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Cross-border corporate insolvency: a modest proposal for an enhanced international approach

El Borai, Rami

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CROSS-BORDER CORPORATE INSOLVENCY: A MODEST PROPOSAL FOR AN ENHANCED INTERNATIONAL APPROACH

Submitted by

Rami El Borai

In Satisfaction of Ph.D. Dissertation Requirement

Supervised by

Professor Joseph Norton
Centre for Commercial Law Studies
Queen Mary, University of London

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Dedication

To my Family who have supported me throughout my studies and have always believed in me.

Abstract

The ongoing process of *globalisation* has witnessed an increase in cross-border corporate insolvencies involving multinational enterprises (MNEs). Yet, national insolvency laws have proven themselves ill-equipped to handle such matters in an international setting. Responsible policy-makers and academics argue for the creation of a viable international insolvency approach.

This debate has revolved around an "either-or" spectrum of (1) the theory of "Universality" that proposes a single court charged with implementing a single bankruptcy law to worldwide claimants, and (2) the theory of "Territoriality" that asserts each jurisdiction can only adjudicate the debtor's insolvency on a territorial basis and distribute local assets to local claimants. But, this debate yet has yielded no practical solution. This thesis suggests that these two theories are not mutually exclusive, and both may be utilized in developing a pragmatic and "better" international insolvency framework.

To date, there has been one non-binding international instrument based on moderate choice of forum/law provisions: the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law). Although the Model Law has significant merits, it falls short of the broader expectations a minimally acceptable international insolvency system should fulfil. In addition, the regional European Union Council Regulation on Insolvency Proceedings (the Regulation) has recently been enacted. This thesis will argue that, while recognizing the special sui generic nature of the EU framework, important lessons can be learned from this Regulation, and when combined with certain elements from a revamped Model Law approach, a "better" international insolvency framework may be found. The concluding observations of this thesis will touch upon a range of existing international vehicles that may be complementary or alternative vehicles to channel interim reforms.

Unless otherwise expressly indicated, this thesis speaks as of 1 January 2006.

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Introduction

For background purposes, the following considers certain basic terms and definitions relevant to this thesis, including selective examples of recent, major international corporate insolvencies; the basic scope, assumptions and objectives underpinning this thesis; and, the methodology used in developing this thesis.

A. Terms and Definitions

Insolvency[1] **law** is applied when an enterprise is no longer able to meet its obligations to creditors[2]. The primary aim of the ensuing proceedings is the maximization of the economic value of the enterprise's estate by preventing its muddled dismemberment and (according to a statutorily prescribed prioritisation scheme) the satisfaction of its claimants to the fullest extent possible. In some cases, opportunities for the enterprise's reorganization might be provided. To achieve these objectives in a fair and orderly fashion, the overall insolvency framework should respect creditors' rights and the relative priority of their claims, equally treat similarly situated claimants, and generally seek to strike an equitable balance between the conflicting interests of the parties that have a financial stake in the matter.

Insolvency law has long been applied solely in the domestic domain, with the legal assumption being that a given corporation would be governed by the insolvency laws of the forum in which it was duly registered, located and operating[3]; it was taken for

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[1] Unless otherwise stated "insolvency" as used throughout this volume refers to the insolvency-liquidation of an indebted corporation. In a number of jurisdictions, however, insolvency proceedings may entail the reorganization of the indebted entity. When reorganization proceedings are treated in this work, reference thereof will be expressly made.

[2] The insolvency of a debtor can be ascertained pursuant to either a "balance-sheet" test, (which assesses whether the total of the debtor's outstanding liabilities exceeds the value of his assets) or a "cash-flow" test (which determines the inability of a debtor to pay his debts as they fall due). The concept of insolvency as used in this work is the "cash-flow" insolvency concept.

[3] Robert K. Rasmussen, A New Approach To Transnational Insolvencies, 19 MICH. J. IN'L L. 1, 1 (1997); Jay Lawrence Westbrook, Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum, 65 AM. BR. L. J. 457, 457 (1991). *See also* S. L. Bufford et al., International Insolvency, available at www.abiworld.org/international/intlInso.pdf (last visited on March 2006). *See in general,* Jay Lawrence Westbrook, Creating International Insolvency Law, 70 AMBKRLJ 563 (1996). Neil Cooper, International Initiatives: INSOL., 6 International Insolvency Review 85 (1997).

granted that all three of these connecting factors would be in the same jurisdiction. The domestic court before which claims were submitted would apply its own insolvency laws to determine the overall amount of the debt, the administration of the indebted corporation's estate, the process of its liquidation and the distribution of the proceeds to the various stakeholders[4].

Within this domestic setting, this process may have entailed lengthy and complex procedures; however, issues pertaining to the default of this domestic corporation were dealt with largely in a predictable and transparent manner. Additionally, there was usually little or no doubt as to the identification of the competent forum to settle creditors' claims and no uncertainty as regards the applicable law to such domestic proceedings.

With the development of international trade and investment and the surge of new technologies, corporations and their subsidiaries and affiliates have extended their operations beyond domestic boundaries[5]. Such an expansion has not only contributed to an even greater increase of trade and investment, but has also led the domestic corporation to create one or several other related corporate entities overseas. This "**conglomeration**" of corporations is formally known as a multinational corporation or multinational corporate group[6].

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[4] The term "stakeholders" refers to those who may have an interest (financial or otherwise) in the insolvent corporation. This includes creditors and shareholders and other categories such as workers, communities and governments. *See* Richard Lieb, Creditor Rights and the Public Interest: Restructuring Insolvent Corporations (University of Toronto Press 2003, Book Review), 11 AM. BANKR. INST. L. REV. 551, 555 -556 (2003).

[5] *See supra* note 3.

[6] Henry Lewis Goodman, Mark P. Friedman & William H. Schrag, Use of the United States Bankruptcy Law in Multinational Insolvencies: The Axona Litigation—Issues, Tactics, and Implications for the Future, 9 BANK. DEV. J. 19, 19-20 (1992); Evan D. Flaschen & Leo Plank, The Foreign Representative: A New Approach to Coordinating the Bankruptcy of a Multinational Enterprise, 10 AM. BANKR. INST. L. REV. 111, 112-115 (2002); Hector Jose Miguens, Liability of a Parent Corporation for the Obligations of an Insolvent Subsidiary Under American Case Law and Argentine Law, 10 AM. BANKR. INST. L. REV. 217, 217-220 (2002).

Typically, a **multinational corporation** consists of a network of subsidiaries and/or branches present and operating in more than one country. Through their sophisticated structures, capitalization and operations in several domestic markets, multinational corporation have come to place themselves as primary economic players in the international market[7]. Nowadays, it is no surprise to see a number of multinationals whose financial base and economic strength, impact and influence outgrow the countries in which such multinational corporations are operating and/or established[8]. Though these corporate conglomerates usually respond to high standards of supervision and control as regards risk-assessment and financial exposure, they are not immune from experiencing financial distress, and possibly insolvency. Recent cross-border insolvency cases, such as the Kirch Group, Yukos, Swissair, Landis, Fairchild Lornier, Philipp Holzmann, Daisytek, Parmalat, MG Rover and Collins & Aikman testify to that reality.

