Related Party Transactions in Insolvency

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Abstract

Transaction avoidance rules are widely considered to be an important tool for the regulation of related party transactions in insolvency. Existing 'best practice' guidance on the design of insolvency laws assumes that such avoidance rules are best operationalised within collective insolvency procedures. But in many jurisdictions the commencement of collective insolvency proceedings is value destructive; so much so that creditors may prefer to see firms fail outside such proceedings, even if this means foregoing opportunities to use the avoidance tools available within them. This suggests that avoidance tools may be most powerful when available outside insolvency proceedings as well as within them. Many jurisdictions do have some such form of avoidance action, often described as the 'actio Pauliana outside bankruptcy', on their statute books. But these forms of action have been neglected in the literature on the control of related party transactions in insolvency, and, perhaps as a consequence, have not benefited from international initiatives to improve the operation of domestic insolvency rules in cross-border cases in the same way that transaction avoidance actions brought in connection with collective insolvency proceedings have benefited. The chapter begins by evaluating the case for approaching transaction avoidance within insolvency proceedings, before turning to consider aspects of the design of the 'actio Pauliana outside bankruptcy', including measures to improve its efficacy in cross-border cases.

Keywords: corporate bankruptcy, corporate insolvency, related party transactions, transaction avoidance, creditor rights

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Related party transactions in insolvency

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> "Again, if any one has transferred his property to another in fraud of his creditors, upon judgment to that effect by the chief provincial magistrate, the creditors of the transferor may seize his property, avoid the transfer and recover the thing transferred; that is, they may claim that the things have not been transferred at all and accordingly are still within the legal possession of the debtor."
>
> (Institutes of Justinian, 4, 6, 6, as translated by Radin).

Abstract

Transaction avoidance rules are widely considered to be an important tool for the regulation of related party transactions in insolvency. Existing 'best practice' guidance on the design of insolvency laws assumes that such avoidance rules are best operationalised within collective insolvency procedures. But in many jurisdictions the commencement of collective insolvency proceedings is value destructive; so much so that creditors may prefer to see firms fail outside such proceedings, even if this means foregoing opportunities to use the avoidance tools available within them. This suggests that avoidance tools may be most powerful when available outside insolvency proceedings as well as within them. Many jurisdictions do have some such form of avoidance action, often described as the '*actio Pauliana* outside bankruptcy', on their statute books. But these forms of action have been neglected in the literature on the control of related party transactions in insolvency, and, perhaps as a consequence, have not benefited from international initiatives to improve the operation of domestic insolvency rules in cross-border cases in the same way that transaction avoidance actions brought in connection with collective insolvency proceedings have benefited.

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Introduction

The managers of a failing firm may prefer to gift corporate assets to related parties than to await execution against the assets by creditors.[2] They may also wish to prefer related party creditors to creditors with whom the firm has negotiated at arm's length.[3] The latter kind of transaction causes no direct loss to the firm,[4] assuming the transfer discharges a genuine debt, but is nevertheless (assuming the firm is, or in all probability will be, balance-sheet insolvent) obviously harmful to non-preferred creditors, who are left to look to a diminished pool of assets for satisfaction. The absence of constraints (soft or hard) on either form of behaviour might be expected to adversely impact on the cost and/or availability of unsecured credit *ex ante*. Secured credit may substitute,[5] but will not always be available – the debtor may not have any assets that can be validly pledged[6] – and in any case has its own costs.[7]

There is a wealth of literature on the strategies that may be deployed by the state to regulate related party transactions.[8] The most extreme strategy is a prohibition on the firm engaging in those forms of related party transaction considered most harmful. The transfer of corporate assets by a distressed firm with a view to placing them beyond the reach of creditors would surely rank among these: it involves "the violation of one of the most fundamental norms of the debtor-creditor relationship: that the debtor will not deliberately seek to prejudice the ability of a creditor to enforce their claim against the debtor's assets".[9] But a prohibition on a firm transacting in this way, or on other forms of related party transactions considered

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2 R.C. Clark, 'The duties of the corporate debtor to creditors' (1977) 90 Harvard Law Review 505, 509-510.

3 K.S. Thorburn, 'Corporate Governance and Financial Distress' in H. Sjögren and G. Skogh (eds) *New Perspectives on Economic Crime* (Edward Elgar 2004) 83.

4 Of course, the deployment of assets to discharge debts may reduce the firm's ability to pursue its projects, with corresponding costs.

5 Thorburn n 3 at 84.

6 ibid.

7 Most obviously, in the form of constraints on the use and disposal of assets: J.D. Leeth and J.A. Scott, 'The Incidence of Secured Debt: Evidence from the Small Business Community' (1989) 24(3) Journal of Financial and Quantitative Analysis 379, 380.

8 See e.g. R. Kraakman et al, *Anatomy of Corporate Law* (3rd ed., OUP 2017) Chapter 6; L. Enriques, 'Related Party Transactions' in J. Gordan and W.G. Ringe (eds) *The Oxford Handbook of Corporate Law and Governance* (OUP 2015).

9 J. Armour, "Transactions Defrauding Creditors" in J. Armour and H. Bennett, *Vulnerable Transactions in Corporate Insolvency* (Hart, 2003), referencing the discussion in Clark n 2 of the normative ideals underpinning fraudulent conveyance law.

most harmful to creditors (e.g. related party preferences), is unlikely to be effective in an end-game,[10] unless the sanctions for breach extend beyond the firm to personally implicate its controllers.

Personal liability for controllers (for example, director liability rules, or perhaps some form of veil piercing doctrine[11]) is a more powerful strategy, but may nevertheless be an incomplete solution for creditors aggrieved by asset transfers to related parties: the pockets of directors or shareholders may not be sufficiently deep.[12] It is perhaps unsurprising then to find another strategy strongly emphasised in the literature on related party transactions in insolvency: transaction avoidance law[13], which directly targets the counterparty to the transaction – the person(s) who received value from the firm.[14] There are significant differences in transaction avoidance rules across countries,[15] but a common feature is the relaxation of substantive and/or procedural rules where the counterparty is a related party:[16] a proscribed intention on

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10 See similarly *Anatomy of Corporate Law* n 8 at 212, suggesting *per se* prohibitions are unlikely to reduce incentives to engage in "steal and run" transactions.

