolvent; and, although they attribute that fact to the beneficial effect of the Chapter 15 proceedings, I consider that there is no ground to uphold the bankruptcy orders on this alternate basis.

29. In the circumstances, it seems to me that the judge was wrong to grant the bankruptcy orders. Taking into account only those assets and liabilities which were properly to be taken into account, the Millards had a substantial surplus of assets over liabilities. They could not, therefore, establish a prima facie case of insolvency, and so were not entitled to present petitions for their own bankruptcy. The judge therefore had no discretion to make bankruptcy orders. I consider that the appeal should be allowed on this ground.

30. I do not regard such a result as involving indirect enforcement of the Commonwealth's judgment debts. It is because they are unenforceable in this jurisdiction that they are not to be taken into account for the

purpose of determining the Millards' solvency; and withholding bankruptcy orders, with the consequence that the Chapter 15 remedies will not be available, does not render them any more enforceable than they otherwise are. The law in this jurisdiction will not enforce foreign revenue debts; but that does not mean that it must take steps to hinder enforcement of the debts in jurisdictions where they are enforceable.

A further procedural point

31. In the course of argument before us, the court raised a further procedural point based upon section 17(2) of the Bankruptcy Law. That subsection is in the following terms:

> *No petition by a debtor against himself shall be received unless accompanied by the statement required by subsection (1), nor shall any order be made on any such petition unless a copy thereof shall have been served on the Trustee, and the Trustee, admitting such service, shall apply for such order. Any order made on such petition shall be an absolute order* (emphasis added).

32. In the present case, there was no suggestion that the Trustee had applied for the bankruptcy orders – although the orders themselves, following the prescribed form, stated that they had been made on the application of the Trustee. It was said on behalf of the Millards that the absence of any application by the Trustee was an immaterial mistake, and that the Trustee – who is also the Clerk to the Court – must have known of the applications. Given the mandatory terms of the subsection, this does not seem to me to be an adequate answer. Although it may be that the Trustee is not expected to take over the full promotion of the petitions, the requirement that the Trustee apply for the orders provides at least some assurance to the court that the orders are properly sought. Given the apparent rarity of debtors' petitions, it is perhaps unsurprising that the necessity for such an

application was overlooked; but the absence of such application means that the judge had no jurisdiction to make the orders.

33. The Commonwealth sought to amend its Notice of Appeal to raise this point, provoking fierce opposition from the Millards. Since the point goes to jurisdiction, it seems to me that the court can and should take the point of its own motion, regardless of whether it has been included in the parties' written cases. I would, however, be reluctant to base my disposition of the appeal on this point alone, since investigation of the circumstances might reveal that the Trustee had in fact adopted the petitions without making formal application. Nevertheless, this is a requirement which must in future be strictly observed.

Disposition

34. For the reasons I have given, I would allow this appeal and set aside the bankruptcy orders.

CAMPBELL J.A.

35. I agree with the judgment of John Martin JA and with the reasons he has given

CHADWICK P.

36. I also agree.