When this international corporate insolvency situation arises, it is needless to say that the resulting economic, financial market and social impact can be significantly detrimental in more than one country.[9]. For instance, the recent debacle of the Enron group has produced significant global economic aftershocks, especially in the energy industry, not to mention the shaken confidence of investors in the stock markets and the rather drastic measures the United States government had to undertake, such as the issuance of the Sarbanes-Oxley Act of 2002, so as to try to prevent or to limit future recurrences. In turn, this legislation has had significant global impact on corporate governance and financial market developments in many other countries[10]. Aside from the economic and political implications of the Enron downfall, there have also been legal and jurisdictional issues that transpired therefrom. For example, Enron Directo Sociedad

[7] *See* Cynthia Day Wallace, The Multinational Enterprise and Legal Control: Host State Sovereignty in an Era of Economic Globalization 1082 (2002).
[8] Id.
[9] *See also* Brewer, Thomas L. and Stephen Young, The Multilateral Investment System and Multinational Enterprises, Oxford University Press 45, (1998).
[10] Felicia H. Kung, The Rationalization of Regulatory Internationalization, 33 L & POLY IN INTL BUS 443, 467 (2002).

Limitada[11], a fully owned Spanish subsidiary of the Enron Group, had most of its assets and employees in Spain. A creditor of Enron Directo has, based on the rather regular meetings of the Enron Directo's board of directors in England, sought to establish the competence of English courts. In fact, the English court issued an order whereby it recognized its primary competence to adjudicate the insolvency of the Enron Directo. As a result, a French court refused the opening of main insolvency proceedings requested by Enron Directo, advancing that although Enron Directo was incorporated and operating in Spain, it was effectively headquartered in England. This case illustrates how important it is to have an acceptable degree of cooperation between forums so as to ensure a coordinated and coherent adjudication of the insolvency at stake.

Similarly, another significant recent cross-border insolvency case, also in the energy industry, entailing both serious economic consequences as well as jurisdictional conflict is the recent Yukos case[12]. This oil giant was established in Russia in 1993 from a collection of small regional oil and gas companies. From its inception to 2002, Yukos had become a leading company in the oil and gas industry, and its production in 2002 had reached 590 million barrels of oil with a total market capitalization of more than US$40 billion. Following the fraud and tax evasion charges filed against its directors in 2003 by the Russian governmental authorities, Yukos entered into formal insolvency proceedings in Russia. With a total estimate of nearly $30 billion in debt, the assets of the Russian giant were set to be sold in a public auction as per Russian law. Surprisingly, in 2004, Yukos filed a Chapter 11 petition in Houston, seeking a restraining order against several of its creditors, so as to prevent them from proceeding with the public auction and the sales of its assets. The federal district court of Houston found that, although Yukos is a foreign entity that was not incorporated in the US, the presence of account trust money and the Yukos' chief operating officer in the US, were sufficient to confer to the

[11] This case was unreported but for a discussion of its rationale and the arguments presented to confer main jurisdiction to the UK court, *see* Skeleton Argument on Behalf of the Petitioner in Re Enron Directo Sociedad Limitada, available at http://www.iiiglobal.org/country/european_union.html (last visited February 2006).

[12] In Re Yukos Oil Co. 320B.R.130.

American courts an international jurisdiction over the debtor's estate. This case denotes how the differences as to the criteria of jurisdiction from one forum to other can create substantial conflict of jurisdiction to the disadvantage of the indebted entity's stakeholders. It is important to note that, although the Yukos case was later dismissed when the Houston federal court decided that, from the "totality of the circumstances", it should not interfere and adjudicate cases that bear sensitive political implications and that fall within the act of sovereign state doctrine, this detour was in fact very costly and time consuming.

The recent Parmalat insolvency for instance presents an actual illustration of the legal challenges that arise from the insolvency of large multinationals. Parmalat SpA was a parent company incorporated in Italy. Though controlled by a family group, Palmarat had - through a rather aggressive 20 year long acquisitions policy using offshore financing vehicles - expanded its operations and spread throughout Europe, South America, Asia and Australia. One of its most notorious special purpose vehicles was IFSC Limited (commonly known as Eurofood), a company incorporated in Ireland. In 2003, after a hole of some USD 7 billion in the assets of Parmalat SpA was discovered, Parmalat entered into formal insolvency proceedings in Italy, entailing the appointment of a special commissioner (administrator). In 2004, Bank of America, a creditor of Eurofood, filed a winding up petition against the latter company in the High Court of Ireland, which appointed a provisional liquidator to Eurofood. Ignoring the decision of the High Court of Ireland, the Italian government - perceiving Parmalat and its subsidiaries (including Eurofood) as providers of public services and carrying an Italian identity - placed Eurofood under extraordinary administration and as in the case of its parent company, appointed a special commissioner to dispose of the assets of the Irish subsidiary. Such a conflict of jurisdiction is typical in cross-border insolvency cases, where more than one forum may present a legitimate claim to support its competence to adjudicate the insolvency at stake. The Eurofood case was later referred to the European

Court of Justice[13], which has, questionably, conferred main jurisdiction to the Irish court. The reasoning of the ECJ was that Eurofood *centre of main interests* is the place where Eurofood was incorporated, *i.e.* Ireland. As will be discussed in the subsequent chapters of this thesis, whether under the EU Regulation or the UNCITRAL Model Law, the determination of the debtor's home country poses considerable difficulties and raises conflict of jurisdictions uneasy to resolve.

Though also decided on the basis of the EU Regulation, a recent decision of the Commercial Court of Nanterre (France) applied a broader construction of the debtor's *centre of main interests*, thereby taking more into account the very spirit of the Regulation and its primary aim to ease the insolvency process and administration of multinationals. The French court adjudicated this case, Emtec Consumer Media Benelux[14], in February 2006, which entails the insolvency of the Emtec group formed by three large companies, two of which are incorporated in France, and one incorporated in Belgium (Emtec Benelux). Upon the latter's filling of a voluntary insolvency petition before the Court of Nanterre for the opening of main proceedings in France, the court has acknowledged its primary jurisdiction even though Emtec Benelux presumably (as per the EU Regulation) has its *centre of main interests* in Belgium. Among the criteria taken into account by the court so as to assert primary jurisdiction over the foreign entity, attention was given to the forum of meeting of the board of directors, the applicable law to major contracts, the place where the commercial strategy of the subsidiary is decided and the emplacement of the banking and financial institutions to which the subsidiary is indebted. All of these criteria unequivocally pointed to France, and as a result to the primary jurisdiction of the French court.

The cases mentioned above provide an introductory and brief snapshot of the increasing currency of international corporate insolvencies and of the impact and legal

[13] *See* Court of Justice of the European Communities (E.C.J.), Judgment of May 2, 2006, Case C-342/04 (not yet published in O.J.).