11 See Clark n 2 Part IV, analysing veil piercing as a substitute for and complement to fraudulent conveyance law.

12 Of course, the prospect of personal liability might be sufficient to deter the conduct altogether, particularly where the sanctions are criminal as well as civil. This kind of deterrent effect, however, will only be expected where there is a strong prospect of enforcement, and director liability rules are often only weakly enforced. Private enforcement may be hampered by a lack of incentives to bring the action, as where the action must be brought by the company itself; the possibility of a derivative action will not necessarily assist (even if such actions can be brought by creditors as well as shareholders) if recoveries will enure for the benefit of the company or the general body of creditors, rather than the initiator: see B. Black and B. Cheffins, 'Outside director liability across countries' (2005) 84(6) Tex. L. Rev 1385 (the authors focusing on outside directors, who will be less well positioned to commit the company to the kind of transactions addressed in this paper, but noting that much of their discussion of procedural and practical obstacles to the enforcement of civil liability rules applies equally to executive directors). In an insolvency context an insolvency practitioner may be empowered to bring actions in right of the company, but they will not necessarily be adequately incentivized to do so: C. Gerner-Beuerle, P. Paech and E.P. Schuster, 'Study on Directors' Duties and Liability' (LSE Enterprise Study, London April 2013) section 6.3. Public enforcement depends on *inter alia* the regulator having access to information about director (mis)conduct, but this may be scarce in an insolvency context, given that initial investigations are often entrusted to insolvency practitioners whose incentives to investigate causes of action that will not swell the estate available for distribution may be weak.

13 This term is something of a misnomer, as many transaction avoidance rules do not operate to render a transaction void *ab initio*, but rather provide for some *ex post* adjustment in the position of the counterparty: C. Cauffman, 'The Relationship between Transfer Rules and Rules on Creditors' Avoidance of Debtor's Transactions' in W. Faber and B. Lurger, *Rules for the Transfer of Moveables* (2016) 123.

14 Of course, this person may be a director and/or shareholder, but they need not be.

15 For recent cross-country surveys, see G. McCormack, A. Keay, S. Brown and J. Dahlgreen, *Study on a new approach to business failure and insolvency*: *Comparative legal analysis of the Member States' relevant provisions and practices* (January 2016) Ch 4 and R. Bork, *Clash of Principles: Equal Treatment of Creditors vs. Protection of Trust in European Transactions Avoidance Laws* (CERIL Report 2017/1).

16 I. Mevorach, 'Transaction Avoidance in Bankruptcy of Corporate Groups' (2011) 2 ECFR 235, 242; McCormack et al ibid, 4.6.

the part of the debtor may be inferred where it might otherwise have to be established,[17] or the 'suspect' or 'twilight' period (the time within which the transaction must have occurred if it is to be susceptible to avoidance) extended,[18] for example.

Existing best practice guides on the design of corporate insolvency laws (produced by development banks and other international organisations) tend to approach transaction avoidance rules within the context of insolvency procedures, i.e. as one part of the conduct of collective insolvency proceedings.[19] This approach has obvious advantages: in insolvency proceedings, an independent trustee or insolvency practitioner can be recruited to investigate pre-commencement transactions and litigate on behalf of the general body of creditors (thereby avoiding duplication of these efforts), the fruits of their industry enuring for creditors' collective benefit (thereby promoting 'evenhandedness'[20] between creditors). But the commencement of insolvency proceedings can also reduce the value of the debtor's estate, for example by delaying the closure of a non-viable business.[21] The weaker the insolvency court, the graver will be the risk of this or other forms of value destruction.[22] Faced with a significant risk of value destruction, creditors may prefer to see insolvent firms close outside collective insolvency proceedings. Consistently with this, Claessens and Klapper (2005) find that bankruptcy filings are more frequent in countries with better functioning judicial systems.[23] Other qualitative literature similarly reports non-usage of bankruptcy laws in emerging markets, linked to inefficiencies in enforcement and implementation.[24]

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17 See for example Insolvency Act 1986 s.239(6) (the English preference rule).

18 See Bork n 15 at para.24. As Bork explains (para.29), this is not to be confused with a limitation period (the time within which the avoidance action must be brought).

19 See below, text to n 36.

20 One of the normative ideals identified by Clark (ibid n 2) as underpinning fraudulent conveyance law. See further below, text to n 37 *et seq*.

21 See for example J. Franks and G. Loranth, 'A Study of Inefficient Going Concerns in Bankruptcy' (2005 working paper) and K. van Zwieten, 'Corporate rescue in India: The role of the courts' (2015) Journal of Corporate Law Studies 1, the former exploring continuation bias in Hungarian bankruptcy cases, the latter in Indian corporate reorganization cases.

22 K. Ayotte and H. Yun, 'Matching Bankruptcy Laws to Legal Environments' (2009) 25(1) Journal of Law, Economics and Organisation 2, 4 (on judicial capacity and continuation bias); see also A. Lambert-Mogiliansky, C. Sorins and E. Zhuravskaya, 'Capture of Bankruptcy: Theory and Evidence from Russia' (CEFIR Working Paper No.3, June 18, 2003), exploring the risks of allocating discretion to judges to avoid inefficient liquidations where there is a possibility of court capture.

23 S. Claessens and L.F. Klapper, 'Bankruptcy Around the World: Explanations of its Relative Use' (2005) 7(1) Am. Law. Econ. Rev. 253.

24 See for example M. Uttamchandani, ' "No Way Out": The Lack of Efficient Insolvency Regimes in the MENA Region' (World Bank, 2010); A Ramasastry, 'EBRD legal indicator survey:

This background suggests that transaction avoidance tools may be most powerful when available outside insolvency proceedings as well as within them, so as to be available for use by creditors in circumstances where the commencement of collective proceedings is considered by all creditors to be unnecessary or undesirable. Creditors using such rules will not of course be able to avoid courts. But transaction avoidance proceedings are likely to be simpler to adjudicate than corporate insolvency proceedings are to supervise, and their outcome is less likely to have the kind of political salience that might warrant state intervention. As such, weaker courts might be predicted to be more effective in applying avoidance rules outside insolvency proceedings than they are in supervising an insolvency practitioner investigating suspect transactions as part of the performance of a suite of functions in a collective insolvency procedure.

Making transaction avoidance rules available to creditors outside the context of insolvency proceedings is hardly a novel idea. Fraudulent conveyance law is ancient, and its relief has never been conditioned on the commencement of collective proceedings. Under Roman law what became known[25] as the *actio Pauliana* was available both in and outside early prototypes of bankruptcy procedures;[26] it allowed a creditor harmed by the (intentional)[27] disposition of an asset of the debtor to have recourse to the transferee, as if the asset the subject of the conveyance had not been validly transferred to them.[28] The common law analogue, appearing first in statutory form in 1376[29] (followed in 1571 by the more well-known Statute of Elizabeth[30]),

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assessing insolvency laws after ten years of transition' *Law in Transition* Spring 2000; H. Broadman et al, *Building Market Institutions in South Eastern Europe* (World Bank, 2004) 44-48.