[14] Tribunale de Commerce [TC] [ordinary court for commercial issues] Nanterre, February 15, 2006, No. PCL 2006J00174.

issues that may arise from these multinational insolvencies. A thorough look into Eurofood and Emtec can further indicate that not only these jurisdictional conflicts arise between forums applying different insolvency laws, but also the judicial battle can take place between two forums both implementing the same law (in the instant cases the EU Regulation) and the outcome will primarily depend on the more or less restrictive construction of that law by either domestic courts or by a central judicial authority such as the ECJ. This issue, however, will be more fully treated in Chapter Five.

As the scope of this thesis pertains to the insolvency of these multinational corporations, it would be helpful for the reader to have some definitional context for certain of the key terms that will be used recurrently throughout this volume, such as **"bankruptcy"**, **"insolvency"** and **"multinational"**. Regrettably, the definitional area, at best, is a torturous one fraught with legal controversies, ambiguities and legal fictions. Indeed, in the American context, the word "bankruptcy" is the official term used in federal case law and statutes, whereas the vast majority of other countries use the term "insolvency". For the purpose of this thesis, which refers to the American federal bankruptcy system, to the European Union insolvency model, and to the UNCITRAL Model Law, the terms "insolvency and "bankruptcy" will be interchangeably used so as to designate the same process of liquidating the estate of a corporation that is unable to meet its financial obligations, and of distributing the proceeds to its creditors. In some, jurisdictions however, a reorganization alternative to liquidation might be available. When this is the case, this volume will explicitly refer to the process of **"reorganization"** or **"restructuring"** of the financially distressed entity.

Due to this linguistic ambiguity, it should also be noted that **"multinational's insolvency"** and **"multinational's bankruptcy"** both refer to the financial default of a multinational corporation. Additional expressions also refer to such a default and these are "international insolvency", "cross-border insolvency", "transnational insolvency", "global insolvency", "international bankruptcy" and "transnational bankruptcy". While some of these expressions are more frequently used than others, they all refer to the

default of a multinational corporation and the ensuing proceedings for its liquidation. When the words "regime", "system" or "framework" follow any of the aforementioned terms, the overall expression aims at designating an international legal arrangement[15] arguably effective to deal with cross-border insolvencies. By definition, such a framework is not subordinated to the sovereignty of any particular state and is the regime to be created by the international community to address the issues that arise from the insolvency process of multinationals. Chapter One will touch upon the notion of the "**multinational**", but for working definitional context, the term refers to a corporation and its affiliates (whether or not enjoying an independent legal personality) that conduct business in many countries.

B. Scope, Assumptions and Objectives

The insolvency of domestic corporations and individuals is **not** the subject of this thesis. Similarly, securities and insurance corporations and banking and credit institutions are excluded due to their special status and the specific public policy issues their insolvency induces. However, in some areas, reference will be made to certain insolvency statutes or provisions that are applicable to all types of corporations (domestic and transnational), and in some instances, to individuals. In such cases, only the effects of such instruments on multinational corporations will be taken into account.

A **starting assumption** for this thesis will be that domestic insolvency laws - traditionally applied to the settlement of the financial default of domestic corporations - have proved ineffective in dealing with the insolvency of large multinationals[16]. Indeed,

[15] Such a structure may either include substantive insolvency laws or can merely provide for conflict of law rules. This prospective framework may also entail the creation of an international court or provide for rules on the choice of forum.

[16] The issues that arise from cross-border insolvency cases are complex because they often involve not only one multinational debtor, but all of the latter's creditors who are located in more than two jurisdictions. Dealing with such a fragmented process can increase the number of unknown problems across sovereign borders and necessitates the adoption of clear rules. *See, e.g.,* United States v. BCCI Holdings (Luxembourg) S.A., 48 F.3d 551 (D.D.C. 1995); see also Maxwell Communication Corp. v. Société Générale (In re Maxwell Communication Corp.), 93 F.3d 1036 (2d Cir. 1996); In re Olympia & York Dev. Ltd., [1993] 12 O.R.3d 500 (Ont. Gen. Div.) (Proceedings in Canada and the United States); In re Maruko Inc., 160 B.R. 633 (Bankr. S.D. Cal. 1993); In re Axona Int'l Credit & Commerce Ltd., 88 B.R. 597 (Bankr. S.D.N.Y. 1988); *see more generally* Thomas Gaa & Paula E. Garzon, International Creditors'

the acquisitions of assets, along with the creation of debts and credits on a global level, have contributed to the increase of the number of claimants located in several jurisdictions. But, as argued by the great weight of bankruptcy experts, domestic insolvency laws have, by and large, not kept pace with globalisation and are often inadequate to handle the insolvency process of large multinationals and the various resulting claims. A **corollary initial assumption** is that this inadequacy has led academics, scholars and the international community in general to acknowledge the increasing need for the creation of some form of viable international insolvency approach or framework that is capable of facilitating and improving the insolvency processes of large multinationals[17].

As a **further starting point** for this thesis, it will also be assumed that such an international insolvency regime[18] should be constructed over time, giving due

Rights and Bankruptcy, 31 International Lawyer no. 2, 273, 275-277 (1997); Arnold Quittner, Maxwell Communications and Cross-border Insolvency Issues, Practicing Law Institute Commercial Law and Practice Course Handbook Series 752, 647 (1997).

[17] In this respect, the use of international treaties that grant local creditors the right to pursue foreign debtors in other countries has been long recognized. With the increase of global trade and business activities, the various international instruments have proved relatively deficient to overcome the challenges brought forth by globalisation. These deficiencies underscore the importance of the creation of an international insolvency regime able to resolve today's complex and cross-border insolvency cases. To this end, one has to rely on two sets of rules. Firstly, it is important to define the competent forum, which should be in charge of adjudicating these cases. Secondly, it is important to agree on legal principles to ensure the mutual recognition and enforcement of judgments rendered by this competent forum.

[18] This work departs from the assumption that an international convention on cross-border insolvency is the most appropriate solution to resolve the issues arising from multinationals' default. The success of such a convention is arguably conditioned on the willingness of local courts to apply principles of law different from those that apply in purely domestic disputes. So far, the reluctance of domestic courts to cooperate in cross-border cases underscores the fact that any multilateral agreement on cross-border insolvency must be enforceable and must define the rules according to which competing claims can be resolved. Otherwise, national practices may render the establishment of an international insolvency regime futile. This prospective regime will have to address widespread practices such as "ring fencing" by which local courts ensure that assets located in their jurisdictions receive special protection. Essentially, the aim of ring fencing is to ensure that local creditors receive preferential treatment over foreign creditors. "Ring-fencing" is permitted in some jurisdictions. "ring-fencing assets for the exclusive advantage of a restricted sub-group of creditors linked to a specific country; the utilization of so-called "bankruptcy havens" for the purpose of defeating attempts to gather and administer property on a collective basis". *See* Ian F. Fletcher, The European Union Convention on Insolvency Proceedings: An Overview Comment, with U.S. interest in Mind, 23 Brook. J. INT'L L. 25, 25 (1997). Other than the international convention approach, there are proposals of a "contractual" approach to limit the negative effects of Cross-Border Insolvencies. Robert K. Rasmussen, A New Approach To Transnational Insolvencies, 19 MICH. J. IN'L L. 1, 16-19 (1997) (the author compares market oriented solutions - such as a contractual protection of creditors in transnational

consideration to the prevailing insolvency law principles of **"Universality"** or **"Territoriality"**[19]. The former principle proposes that, for each multinational or cross-border insolvency case, a single court that is in charge of implementing a single bankruptcy law to worldwide claims should decide the insolvency of the multinational in question[20]. In contrast, the Territoriality principle provides that each jurisdiction can only adjudicate the debtor's insolvency on a territorial basis and distribute to domestic claimants the proceeds resulting from the liquidation of the debtor's local assets.