[25] As a result of the work of a glossator sometime after completion of the Digest: W. Buckland, *A Textbook of Roman Law from Augustus to Justinian* (3rd ed., CUP 1966) 595; J. Getzler, 'Assignment of Future Property and Preferences' in *Fault Lines in Equity* 83; I. Pretelli, 'Cross-Border Credit Protection Against Fraudulent Transfers of Assets: *Actio Pauliana* in the Conflict of Laws' (2011) 13 *Yearbook of Private International Law* 590, 591.

[26] Pretelli ibid at 595; see also R. Obenchain, 'The Roman Law of Bankruptcy' (1928) III(4) Notre Dame Lawyer 169, 187-195.

[27] The action was described as one *in fraudem creditorum* but this was not a reference to fraud in the strict sense (i.e. as connoting some form of deceit): F.W.S. Cumbrae-Stewart, 'The Actio-Pauliana: its origin, nature and development: being a dissertation on frauds upon creditors in the civil law' (doctoral dissertation, 1920, University of Oxford). Summarising the position, Buckland wrote "There must be intent to defraud, but knowledge that creditors would suffer was enough and might be inferred from the circumstances" ibid n 25 at 596.

[28] Buckland ibid.

[29] 50 Edward III, cap. 6 (1376), noted in Cumbrae-Steward n 27 at 1.

[30] 13 Elizabeth I, cap. 5 (1571).

similarly predated the introduction of procedures for collective execution.[31] Many jurisdictions have retained some form of this action, often described as the '*actio Pauliana* outside bankruptcy', on their statute books.[32] But these forms of action have received little attention in international best practice guidance on the design of insolvency and creditor rights regimes, have not been studied systematically by empiricists,[33] and have not benefited from international initiatives to improve the efficacy of domestic insolvency rules in cross-border cases in the same way that transaction avoidance actions conducted in connection with insolvency proceedings have benefited.

This chapter begins by evaluating the case for approaching transaction avoidance within insolvency proceedings, before turning to consider aspects of the design of the '*actio Pauliana* outside bankruptcy', including measures to improve its efficacy in cross-border cases.

Transaction avoidance in the context of insolvency proceedings

The leading best practice guides on the design of insolvency laws are the UNCITRAL Legislative Guide on Insolvency Law (2004) and the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (2015). The former offers detailed guidance on issues central to the design of insolvency laws, and particularly the design of insolvency procedures for business debtors, explaining the choices confronting legislators and making some recommendations. The latter, developed under the leadership of the World Bank in collaboration with UNCITRAL and other international financial institutions, is a much shorter document designed to articulate core principles or 'benchmarks' for testing the effectiveness of domestic insolvency

[31] L.E. Levinthal, 'The Early History of Bankruptcy Law' (1918) University of Pennsylvania Law Review 223, 227.

[32] See the surveys in A. Boraine, 'Avoidance Provisions in a Local and Cross-Border Context: A Comparative Overview' (INSOL International Technical Series Issue No. 7, December 2008), W. Faber and B. Lurger, *Acquisition and Loss of Ownership of Goods* (De Gruyter 2011), and Cauffman n 13. The action is apparently unknown in Scandinavian law: see W. Faber and B. Lurger, *National Reports on the Transfer of Moveables in Europe* (vol. 5: Sweden, Norway and Denmark, Finland and Spain; Sellier 2011) 104 and U. Göranson, '*Actio Pauliana* outside bankruptcy and the Brussels Convention' (1992) 39 Law and Reality 89, 89.

[33] The seminal paper by S. Djankov, R. La Porta, F. Lopez-de-Silanes, and A. Schleifer, 'The law and economics of self-dealing' (2008) 88(3) Journal of Financial Economics 430 includes 'rescission' in its index of controls on self-dealing, but this is a reference to shareholder-initiated private enforcement.

laws and other aspects of debtor/creditor rights, including debt enforcement, secured transactions, and credit information systems.

The Legislative Guide notes that the "problems of favouritism and fraud" arising in circumstances of financial distress can be addressed through a range of legal strategies, including but not limited to transaction avoidance within the context of insolvency proceedings.[34] Acknowledgment is made of the fact that "many non-insolvency laws also address these types of transaction as being detrimental to creditors",[35] which may be a reference to the *actio pauliana* outside insolvency proceedings. But the Guide focuses on the avoidance of transactions within the context of insolvency proceedings, with the insolvency practitioner identified as the preferable party to have carriage of such actions.[36] The focus in the Guide on avoidance within insolvency proceedings is driven by an expressed preference for collective over unilateral action:

> It is a generally accepted principle of insolvency law that collective action is more efficient in maximising the assets available to creditors than a system that leaves creditors free to pursue their individual remedies and that it requires all like creditors to receive the same treatment. Provisions dealing with avoidance powers are designed to support these collective goals, ensuring that creditors receive a fair allocation of an insolvent debtor's assets consistent with established priorities and preserving the value of the insolvent estate…[37]

The Principles address transaction avoidance only within the context of insolvency proceedings.[38]

The Guide suggests that there are at least two advantages associated with entrusting transaction avoidance to insolvency practitioners. The first, alluded to in the Guide's reference to the efficiency of collective action, is the possibility that the insolvency practitioner will be able to pursue counterparties more cheaply than one or more creditors acting unilaterally. But this will of course not necessarily be so: (some) creditors may have superior information to an insolvency practitioner, and the

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[34] Legislative Guide on Insolvency Law (UNCITRAL 2004) paras. 7, 148, 153.
[35] ibid para. 150.
[36] ibid Recommendation 93.
[37] ibid 151, see also 152 and 195.
[38] Principles for Effective Insolvency and Creditor/Debtor Regimes (World Bank, 2016) section C.11.

insolvency practitioner may not be adequately incentivised to control their own costs in acquiring the information necessary to identify and pursue such claims (particularly, and perhaps paradoxically, where they owe their duties to the general body of creditors, rather than, for example, to a senior lender[39]). An insolvency practitioner's fees may 'eat up' any gain unsecured creditors might otherwise have expected to enjoy by participation in collective insolvency proceedings.[40]

Greater emphasis is placed in the Guide on a second feature of avoidance actions taken in insolvency proceedings, *viz*. that the fruits of such actions will typically be held for the benefit of the general body of creditors, thereby promoting equality of treatment among creditors.[41] It is of course possible to design an *actio Pauliana* that is available outside insolvency proceedings so that it functions in a similar way, by requiring the fruits of any such action to be enjoyed by all creditors, or (more narrowly) by all those creditors who were harmed by the transaction. The English action for the avoidance of gifts or transactions at undervalue executed for the purpose of putting assets beyond the reach of persons with claims against the debtor or otherwise prejudicing their interests (Insolvency Act 1986 s.423), is an example of such a rule. An application can be made under s.423 by anyone who is a "victim" of the transaction,[42] provided that no insolvency proceedings have been commenced (if they have been, the proper person to bring the action is the insolvency practitioner).[43] But the application is deemed made on behalf of every victim of the transaction,[44] and the court's discretion to fashion a remedy must be exercised with this in mind.[45] Where the debtor is insolvent, such that the transaction will have prejudiced all those who were unsecured creditors at the time (except to the extent that their claims against the debtor were subsequently satisfied), the possibility of this type of action being brought outside insolvency proceedings appears remote. In the absence of provision for rewarding the claimant who takes on litigation risk, no creditor may be

[39] J. Armour, A. Hsu and A. Walters, 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) 5(2) European Company and Financial Law Review 148.
[40] ibid.
[41] Legislative Guide n 34 at paras. 152 and 195.
[42] "Victim" is defined as a person who is, or is capable of being, prejudiced by the transaction: Insolvency Act 1986 s.423(5).
[43] Unless the court gives leave to the victim to commence the action: Insolvency Act 1986 s.424(1).
[44] Insolvency Act 1986 s.424(2).
[45] R.M. Goode, *Principles of Corporate Insolvency Law* (4th ed., Sweet and Maxwell, 2011) para.13-139; R. Parry, *Transaction Avoidance in Insolvencies* (OUP 2001) para.10.83; *Erste Group Bank AG (London) v JSC (VMZ Red October)* [2015] 1 C.L.C. 706 paras 123-124.

willing to bring the action for others' benefit;[46] even if a creditor did so, the requirement to fashion the remedy to benefit all who were prejudiced by the transaction would tend to encourage the opening of insolvency proceedings, so as to facilitate use of insolvency law's mechanisms for identifying and verifying creditor claims and making distributions.

More attractive to creditors will be the *actio Pauliana* in its simplest, non-collective, form: that is, as a tool that permits a creditor claimant "to execute against the good transferred by the contested act as if it had never left his debtor's estate",[47] to the extent of the debtor's indebtedness to them.

> The *actio Pauliana*, if successful, enables the creditor to demand payment, ultimately with the support of executory means, from the debtor's *transferee* (the third party), in so far as the debtor fails to perform his obligations.[48]

Is the availability of such an action offensive because contrary to an equality norm? It appears possible to dismiss this objection without resolving the difficult question of whether embrace of collective insolvency proceedings necessarily implies embrace of an equality norm (and, if so, of what particular kind).[49] The simplest form of *actio Pauliana*, which permits a creditor to execute against assets as if the debtor had not transferred them, appears best understood as a form of debt enforcement. It differs from other forms of debt enforcement only in that the asset against which execution may be made is no longer in law the debtor's; the transaction is 'avoided' only in the limited sense that an asset that is no longer the debtor's is treated, to the extent of the creditor's claim against the debtor, as if it still were, so as to be available for attachment by the creditor – this is the "fiction" on which the action depends.[50] Understood in this way, the *actio Pauliana* outside insolvency proceedings appears no

[46] See analogously (in relation to shareholder derivative actions under UK law for breach of directors' duties) Black and Cheffins n 12 at 1407.
[47] Cauffman n 13 at 125; see also Pretelli n 25 at 598.
[48] Göranson n 32 at 90.
[49] As to which, see R.J. Mokal, *Corporate Insolvency Law* (OUP 2005) Ch 4, explaining the "priority v. immunity" fallacy ("espousing the aim that all creditors line up does not entail any particular order in which they should line up. It does not commit the system to placing all creditors (as it were) unidistant from the asset pool. The *pari passu* principle would put each ('similar') creditor side by side rather than (say) one after the other. But this arrangement is not a necessary concomitant to the absence of the value-destroying race. So long as there is a queue (with creditors standing side by side, one after the other, or in whatever order), there is no race"); see also the illuminating discussion in the more recent paper by D. Skeel Jr, 'The Empty Idea of "Equality of Creditors"' (2017 working paper).
[50] Buckland n 25.

more troubling, from an equality perspective, than any other species of individual debt enforcement.[51]

Creditor-initiated transaction avoidance outside insolvency proceedings

Corporate insolvency procedures are highly complex; they require sophisticated infrastructure, including well-resourced and independent courts, for effective implementation.[52] The features of collective insolvency proceedings that are expected to facilitate value preservation may readily become vehicles for value destruction. The stay (that which effects the transition from individual to collective execution) may introduce new opportunities for expropriation by corporate controllers,[53] which courts may not be adequately incentivised (or resourced) to constrain; insolvency practitioners and judges may be persuaded to support the deployment of firm assets in continuation of business operations even where the business is not viable,[54] or they may simply be ill-equipped to facilitate the rapid sale of assets worth more broken up than kept together.[55] Where creditors anticipate this or other forms of value destruction in insolvency proceedings, they may prefer to see firms fail outside such proceedings – even if this means foregoing opportunities to use the transaction avoidance tools available within them – and to fall back on other (formal and informal) mechanisms to recover as much as possible of their claim against the debtor.

In this context, a simple (non-collective) form of *actio Pauliana* appears to offer much of value to creditors aggrieved by transfers of assets to related parties on the eve of enterprise closure. It may be immediately objected that such an action will

[51] Of course, it might be that certain kinds of unsecured creditors are more likely to be able to bring this type of action than others, given that (unlike general debt enforcement action by an unsecured creditor) the bringing of the action against the third party recipient is premised on the creditor claimant having some information about the way in which the debtor's assets have been disposed of. This undoubtedly raises a form of 'equality problem', but of a much narrower kind.

[52] C. Wihlborg and S. Gangopadhyay, 'Infrastructure Requirements in the Area of Bankruptcy Law' (Brookings-Wharton Papers on Financial Services, 2001) 26-27; M. Rowat and J. Astigarraga, *Latin American Insolvency Systems: A Comparative Assessment* (World Bank Technical Paper No. 433, 1999).

[53] Provided that managers remain in possession: O. Goswami, *Corporate Bankruptcy in India* (OECD 1994) 56.

[54] See Franks and Loranth n 21, observing this in a set of Hungarian bankruptcy cases (and linking this to the role and remuneration of the trustee) and van Zwieten, 'Corporate rescue in India: The role of the courts' n 21, on continuation bias in the bankruptcy practice and procedure of Indian bankruptcy courts.