Despite lengthy debates on this issue, to date there has been only one non-binding international instrument that suggests an approach geared towards the recognition of foreign insolvency proceedings and that is based on moderate choice of forum/law provisions (and not on substantive law): the **UNCITRAL Model Law on Cross-Border Insolvency** (the Model Law). Although the Model Law has a number of significant merits that could serve as a foundation for a more rational international corporate

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insolvency cases – to the current legislative insolvency norms and proceedings). *See also* Alan Schwartz, Contracting about Bankruptcy, 13 J.L. ECON. & ORG. 127, 127 - 131 (1997). "Contractualism" as an alternative to universalism is not workable domestically or internationally unless it is based on a system of dominant security interests. The theoretical benefits of such a system remain highly controversial and its prospects for international adoption are bleak". *See* Lawrence J. Westbrook, A Global Solution to Multinational Default, 98 MICH. L. REV. 2276, 2277 (2000).

[19] *See* Gerald Dunne, Transnational Insolvency: Centrality versus Territoriality, 112 Banking Law Journal, no. 3, at 211(1995); Jay M. Goffman and Evan A. Michael, Cross Border Insolvencies: A Comparative Examination of Insolvency Laws of Industrialized Countries, 12 JBKRLP 5 ART. 1 (2003); Wolfgang Lueke, The new European Law on International Insolvencies: A German Perspective, 17 BANKR. DEV. J. 369, 373 -373 (2001); Liza Perkins, A Defense of Pure Universalism in Cross-Border, Corporate Insolvencies, 32 N.Y.U. J. INT'L L. & POL. 787, 803 -806(2000); Lynn M. LoPucki, The Case for Cooperative Territoriality in International Bankruptcy, 98 MICH. L. REV. 2216, 2216 -2220 (2000); Daniel M. Glosband & Christopher T. Katucki Symposium, Transnational Insolvency: A Multinational View of Bankruptcy "Claims and Priorities in Ancillary Proceedings under Section 304", 17 BROOK. J. INT'L L. 477, 480 -482 (1991); Lynn P. Harrison ET AL., Dealing with Secured Claims & Structured Financial Products in Bankruptcy Cases, 853 PLI/COMM 277, 285 -286 (2003); William L. Norton, Jr., Chapter 152. International Insolvencies: Fundamental Principles of Cross-Border Insolvencies in the United States, NRTN-BLP § 152:1(2003); Martin I. Klein, Multinational Insolvencies: Implementing International Bankruptcy Cooperation, 12 No. 6 BANKR. STRATEGIST 7, 7-8 (1995); Daniel M. Glosband & Christopher T. Katucki, Current Developments in International Insolvency Law and Practice, 45 BUS. LAW. 2273, 2273 -2274 (1990).

[20] The theory of Universalism allows all creditors to be paid from the debtor's assets regardless of their locations and the placement of the debtor under collective proceedings is recognized worldwide. This recognition may be automatic or subject to a formal order of recognition ("exequatur"). Automatic recognition means that the foreign insolvency judgment produces the same effects in the recognizing forum as in the forum of issuance. *See* Chapter One.

insolvency framework, the Model Law falls short of the broader expectations a minimally acceptable international insolvency system should fulfil[21].

In light of this theoretical deficiency and the absence of an international consensus on the matter, regional insolvency instruments have emerged, creating insolvency regimes built on an intermediary approach known as **"Modified Universalism"**[22]. The move to create such regional insolvency regimes has been driven by the realization of countries participating in common market schemes or free trade areas of the importance of predictable and fair rules to deal with the insolvency of multinationals across multiple jurisdictions. One important regional insolvency arrangement that achieves this objective is the **European Union Regulation on Insolvency Proceedings**[23] (the Regulation). While the Regulation is also based on a choice of law/forum approach with recognition and enforcement mechanisms, it offers a more complete and predictable approach to deal with the insolvency of multinationals within the European Community.

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[21] *See* the reference in "Interim Report on Review of the Law of Insolvency: The Enactment of UNCITRAL's Model Law on Cross-Border Insolvency" ¶ 3.5.1 (describing the principles of the Model Law as being "modest").

[22] "The other branch of limited cooperation can be called modified Universalism. It accepts the central premise of Universalism, that assets should be collected and distributed on a worldwide basis, but reserves to local courts discretion to evaluate the fairness of the home-country procedures and to protect the interests of local creditors". *See* Jay Lawrence Westbrook, Choice of Avoidance Law in Global Insolvencies, 17 BKNJIL 499, 517-519. (Giving an integral definition of Modified Universalism in the American context); Jay Lawrence Westbrook, Multinational Enterprises in General Default: Chapter 15, The All Principles, and The EU Insolvency Regulation, 70 AM. BANKR. L.J. 533, 534 -535. These issues will be more fully covered in Chapter Three and Chapter Four.

[23] Council Regulation N°. 1346/2000 on Insolvency Proceedings available at http://Europa.eu.int/eur-lex/en/lif/dat/2000/en_300R1346.html [Hereinafter the Regulation]. The Regulation is seen to be the first regional enactment of Modified Universalism as it concretizes the possibility for one insolvency proceeding in one of the member states (the home Member State, as defined in the directive) to be recognized and enforceable within the 15 EU Member States. *See generally* Ian F. Fletcher, The European Union Convention on Insolvency Proceedings: An Overview and Comment, with U.S. Interest in Mind, 23 BROOK. J. INT'L L. 25 (1997); Eberhard Schollmeyer, The New European Convention on International Insolvency, 13 BANKR. DEV. J. 421 (1997). Another significant initiative seeking to achieve similar goals is the American Law Institute's Transnational Insolvency Project; *see* Am. L. Inst., Principles of Cooperation In Transnational Insolvency Cases Among The Members Of The North American Free Trade Agreement (2003), available at www.ali.org/ali/trans_insolv.htm (last visited January 2006).

This thesis will **argue** *inter alia* that, notwithstanding the special nature of the EU framework and legal instruments and institutions, important lessons might be learned from the Regulation[24], and when combined with certain elements from a revamped Model Law approach, a "better" international insolvency foundational framework might be established, upon which more effective and more globally-oriented and responsive insolvency rules and approaches might evolve over time. Indeed, despite the unique nature of the European Union and the level of integration between its member states, it will be **argued** in Chapter Three and Four that the Regulation may offer valuable insights to responsible policy-makers and academics with respect to key international insolvency-related issues such as the choice of law, choice of forum and recognition mechanisms. The contributions of the Regulation in these areas possible might be able to render the Model Law more responsive to the demands of domestic policies.