[55] Uttamchandani n 24.

have to be brought in a court, such that its availability will not assist in jurisdictions where insolvency proceedings are value destructive because courts are weak. It certainly does seem likely that, as a matter of public law, courts will be have to be recruited to adjudicate on the adjustment of what is otherwise a settled transaction.[56] But the task for a court in adjudicating a basic *actio Pauliana*-type action appears likely to be considerably simpler than that of a court supervising the conduct of a collective insolvency procedure. The basic *actio Pauliana* invites *ex post* review of a single transaction,[57] and there are only the interests of the creditor claimant and the defendant recipient - neither of which need be insolvent for the action to be brought (the motivation for the action is the insolvency of a third party, the debtor) - to balance in the exercise of any judicial discretion. The typical corporate insolvency procedure will involve a court in a wider range of questions (some of which will require judicial 'forecasting', for example in relation to the prospects of the debtor securing further finance)[58] for the benefit of a wider range of stakeholders, and the impact of the debtor's insolvency on these stakeholders may be sufficient to attract the interest and intervention of politicians. Weaker courts might therefore be predicted to be more effective in applying transaction avoidance rules outside insolvency proceedings than they are in supervising corporate insolvency proceedings with one or more transaction avoidance elements.

In jurisdictions where courts are weak, it might be thought that providing strong protection for secured creditors, including out-of-court enforcement rights, is a superior means of controlling related party transactions in insolvency. The effect of granting security will typically be that, in the absence of the secured creditor's consent, the debtor will be unable to dispose of the secured asset free and clear of the security interest (other than perhaps, depending on the nature of the interest and the applicable law, in the ordinary course of business). This significantly restricts the debtor's ability to transfer the asset beyond the reach of creditors in insolvency (the

[56] Consistently with this, the UNCITRAL Legislative Guide (ibid n 34) suggests "Avoidance of a particular transaction generally requires an application to the court to declare the transaction void…" (para.192).
[57] This is not to say that such actions should allow for the untrammelled use of hindsight by judges: see below, text to n 76 *et seq*.
[58] Of course, the law may permit the court to defer to the commercial judgment of a trustee or insolvency practitioner in relation to some of these questions. But the court will nevertheless likely have a role in the supervision of insolvency practitioners / trustees, e.g. by being required to adjudicate claims by creditors of a breach of duty by the insolvency practitioner / trustee with a view to the imposition of personal liability.

transferee's interest will typically be limited to the amount (if any) exceeding the secured creditor's claim over the asset, and the secured creditor will remain entitled to enforce against the asset to the extent of their claim), and in so doing may reduce incentives to attempt such transfers. Of course, security will not always be available (the debtor may not have assets that can be validly pledged under the applicable law[59]), and in any case comes with its own costs. Most obviously, there are costs associated with constraining the debtor's ability to use and dispose of its own assets.[60] But there are also other costs associated with strong protection for secured creditors, and particularly with endowing such creditors with strong out-of-court enforcement rights. This includes the risk that in circumstances of distress those lenders might precipitously enforce against assets with a view to securing early repayment even where such enforcement reduces the value of the debtor's estate, as where assets worth more kept together are sold on a piecemeal or break-up basis (liquidation bias).[61]

Interestingly, a model developed Gennaioli and Rossi suggests that strong investor protection, defined to include protections against self-dealing and tunnelling[62], can mitigate the risk of liquidation bias that is otherwise expected to be associated with entrusting control rights to a senior secured lender. In this model, it is stronger investor protection that enables a senior secured lender to consent to participate in a reorganisation, rather than insist on immediate realisation: "When investor protection is strong, contracts can pledge the controlling creditor a large share of the firm's reorganization value, so that any liquidation bias is removed and the first best is attained…".[63] This suggests that secured transactions law and fraudulent conveyance law are probably better understood as complements, rather than substitutes.

Refining the proposal

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59 Thorburn n 3 at 84.

60 Above, note 7.

61 V. Vig, 'Access to Collateral and Corporate Debt Structure: Evidence from a Natural Experiment' (2013) LXVIII(3) Journal of Finance 881.

62 N. Gennaioli and S. Rossi, 'Contractual Resolutions of Financial Distress' (2013) 26(3) Review of Financial Studies 602, 4.2.

63 ibid 604. The model assumes that the senior secured lender is under-collateralised, which the authors expect to be necessary to fully induce participation in the reorganisation: ibid 603.

The above analysis suggests there is a good case for ensuring that creditors have access to a simple (non-collective) form of *actio Pauliana*. To be effective, such a tool will have to reach both transferees and subsequent acquirers, other than (to mitigate the threat to certainty of receipt, with its attendant costs) those acquirers who take *bona fide* and for value.[64] This will require mechanisms for following ("the process of following the same asset as it moves from hand to hand")[65] and for tracing ("the process of identifying a new asset as the substitute for the old"),[66] the latter being necessary to constrain evasion of the rule by the conversion of the asset the subject of the initial transaction into another form of asset.

A threshold question is whether the *actio Pauliana* outside insolvency proceedings should provide relief only against non-preferential transactions, or whether preferential transactions (i.e. those the effect of which is to discharge or part-discharge a genuine debt) could also legitimately fall within its scope. Both forms of transaction are (assuming the debtor's insolvency) harmful to unsecured creditors, albeit for different reasons; both could in theory be regulated by an *actio Pauliana* outside insolvency proceedings. Allowing preferences to be attacked in this way would however lead to the result that the *actio Pauliana* could be used to reverse a payment made to one creditor so as to effect payment to another. At first glance this appears incoherent:

> Outside a compulsory, collective proceeding, treating simple preferences as fraudulent conveyances would not prevent one creditor from being paid at the expense of the other. It would merely prefer the creditor who was second in time rather than the one who was first.[67]

Whether this point is fatal to the inclusion of preferential transactions within the scope of the *actio Pauliana* outside insolvency proceedings depends on the reason that the

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[64] See J.L. Westbrook, 'Choice of Avoidance Law in Global Insolvencies' (1991) 17 Brooklyn Journal of International Law 499, 506: "Virtually all systems distinguish for this purpose between the initial transferee (in US parlance) and subsequent transferees from the initial transferee. The subsequent transferees are given broad protection nearly everywhere, especially if they have given value without knowledge, often leaving the liquidator only with a damage action against the initial transferee".
[65] *Foskett v McKeown* [2001] 1 A.C. 102, 127 per Lord Millett.
[66] ibid.
[67] D.G Baird and T.H. Jackson, 'Fraudulent Conveyance Law and Its Proper Domain' (1985) 38 Vand. L. Rev. 829 at 848, concluding that fraudulent conveyance law is not the proper vehicle for the regulation of preferences; see also K.C. Kettering, 'Codifying a Choice of Law Rule for Fraudulent Transfer: A Memorandum to the Uniform Law Commission' (2011) 19 *ABI Law Review* 319, 332; Garradd Glenn, *Fraudulent Conveyances and Preferences*, revised ed., volume 1, § 289.

preference is considered objectionable. If the basis of complaint is merely that one creditor's position has been improved ahead of another's, the reversal of the preference by means that result in the position of the creditor claimant being improved ahead of other similarly prejudiced creditors is clearly incoherent. But if the basis of the reversal is the violation of a narrower norm, one requiring the *debtor* to be even-handed in the treatment of its creditors,[68] then there is no necessary inconsistency in allowing a preference that was motivated by a desire to improve the position of the payee ahead of others to be attacked by another creditor. The norm that has been violated is one requiring the debtor to act even-handedly, rather than some more general ideal that creditors should share equally where they cannot all recover in full,[69] so the fact that the relief happens to benefit one creditor ahead of others is not necessarily incoherent. This suggests there may be a legitimate basis for regulating related party preferences both within and outside collective insolvency proceedings, as is in fact done (in relation to "insider" preferences) under US state fraudulent conveyance law.[70]

If there is a case for regulating related party preferences outside insolvency proceedings, then the *actio Pauliana* is clearly not the only available tool for doing so. It has been observed, for example, that under certain conditions subordination rules can substitute for fraudulent conveyance rules.[71] In the case of preferences,

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[68] Clark n 2 at 511-512; see also R. Weisberg, 'Commercial Morality, the Merchant Character and the History of the Voidable Preference' (1986) 39(1) Stanford Law Review 3 at 46, describing the historical development of the English preference rule in these terms: "As Lord Mansfield ultimately developed the idea, the debtor commits a preferential transfer before he commits an act of bankruptcy only if he exhibits a very strange sort of moral will. If the creditor puts great pressure on the debtor, the transfer does not meet that test. Rather, it is only a preferential transfer when, in effect, *the debtor tries to create his own scheme of distribution*. The sin of the debtor to violate a norm of commercial fellowship is captured in the idea of ratable distribution… Yet the obligation of loyalty to this commercial fellowship remains in the debtor, not the creditor. The creditor may hold on to the preference where he puts pressure on the debtor, as if he is not fully responsible to the commercial fellowship, *but the debtor is*" (emphasis added). See similarly Skeel n 49 at 8 on the development of the US preference rule: "Equality meant that the debtor could not play favourites among its creditors…".

[69] Such notion being difficult to reconcile with the fact that outside insolvency proceedings individual creditors "are permitted to and, indeed, must safeguard their own interests" (Baird and Jackson n 67 at 849), the basis on which the *actio Pauliana* outside insolvency proceedings was defended above, text to n 51.

[70] Uniform Voidable Transactions Act 2014 s.5(b). "Insider" is relevantly defined in section 1(8) to include a director of the debtor, an officer of the debtor, a person in control of the debtor, and a relative of a director, officer or person in control of the debtor. The Act has been adopted in 16 states and introduced in a further 8, though Kettering reports that four of the adopting states did not take up s.5(b): K.C. Kettering, 'The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act' (2015) 70 Business Law 777.

[71] Clark n 2, Part II; see also D.G. Carlson, 'The Logical Structure of Fraudulent Transfers and Equitable Subordination' (2003) 45(1) William and Mary Law Review 157. As Carlson makes clear,

however, subordination rules will generally only be able to play a limited role. Such rules typically empower a court to demote a debt claim that would otherwise fall to be treated as senior to other claims or as ranking *pro rata* with other claims. Rules of this kind are premised on the continuing existence of the relevant claim (that which is to be subordinated). But in the paradigm case of a related party preference authorised by directors in anticipation of firm failure, the directors will have already marshalled the firm's unencumbered assets to discharge the related party's claim, such that there is nothing left to which a subordination rule can be applied. In theory, the state could of course introduce a rule that mandatorily relegates related party debt claims to a subordinated status from the outset (i.e. whenever such debt is incurred), but such a rule seems highly unattractive, given the potential for related party loans to be value-enhancing for the firm.[72] A more appealing alternative avenue for the regulation of related party preferences in insolvency is a director-targeting personal liability rule.[73] If such a rule were strongly enforced, it might be sufficient to deter directors from 'playing favourites' among the debtor's creditors. In practice, however, such rules are unlikely to be perfectly enforced,[74] such that they are unlikely to perfectly deter. Given this, the availability of an *actio Pauliana* that allows non-preferred creditors to target related party payees – those who have actually received the value from the firm - may be a valuable additional tool in jurisdictions where the initiation of collective insolvency proceedings (and any enlivenment of any associated preference rule) is considered unattractive by all creditors.

As to non-preferential transactions, should all forms of such transaction fall within the scope of the *actio Pauliana* outside insolvency proceedings if some harm to creditors can be established? In theory, the action could be designed to encompass any transaction that proves with the benefit of hindsight to be harmful to creditors, but

US equitable subordination rules are not confined to federal bankruptcy law (see Part II(E)); on this, see also A. Feibelman, 'Equitable Subordination, Fraudulent Transfer, and Sovereign Debt' (2007) 70 *Law and Contemporary Problems* 171.

[72] As Gelter has demonstrated, even new related party loans dispensed after the firm has become insolvent may be value-maximising for the firm: M. Gelter, 'The subordination of shareholder loans in bankruptcy' (2006) 26 International Review of Law and Economics' 478; see also M.R. Tucker, 'Debt Rechacterization During an Economic Trough: Trashing Historical Tests to Avoid Discouraging Insider Lending' (2010) 71(1) Ohio State Law Journal 187.

[73] See for example the English rule in *Liquidator of West Mercia Safetywear v Dodd* (1988) 4 B.C.C. 30, which has been applied in a series of cases to require directors who self-interestedly authorised the payment of preferences to *inter alia* related parties in anticipation of the commencement of insolvency proceedings to restore to the company the sums they authorised to be paid out to creditors: see K van Zwieten, 'Director liability in insolvency and its vicinity' (2018) *Oxford Journal of Legal Studies* (forthcoming).