The **primary focus** of this thesis, however is that the international community should exit, as argued in Chapters One and Two, from the unproductive theoretical deadlock between Universality and Territoriality and unrealistic visions of harmonized national insolvency laws. Instead, the focus should be on enhancing the pragmatic elements and framework suggested under the Model Law. **Additionally**, the international community should begin to explore finding appropriate vehicles within which the revamped and enhanced Model Law approach can be applied and further mature, one example of this being discussed in the concluding remarks (Chapter Five).

In searching for the appropriate transmission vehicles, this thesis will **not** propose the definitive institutional or instrumental components of an international insolvency treaty; this is a subject that merits further study. While a comprehensive international treaty with detailed substantive, procedural, institutional and dispute resolution

[24] "Comparative study is crucial to negotiations for the evolution of transnational cooperation in bankruptcy matters. It is impossible to fashion mutually satisfactory and workable solutions to transnational cases without a sound appreciation of the differing premises and differing methods found in the other countries involved". *See* Jay Lawrence Westbrook, Creating International Insolvency Law, 70 AM. BANKR. L.J. 563, 567-568 (1996).

provisions would be ideal, given the current international environment, the prospects of such a treaty being enacted in the near or medium-term are unrealistic. However, this thesis will touch upon, in Chapter Five, a range of existing international vehicles[25] for the purpose of determining whether there may be complementary or alternative tools to channel reforms in the area of cross-border corporate insolvency.

C. Methodology

Chapter One, by way of introduction, highlights, for background purposes, selective issues that might stem from the default of multinational corporations and exposes preliminarily some of the complexities that arise in such proceedings. This discussion should facilitate the understanding of why it is important to create an international insolvency system and what the implications of domestic insolvency laws are (whether economic, social or legal difficulties) when applied to multinationals. Throughout the issues treated, a long-term inclination (*i.e.*, an informed preference of the author) toward the theory of Universalism as the most appropriate *theoretical* approach in resolving transnational insolvency cases will become apparent. This leaning will become a logical theoretical conclusion to this Chapter, i.e. "Universalistic" principles appear more conducive than Territorial precepts in resolving a number of the difficult "transnational" insolvency issues that might involve the multinational.

But, no matter how theoretically appealing Universalism may be in resolving certain cross-border insolvency cases, any effective concrete enactment of this approach has yet been realized. **Chapter Two** will address the most common criticisms of Universalism (both legal and political). It will demonstrate that Universalism is not exempt from legal imperfections. In fact, a Universalistic methodology to resolve the financial distress of large multinationals may be more detrimental to certain categories of

[25] Such as International Financial Institutions, WTO Dispute Settlement Understanding, Free Trade Agreements and Bilateral Investment Treaty networks. These potential reform vehicles are discussed in Chapter V.

creditors and/or countries. This Chapter also will stress the even greater political infeasibility of Universalism under its pure form. As a global solution based exclusively on either a Universalistic or Territorial approach may not be practically attainable in the foreseeable future, Chapter Two ultimately supports an international insolvency regime that may be built on a less stringent ("modified") form of Universalism, or on a more coordinated form of Territoriality.

Chapters Three and Four will suggest that the recent EU Regulation illustrates such a "blended" approach, from which a number of lessons might be able to be transmitted to the Model Law, thereby contributing to the latter's enhancement[26].

To identify such potential contributions, **Chapter Three** will focus, by way of example, on choice of forum provisions and their effects under both the Model Law and the Regulation. Although the EU Insolvency Convention was an important source of inspiration to the UNCITRAL working group[27], and the Model Law and the Regulation follow similar standards in identifying the forum entitled to open insolvency proceedings against the multinational debtor[28]; their purpose, objectives and effects greatly differ from each other. This comparative Chapter will be used to highlight what short or medium-term improvements could be made to the Model Law as regards its choice of forum provisions.

[26] This does not imply that the EU insolvency model may or should be projected onto a global level to create an international insolvency system. Rather, understanding the rationale of the Regulation and the underlying reasons of its success may reveal necessary pre-conditions to create an international insolvency regime predicated on the compromise between Universality and Territoriality.

[27] It should be noted that the Regulation contains the same provisions of the EU Insolvency Convention (1995), which was not ratified. See Andre Berends, The UNCITRAL Model Law on Cross-border Insolvency: A Comprehensive Overview, 6 TUL. J. INT'L & COMP. L. 309, 320 (1998).

[28] The approach of the Model Law however is only geared towards recognition of foreign insolvency proceedings, and not with the determination of criteria allowing a given forum to open insolvency proceedings against the debtor.

Because unambiguous choice of forum provisions are insufficient to overcome the difficulties that arise with cross-border insolvency cases, **Chapter Four** will stress, based on the study of the EU Regulation, the role coherent choice of law provisions should play in any transnational bankruptcy regime. A primary focus of this Chapter is to demonstrate that the applicable law to the insolvency process of multinationals produces crucial effects on the priority ranking of creditors and as such affects the incentives of each forum to cooperate with and defer to foreign proceedings when a more effective administration of the debtor's estate would so require. In this respect, it will be shown how the Regulation could reconcile conflicting priority claims and whether this Regulation's original and balanced conflict of law approach might be able to be transmitted to the Model Law.

Although this thesis does not contemplate the creation of a full-fledged treaty on cross-border insolvency containing substantive and procedural rules, it is important to consider complementary or alternative vehicles able to channel the improvements identified in the third and fourth Chapters. To do so, **Chapter Five** will study preliminarily a series of international trade and investment instruments and institutions, which might be argued as potentially constituting viable reform vehicles in the area of cross-border insolvency in the short or medium term. It is suggested that such vehicles might contribute to the enhancement of the Model Law, which should respond to the demands of the "de facto" international market resulting from globalisation and from the drive to create a more liberal international environment that promotes trade and investment.

Chapter One.
Implications of Multinationals' Default and the Need for a "Universalist-type" International Insolvency Regime.

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I. Introduction

In the "Introduction" to this thesis, by way of selective "real'life" examples, the reader is provided a "flavour" of the current day practical importance and complexities of multinational insolvencies. In addition, the reader is given a glimpse into the legal ambiguities of current domestic insolvency laws and into the two main theories/principles for conceptualising international insolvency reform (*i.e.,* Territorialism and Universalism). In this Chapter One, the main point being made is that the current absence of a viable, comprehensive and coherent transnational insolvency regime causes significant transactional *ex ante* effects (Part II) and presents investment-related decision costs (Part III) for the multinational corporation/enterprise, as debtor and creditor. Further, in the context of *ex post* insolvency efforts to achieve a suitable insolvency resolution (Part IV), the absence of an international insolvency framework creates further uncertainties and dilemmas. From a theoretical perspective, the logical conclusion, as will

be discussed, appears to be the creation of an insolvency regime based on "*Pure Universalism*", possibly in the long-term. Only such an approach will, if ever implemented, be able to fully address many of the fundamental issues raised, by way of illustration and not by exhaustion, in this Chapter. However, as analysed in Chapter Two, such conclusion may be more theoretical than practical. Given this, then the realistic fallback and better short and medium-term alternative would be a "*modified Universalist*" approach (Chapters Three and Four) that, while not addressing initially many of the fundamental issues, can be developed incrementally and more fully over time (*i.e.,* phased) through the use of available international legal instruments and vehicles (Chapter Five). As such, this Chapter One attempts to provide the reader a broader and appropriate context in which to place the *modest thesis* being developed in this volume as an "interim" stage in the longer-term search for a comprehensive, satisfactory and workable corporate insolvency regime.