[74] See above, n 12.

the costs of such a rule are, for the reasons set out by Baird and Jackson in their seminal paper on fraudulent conveyance law,[75] likely to exceed any benefits. In the same way that a rule mandating the subordination of related party creditor claims would likely limit the availability of insider capital even in circumstances where it might reasonably be expected to increase firm value[76], a rule allowing for the *ex post* unwinding of any transaction with a related party that later proves harmful to creditors would limit the firm's ability to enter such transactions even where they are capable of benefiting creditors. The example given by Baird and Jackson is of a management buy-out, the kind of transaction from which (depending on the transaction structure, the use to which newly borrowed funds are put, the subsequent performance of managers, and various factors exogenous to the firm) creditors may ultimately benefit as well as be harmed:

> A creditor would not want to impose all possible restraints upon a debtor, even if the absence of a restraint exposes the creditor to the risk that the debtor will injure it. Fraudulent conveyance law is a restraint that the law imposes upon debtors for the benefit of creditors by giving creditors the power to void transactions. The power of creditors to set aside transactions after the fact limits the ability of debtors to engage in the transaction in the first instance. This power is unobjectionable if the transaction - such as a gift by an insolvent debtor - always injures creditors. But often the transaction - such as a leveraged buyout - might or might not injure creditors. If one applies fraudulent conveyance law to leveraged buyouts, one might protect some creditors who were injured after the fact, but one might work counter to the interests of those creditors who, before the fact, would have wanted their debtor to have the power to enter into such transactions.[77]

[75] Baird and Jackson n 67.
[76] Above, text to n 73. Such an approach would also be expected to distort the signaling effects that might otherwise be generated by the debtor's choice of capital structure: see Stewart Myers and Nicholas Majluf, 'Corporate Financing and Investment Decisions when Firms have Information that Investors do Not Have" (1984) 13(2) Journal of Financial Economics 187 (on the pecking order hypothesis and the role of signalling in overcoming adverse selection problems between insiders and outsiders).
[77] Baird and Jackson n 67 at 834. Of course in some leveraged buyout type-transactions, it will be clear from the outset that the transaction will be harmful to creditors: for an example, see the discussion of *United States v. Tabor Court Realty* 803 F.2d 1288 (3d Cir. 1986) in Carlson n 72 at 194.

The test proposed by Baird and Jackson is whether creditors would contract for the control if they could.[78] As they suggest, gifts by an insolvent debtor must surely fall within the scope of such a rule.[79] Transfers by an insolvent debtor for nominal consideration, and for a consideration at a significant undervalue, could also be treated similarly, provided in the latter case that the disparity is assessed without the benefit of hindsight.[80] The case for a wider rule than this appears doubtful.

The cross-border reach of the actio Pauliana *outside insolvency proceedings*

A debtor seeking to put assets beyond the reach of creditors could transfer assets outside its 'home' jurisdiction and into the hands of a related party who is not subject to the jurisdiction of the home court.[81] The avoidance rules provided by home law, including any *actio Pauliana* available outside insolvency proceedings, may well be expressed to be extraterritorial in scope, so as to in principle subject assets and defendants situated outside the jurisdiction to the rule's operation.[82] But it is one thing to provide that a rule has extraterritorial scope and another to achieve extraterritorial implementation. The latter depends on the substantive and procedural rules of the jurisdiction in which enforcement of the judgment is sought. An insolvency practitioner or creditor may attempt to sidestep these difficulties by instead invoking the application of foreign avoidance law - the avoidance rules of the place of the asset or of the counterparty. But these rules are unlikely to be the same as those of the home jurisdiction, and in any case may be unavailable: their availability might be

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[78] Baird and Jackson n 67 at 835-836.

[79] Where the donee is a shareholder, there may be some overlap between the *actio Pauliana* and any general company law rule restraining disguised distributions to shareholders. But even in this context the *actio Pauliana* may offer some advantages relative to a disguised distribution rule: the disguised distribution rule may only be actionable by the company or its representative, while the *actio Pauliana* is directly actionable by the prejudiced creditor (on the enforcement challenges associated with the former type of rule, see above, n 12). Additionally, the *actio Pauliana* may be more nuanced in its treatment of third party acquirers (those who acquire in good faith and for value from the donee shareholder): if the effect of the disguised distribution rule is to render the transaction void in the strict sense, then there will be no protection for subsequent good faith purchasers.

[80] On the hindsight point, see J. Armour, 'Transactions at an Undervalue' in Armour and Bennett n 9 75-78.

[81] This paragraph draws on K van Zwieten, 'An Introduction to the European Insolvency Regulation, as Made and as Recast' in R. Bork and K. van Zwieten, *Commentary on the European Insolvency Regulation* (OUP 2016), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2775814.

[82] As is the case for example in relation to the s.423 action available under English law (ibid text to n 42): *Re Paramount Airways Ltd (in administration)* [1993] Ch. 233. A sufficient connection with the jurisdiction must be established for the court to exercise its jurisdiction extra-territorially: *Paramount Airways*; *Erste Group Bank AG (London) v JSC (VMZ Red October)* [2015] 1 C.L.C. 706.

conditioned on the opening of local insolvency proceedings, which local courts may lack jurisdiction to open on the facts, or it may be that local law does not permit the local avoidance rule to be applied to the transaction in issue, given its foreign elements.[83]

International initiatives to improve cooperation and coordination in cross-border insolvencies have mitigated some of these difficulties in relation to transaction avoidance that occurs as part of the conduct of collective insolvency proceedings. Where a debtor has their centre of main interests in an EU Member State (other than Denmark),[84] the European Insolvency Regulation provides for the recognition and enforcement of judgments deriving directly from and closely connected to insolvency proceedings opened under the Regulation in all other Member States (again, other than Denmark),[85] a provision which *inter alia* enables the enforcement of avoidance judgments obtained by the insolvency practitioner for the benefit of the general body of creditors,[86] even where the defendant is domiciled outside the EU.[87] The general choice of law rule in the Regulation (the application of the law of the place of opening of proceedings, excluding its conflict of laws rules[88]) applies,[89] but is qualified by a second rule allowing the defendant to escape avoidance under the *lex fori concursus* if the *lex causae* would not have allowed any means of challenging the transaction.[90]

The UNCITRAL Model Law on Cross-Border Insolvency,[91] negotiated without the benefit of the principle of mutual trust on which the EIR and other EU instruments depend,[92] does not go nearly so far, making provision neither for the

[83] Kettering ibid n 67; Westbrook, 'The Lessons of Maxwell Communications' (1996) 64 Fordham L. Rev. 2531, 2537-2538.
[84] This is the precondition to the applicability of the European Insolvency Regulation (Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings: Recital 25), to which Denmark is not bound (Recital 88).
[85] Regulation 2015/848 Art. 32.
[86] *Seagon v Deko Marty Belgium* ECLI:EU:C:2009:83 (on jurisdiction but noting the parallel scope of the Regulation's provisions on recognition and enforcement of judgments); *F-Tex SIA v Lietuvos-Anglijos UAB 'Jadecloud-Vilma'* ECLI:EU:C:2012:215 (no application on the facts because the liquidator had assigned the avoidance action to an assignee who would act in his own interest and for his own benefit in pursuing the claim, and could continue to do so even after the closure of the insolvency proceedings).
[87] *Schmid v Hertel* ECLI:EU:C:2014:6.
[88] Snowden in Bork and van Zwieten n 82 at [7.02] and [7.73]-[7.74].
[89] Regulation 2015/848 Art.7(m).
[90] Regulation 2015/848 Art.16.
[91] Now adopted in 43 states.
[92] van Zwieten n 82 at [0.48].

enforcement of foreign judgments[93] nor choice of law (in avoidance or more generally).[94] But it does at least empower courts to apply local avoidance law on the application of an insolvency practitioner in a foreign proceeding (once recognised) 'as if' local insolvency proceedings had been opened,[95] thereby overcoming one of the most obvious obstacles to the invocation of foreign avoidance law, i.e. that its availability is conditioned upon the opening of insolvency proceedings, which cannot be opened under the jurisdictional rules of the forum.