Modern domestic insolvency laws aim at establishing equitable, transparent and fair insolvency proceedings vis- à- vis all creditors[1]. Domestic public policies in many countries embrace these laws in a manner that generally seek to protect local creditors in an effective way[2], though the actual policy orientation toward creditors as opposed to

[1] Although such laws can be, with varying degrees, either pro-debtor or pro-creditors, they usually seek to achieve the "principle of equality" between creditors by preventing each of them to individually sue the debtor. They also aim at reducing the abuses and simplifying the procedures by centralizing the repartition of the debtor's assets whenever possible. Robert F. Reilly *et a*l., How to Value Assets and Liabilities When Determining Insolvency Under the IRC, ABI JNL. LEXIS 112, 1-2 (2001); Kenneth N. Klee, Cram Down II, 64 AM. BANKR. L.J. 229, 229-231(1990); M. Cameron Gilreath, Overview and Analysis of How the United Nations Model Law on Insolvency Would Affect United States Corporations Doing Business Abroad, 16 BANK. DEV. J. 399, 399-400(2000); Susan Block-Lifb, Bankruptcy Fraud: Book Review: A Humanistic Vision of Bankruptcy Law: Karen Gross, Failure and Forgiveness: Rebalancing the Bankruptcy System (Yale University Press 1997), 6 AM. BANKR. INST. L. REV. 471, 472 (1998); Kurt H. Nadelmann, Bankruptcy Jurisdiction: News from the Common Market and a Reflection for Home Consumption, 56 AM. BANKR. L.J. 65, 67-68(1982); Ronald J. Silverman Et al., Second Circuit Explores Parameters of Ancillary Jurisdiction, ABI JNL. LEXIS 87, 4-5(2001); Josefina Fernandez McEvoy *et al.*, Mexico's New Insolvency Act: Increasing Fairness and Efficiency in the Administration of Domestic and Cross-border Cases, ABI JNL. LEXIS 133, 2-7 (2000); Ulrik Rammeskow Bang-Pedersen, Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests, 73 AM. BANKR. L.J. 385, 386-387 (1999).

[2] Insolvency laws may also pursue other policy objectives such as providing for a "fresh start" to financially distressed corporations. In this respect, a number of domestic insolvency laws encourage the

debtor may vary[3]. But, without such "equitable" procedures being applicable in a predictable manner, creditors may be adversely prejudiced in trying to collect on their claims. This unpredictability, in turn, most likely will adversely affect the future availability of credit within the domestic economy.

In order to achieve these desired policy objectives in the context of a multinational's default, extra-domestic legal provisions and approaches may be needed. In contrast, insolvency laws remain territorial in scope, as insolvency proceedings most often require the active intervention of the domestic judiciary and executive authorities, entities that are rooted in the notion of state sovereignty. This "asymmetric" relationship between multinationals' default and domestic insolvency laws brings forth a number of issues that are **not** effectively addressed under any domestic insolvency regime[4]. For instance, an effective adjudication of a multinational's insolvency may require the collection and liquidation of its assets located in several jurisdictions, whereas traditionally, any given court will only have access to those assets located within its territory. While the occurrence of multinational default might produce significant consequences on the domestic level, such default most likely will also highlight

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reorganization (or restructuring) of a financially distressed company when certain conditions are met (discussed below).

[3] Manfred Balz, The European Union Convention on Insolvency Proceedings, 70 AM. BANKR. L.J. 485, 519 (1996); Paul L. Lee, Ancillary Proceedings under Section 304 and Proposed Chapter 15 of the Bankruptcy Code, 76 AM. BANKR. L.J. 115, 165 (2002); Charles D. Booth, Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts, 66 AM. BANKR. L.J. 135, 175-176 (1992).

[4] "No legal system has developed a very efficient and effective way of managing the general default of a multinational enterprise with assets and stakeholders in more than one country. Indeed, in principle such a system cannot be achieved by one country acting alone". *See* Jay Lawrence Westbrook, Multinational Enterprises in General Default: Chapter 15, The Ali Principles, and The EU Insolvency Regulation, 76 AM. BANKR. L.J. 1, 5 (2002) [hereinafter Westbrook, the ALI Principles]. *See also* Mitchell, J., The Economics of Insolvency in Reforming Socialist Economies, 84 COLUMBIA LAW REVIEW 426, 428 (1990) (Where the author argues that Insolvency laws may have broader economic implications such as effects on a country's economic and developmental prospects); George M. Kelakos et al., A Report on the International Insolvency Colloquium, 041901 ABI-CLE 689 (2001). "Because of the void in effective domestic legislation and in international treaties and conventions, the insolvency community has had both the obligation and, as well, the opportunity to achieve advances in the current international regime for dealing with cross-border insolvencies and reorganizations". *See* E. Bruce Leonard, Development and Trends in United States/Canada Cross-border Reorganizations, 9 J. BANKR. L. & PRAC. 343, 346 (2000).

transnational issues as to which the domestic insolvency system and rules are unable to deal with adequately.

A main reason for providing this background Chapter is to demonstrate preliminarily how and the extent to which the inadequacy of domestic insolvency laws - when applied to cross-border insolvency matters - may hinder the objectives of equality, fairness, transparency and predictability to the disadvantage of the indebted corporation' legitimate stakeholders, by having an adverse impact on certain fundamental *ex ante* and *ex post* insolvency filing considerations as to the MNC. Moreover, due to the current absence of a satisfactory global solution to these problems, this Chapter also, when discussing such considerations, will present, *arguendo*, why certain academic commentators and policymakers might conclude that an international insolvency regime built on the principles of "**Universalism**" may present - at least in theory – a promising solution to transnational insolvencies. This argument will be dealt with in length and more critically in Chapter Two.

But, regardless of the legislation in question, insolvency laws exercise an influence on the economic and financial life of many "players"[5]. Not only do they affect the insolvent debtor's business, but also they can directly impact the legitimate expectations of its creditors, shareholders, employees, possibly economic and financial markets and even legitimate Community interests[6]. The absence of a certain, fair, equitable and transparent international corporate insolvency regime can only adversely

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[5] Aghion, Philippe *et al.*, The Economics of Insolvency Reform, 8 Journal of Law, Economics & Organization, 525 (1992); Bruce G. Carruthers & Terence C. Halliday, Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States, 16 BANK. DEV. J. 361, 366-369 (2000); *see also* Omer Tene, Revisiting the Creditor's Bargain: The Entitlement to the Going-Concern Surplus in Corporate Bankruptcy Reorganizations, 19 BANKR. DEV. J. 287, 353 (2003) (arguing that insolvency laws affect not only the insolvent corporation but also solvent companies, lenders, employees, and capital markets.) .

[6] Bob Wessels, Principles of European Insolvency Law, ABI JNL. LEXIS 158, 1-3 (2003); Dennis F. Dunne, Stock Repurchase Agreements in Bankruptcy: A Tale of State Law Rights Discarded, 12 BANK. DEV. J. 355, 356 (1996); James R. Mayer et. al., Recharacterization from Debt to Equity: Lenders Beware, ABI JNL. LEXIS 205 (2003); J. Bradley Johnston, The Bankruptcy Bargain, 65 AM. BANKR. L.J. 213, 309 (1991); Bruce Markell, Changes in Attitudes, Changes in Platitudes: A Short Examination of Non-Uniform Approaches to Business Insolvency, 6 AM. BANKR. INST. L. REV. 35, 37 (1998).

impact and impair sound decision making processes by such affected "players" and other legitimate interests[7].

II. Cross-Border Insolvency and Operational /Contracting Cost Considerations

While revealing public policy trends chosen by governments[8], insolvency laws produce a significant economic impact on a number of cost and decisional related issues, as well as on substantive and procedural law-related issues. Indeed, the insolvency of a corporation often entails unforeseeable and unaccounted costs that should be evaluated in order to determine how detrimental the overall insolvency process may be to the indebted entity and its creditors. These costs, it will be argued, are exacerbated by the current uncertain and fragmental insolvency regime(s) and the absence of a satisfactory international system[9], and these costs often relate to the MNC's financial operations during the pre-insolvency phase[10] (e.g., as discussed below in this Section, the areas of

[7] *Id.*
[8] *See* Berkovitch, Elazar, and Ronen Israel, Optimal Insolvency Law Across Different Economic Systems, The Review of Financial Studies 12, No.2, 347-377 (1999); White, Public Policy Toward Bankruptcy: Me-First and Other Priority Rules, 11 BELL J. ECON. 550 (1980).
[9] On the increasing costs of transnational insolvency litigation and multiple proceedings *see* Bebchuk Lucian A. & A. T. Gusman, An Economic Analysis of Transnational Bankruptcies, 42 J. LAW & ECON. 775, 775-777 (1999); John Ayer, The Role of Finance Theory in Shaping Bankruptcy Policy, 3 AM. BANKR. INST. L. REV. 53, 54-60 (1995); Patrick Halligan, Cramdown Interest, Contract Damages, and Classical Economic Theory, 11 AM. BANKR. INST. L. REV. 131, 133 (2003); William T. Vukowich, Civil Remedies in Bankruptcy for Corporate Fraud, 6 AM. BANKR. INST. L. REV. 439, 439-441 (1998).
[10]Insolvency laws play a major role in the promotion of commercial lending and investment choices. In this respect, insolvency principles built on Universalism have been long argued to reduce the administrative cost of insolvency proceedings. Indeed, the "one court, one law" principle prevents the multiplicity of proceedings, and, by the same token, allow maximization of assets available to the mass of creditors. *See* Adler Barry E., A Re-Examination of Near Insolvency Investment Incentives, 62 U. CHI. L. REV., 15 (1995). *See* more *generally* Bhandari, Jagdeep S., and L. A. Weiss. Corporate Bankruptcy: Economic and Legal Perspectives. Cambridge: Cambridge University Press, 1998; Goode, R. M. Principles of Corporate Insolvency Law. 2nd ed: Sweet & Maxwell, 2003.

interest rates[11] and the cost of compiling information before contracting and otherwise dealing with a MNC[12]).

A. Discerning, *Ex Ante*, the Cost of Insolvency Proceedings

Despite the differences that exist between the diverse insolvency laws, there appears to be a common trend in *managing* insolvency proceedings. The first stage usually begins with the acknowledgement of default and that the debtor is no longer able to honour its duties towards its creditors[13]. This state of financial distress can be reported by the filing of insolvency, either by the distressed corporation or by its creditors who wish to secure their rights. In either case, the ensuing costs from these measures should be construed broadly so as to include not only the cost of filing and pursuing insolvency proceedings, but also the costs of lost managerial time, disruption of a corporation's operation, diversion of assets into risky investments as managers attempt to avoid insolvency, and the costs of firms continuing to operate when their assets would be more valuable elsewhere[14].

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[11] "*A modern, credit-based economy requires predictable, transparent and affordable enforcement of both unsecured and secured credit claims by efficient mechanisms outside of insolvency, as well as a sound insolvency system. These systems must be designed to work in harmony. Commerce is a system of commercial relationships predicated on express or implied contractual agreements between an enterprise and a wide range of creditors and constituencies*". See Gordon W. Johnson, The World Bank's Role in Developing Global Principles and Strengthening Capacity in Developing Countries, 112901 ABI-CLE 207 (2001).

[12] Transactional Cost refers to the costs of borrowing for multinational debtors when the insolvency regime to be applied becomes predictable. Professor Westbrook argues that a reduction of this cost "would result from a coherent system of transnational management of default. The assertion is that the increased predictability of the results of default would significantly reduce the costs of borrowing and other credit for multinationals. The reductions in cost for many millions of transactions would benefit the local citizens of any given country far more than any net loss they might suffer in particular defaults". *See* Jay Lawrence Westbrook, Choice of Avoidance Law in Global Insolvencies, 65 AM. BANKR. L.J. 457, 466 (1991). On the various implications of lower transaction costs, *see* Barry E. Adler, Finance's Theoretical Divide and the Proper Role of Insolvency Rules, 67 S. CAL. L. REV. 1107, 1111-1112 (1994); Richard V. Butler & Scott M. Gilpatric, A Re-examination of the Purposes and Goals of Bankruptcy, AM. BANKR. INST. L. REV. 269, 269 (1994); Charles W. Adams, An Economic Justification for Corporate Reorganization, 20 HOFSTRA L. REV. 117, 117-118 (1991).

[13] Susan Block-Lieb, Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case, 42 AM. U. L. REV. 337, 431 (1993); Douglas G. Baird & Thomas H. Jackson, Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy, 51 U.CHI.L.REV. 97, 103-04 (1984).

[14] Robert K. Rasmussen and David A. Skeel, The Economic Analysis of Corporate Bankruptcy, 3 AM. BANKR. INST. L. REV. 85, 86-88 (1995) [hereinafter Rasmussen, Economic Analysis].

In the context of a multinational's default, it is argued that these pricey disruptions are further aggravated due to uncertainties pertaining to the proceedings to be followed, the laws to be applied, and most importantly, the competent forum that will decide the case[15]. Indeed, the resolution of cross-border insolvency cases can be financially burdensome and the more "transnational" the distressed corporation is, the higher the costs associated with its insolvency can be. The increase of these insolvency costs results from the differences between domestic insolvency laws[16] and the diverse priority claims they entail, which would invite the parties to a difficult evaluation of their payoffs[17], should an eventual insolvency occur. In order to face such impediments to international contracting for instance, practicing attorneys have been encouraged to undertake protective measures to the benefits of their clients[18].