Neither of these instruments have any application to the simple form of *actio Pauliana* advocated here, i.e. the non-collective, creditor-initiated, action to execute against assets transferred out of the debtor's estate as if they had not been transferred, to the extent of the creditor's claim against the debtor. Such actions fall outside the scope of the European Insolvency Regulation,[96] and their treatment under the Brussels I, Rome I and Rome II Regulations is unsettled and contested.[97] The Guide to the Enactment of the UNCITRAL Model Law on Cross-Border Insolvency Law makes clear that the Model Law's provision on transaction avoidance is not intended to apply to the *actio Pauliana* outside insolvency proceedings.[98] UNCITRAL's Working Group V (Insolvency Law) has recently turned its attention to the recognition and enforcement of insolvency related judgments, proposing a Model Law on the subject,[99] but the *actio Pauliana* outside insolvency proceedings also appears excluded from the scope of this project: the Model Law is concerned with the

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[93] See the discussion in *Rubin v Eurofinance SA* [2013] 1 A.C. 236, [133]-[144]. After *Rubin*, UNCITRAL's Working Group V were given a mandate to develop a model law on recognition and enforcement of insolvency judgments, the latest draft of which is available here: https://documents-dds-ny.un.org/doc/UNDOC/LTD/V17/066/58/PDF/V1706658.pdf?OpenElement

[94] See the historical background set out in J. Clift, 'Choice of Law and the UNCITRAL Harmonisation Process' (2014) 9 Brook. J. Corp. Fin. & Com. L. 20 at 27.

[95] UNCITRAL Model Law on Cross-Border Insolvency (1997) Art.23(1), subject to Art.23(2) in the case of foreign non-main proceedings, on which see further R. Sheldon *Cross-Border Insolvency* (Bloomsbury) 150-151, and 145.

[96] The fact that an action can be commenced in and outside insolvency proceedings does not necessarily prevent it from being one directly deriving from and closely connected to such proceedings (*H v H.K.* ECLI:EU:C:2014:2410), but it is clear from the reasoning of the CJEU in *H.K.* and in *F-Tex* (ibid n 81) that an action commenced by a creditor for and on its own behalf, rather than on behalf of the general body of creditors, could not be so characterised; see also on this Pretelli n 25.

[97] P. Rogerson in Magnus and Mankowski (eds) *Brussels I Regulation* (Sellier 2007) Art 1, paras 33-36; Göranson n 32; A. Dickinson, *The Rome II Regulation: The Law Applicable to Non-Contractual Obligations* (OUP 2010) 3.249-3.258; Pretelli n 25 at 637.

[98] UNCITRAL Model Law on Cross-Border Insolvency Law with Guide to Enactment and Interpretation para.200.

[99] UNCITRAL Working Group V, Recognition and enforcement of insolvency-related judgments: draft model law, A/CN.9/WG.V/WP.150, 19 September 2017.

recognition and enforcement of "insolvency-related" judgments, defined so as to require some link with insolvency proceedings.[100]

All of this suggests that attention could usefully be turned to the negotiation of an international convention on cross-border aspects of the *actio Pauliana* outside insolvency proceedings. Such conventions are notoriously difficult to achieve,[101] but if the boundaries of the convention were narrowly drawn so as to focus attention on those forms of transaction condemned under any system there may be scope for arriving at a consensus. This would suggest focusing on gratuitous non-preferential[102] transfers (or non-preferential transfers for nominal consideration), made at a time when the debtor was insolvent. The most basic form of international instrument would deal only with matters of recognition and enforcement, leaving the potentially more vexed questions of jurisdiction and choice of law to be determined by the law of the forum.[103] (This is the approach taken in the draft UNCITRAL Model Law on the recognition and enforcement of insolvency-related judgments). This does not provide as much legal certainty to creditors as a fuller form of instrument would, but might be easier to achieve consensus on, and would still appear to be an improvement on the *status quo*.

Conclusion

The *actio Pauliana* outside insolvency proceedings has been neglected in the literature on the control of related party transactions in insolvency. In jurisdictions where collective insolvency procedures are dysfunctional, transaction avoidance tools that are only available as part of those proceedings will be of no utility to creditors. One strategy for states is to invest in improving the operation of their collective insolvency procedures. Reforms of this kind have occurred on an enormous scale

[100] Art.2(d). The clarification that appears at the end of Art.2(d) suggests that an *F-Tex* style case (ibid n 81), in which an insolvency practitioner assigns an avoidance action to someone else to pursue, could result in an 'insolvency-related judgment' for the purposes of the Model Law (contrary to the position in the Insolvency Regulation: ibid n 81). But some connection with insolvency proceedings is clearly required (consistently with this, see the Preamble, 2(d)).

[101] As witnessed by the tortious history of the negotiation of the European Insolvency Regulation (reviewed in van Zwieten n 82).

[102] Significant differences across jurisdictions as to the treatment of preferences, together with the question of whether preferences are properly regulated at all in the absence of collective insolvency proceedings (ibid text to n 67 *et seq*), suggests achieving consensus on the inclusion of preference actions within the scope of any such convention would be difficult.

[103] Of course, the prerequisites to recognition are likely to encompass matters of jurisdiction, so this question will not be able to be entirely avoided. See e.g. draft UNCITRAL Model Law on the recognition and enforcement of insolvency-related judgments, above n 95, Art.13(g).

over the past decade. But collective insolvency procedures are complex, and to the extent that dysfunctionality stems from weaknesses in the institutional framework, rather than from the design of the law 'on the books', change may be slow to come. In the meantime, there could be significant value in ensuring the availability of an effective form of *actio Pauliana* to creditors outside insolvency proceedings.

It might be thought that reformers would be better focusing on the law of secured transactions than transaction avoidance outside insolvency, given that security appears to some extent to be a substitute for controls on fraudulent conveyances.[104] But fraudulent conveyance law and secured transactions law may be best understood as complements rather than substitutes. Gennaioli and Rossi's work on the contractual resolution of financial distress suggests that strong investor protection, including fraudulent conveyance law, can mitigate the risk of liquidation bias that is otherwise expected to be associated with entrusting control rights to a senior secured lender. [105] This model should be a particularly alluring one in jurisdictions where courts are weak.

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[104] See above, text to n 58 and Thorburn n 3 at 84.
[105] See above, text to n 62.

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