With the enactment of unified global proceedings, it is believed that assets can be distributed equally without the distortions that traditionally occur as a result of substantive legal divergences[19]. This method will also reduce the discrimination against foreign creditors in domestic insolvency proceedings. The forum handling a case would be aware that if it discriminates against foreign creditors to the advantage of local creditors, other forums are likely to reciprocate this discrimination in other cases. As a result, an implicit reciprocity practice may develop in the long run, along with the increase of cooperation among the different forums involved in a transnational

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[15] Westbrook J. Lawrence, Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum, 65 AMBKRLJ 457, 463 (1991) [hereinafter Westbrook, Theory and Pragmatism].
[16] *See* Ian Fletcher, Cross-Border Cooperation in Cases of International Insolvency: Some Recent Trends Compared, 6-7 TUL. CIV. L.F. 171, 171 (1992) (arguing that the insolvency laws of different countries can vary from minor points of detail to substantial issues of principles).
[17] *See* Westbrook, Theory and Pragmatism, *supra* note 14 at 467.
[18] A relevant example is provided by the Practicing Law Institute's (PLI) list of recommendations for creditors and debtors seeking to minimize the risk involved in cross-border transactions. Available at http://www.pli.edu/ (last visited December 2005)
[19] Jay Lawrence Westbrook, Universal Priorities, 33 TEX. INT'L L.J. 27, 31 -32 (1998) (the author argues that a Universalistic system with a possibility of cross-filling would limit the negative effects resulting from different domestic insolvency law and the priority claims they entail) [hereinafter Westbrook, Universal Priorities]; William L. Norton, Jr. Cross-Border Insolvency Concordat, NRTN-BLP § 152:66(1994) (argues that a single forum to adjudicate international insolvencies would result in a number of advantages such as "enhancing control of assets, enhancing business values and fair treatment of creditors. Predictability of the "natural" administrative forum will also be most supportive of international commerce")

insolvency case[20]. Westbrook's best support to this projection is found in the "Rough Wash" argument, according to which, "*a universal rule will even out benefits and losses for local creditors across cases, since losses from local deference to a foreign forum in some cases would be offset by gains from foreign deference to the local forum in others*[21]". Differently stated, a cross-border insolvency framework based on Universality could increase the value available to domestic claimants in a way to offset the losses encountered in cases where the domestic judge defers to foreign insolvency proceedings. Furthermore, the various administrative costs (mainly filing and litigating) would be lower under a universalistic regime, whereas the same costs would swell under a territorial method, as the latter entails multiple insolvency cases and results in a transfer of estate assets from creditors to attorneys and other insolvency professionals[22].

From a microeconomic point of view, Universalism might well secure the transactional gain[23]. Indeed, if the applicable insolvency regime were more predictable, the cost of borrowing for multinationals would be reduced, thus creating other benefits, such as more job opportunities and economic development. To implement this framework, however, on a global level, an international treaty is needed to prevent countries from acting unilaterally and territorially[24]. Indeed, by omitting the global and

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[20] Shoichi Tagashira, Intra-territorial Effects of Foreign Insolvency Proceedings: An Analysis of "Ancillary" Proceedings in the United States and Japan, TEX. INT'L L.J. 1, 6 -7 (1994) (explains the evolution of the Japanese insolvency law from a firm territorial approach to a more flexible cooperative stance. An interesting analogy is made with the American Bankruptcy regime where such reciprocity is best implemented). *See also* Westbrook, Theory and Pragmatism, *supra* note 14 at 468 (Professor Westbrook distinguishes between negative and positive reciprocity depending on whether the adjudicating forum is first to cooperate (negative) or it is cooperating because of a prior case (positive)); *see also* Patrick J. Borchers, Choice of Law Relative to Security Interests and other Liens in International Bankruptcies, 46 AM. J. COMP. L. 165, 180 -181(1998) (arguing that in cross-border insolvency cases, such reciprocity should be differentiated from a less binding international comity.)

[21] *See* Westbrook, Theory and Pragmatism, *supra* note 14 at 464-466.

[22] I.F. Fletcher (Ed.), Cross-Border Insolvency: National and Comparative Studies (Reports delivered at the XIII International Congress of Comparative Law, Montreal 1990) (1992), 31-33; J.S. Ziegel (ed.), in Current Developments in International and Comparative Corporate Insolvency Law, at 16.

[23] *See supra* note 11.

[24] In practice, the vast majority of nations do not adopt either approach in its pure form, essentially because they find pure Territoriality too costly and pure Universalism politically difficult, but not impossible. *See* N. Cooper, R. Jarvis and S. Abeyratne, Recognition and Enforcement of Cross-Border Insolvency (1996), 46; R.M. Goode, Principles of Corporate Insolvency Law (2nd edn. 1997), *esp.* Chap. 13.

binding character of a potential insolvency framework predicated on Universalism, individual countries would naturally tend to adopt a predominantly territorial approach in order to attract foreign direct investments and their resultant "spill-over" effects, such as technology transfer and employment[25].

B. Effects of Insolvency Laws on Interest Rates

In commercial lending transactions, there commonly is an interest rate that is calculated and defined according to many parameters. One of the major factors taken into account when defining such a rate is the likelihood of recovery in the case the borrower becomes insolvent[26]. Under the national umbrella, when both the lender and borrower conduct business exclusively within the same jurisdiction, this interest rate mirrors the financial soundness of the debtor. In this case, the insolvency regime is not of primary importance, or at the very least, it is not as decisive as in cases of multinational's default because there is no doubt concerning either the identification of the competent forum or the laws to be applied. Both are predictable factors that do not present any particular problem[27].

However, the equation is different when the borrower is a multinational corporation that possesses assets and operations overseas. The lender in this case will face the same unpredictability dilemma[28]resulting from uncertain transnational

[25] White Michelle J., The Costs of Bankruptcy," in The New Palgrave Dictionary of Money and Finance, P. Newman, M. Milgate, and J. Eatwell (eds). New York: Stockton Press (1992), 19.
[26] Id.
[27] *See generally* D. Campbell, International Corporate Insolvency Law (1992). I.F. Fletcher (Ed.), Cross-Border Insolvency: Comparative Dimensions (The Aberystwyth Insolvency Papers) (1990).
[28] *See* Westbrook, Theory and Pragmatism, *supra* note 14. *See also* David Costa Levenson, Proposal for Reform of Avoidance Law in the Context of International Bankruptcies from a U.S. Perspective, 10 AM. BANKR. INST. L. REV. 291, 353 -355 (2002) (gives a hypothetical with respect to the Maxwell case where the unpredictability of the insolvency regime to be applied could have threatened the expectations of creditors). "Territorialism with traditional successive distributions is unpredictable, even if the unpredictability of the location of assets is ignored". *See* Ulrik Rammeskow Bang-Pedersen, Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests, 73 AM. BANKR. L.J. 385, 433 (1999)

insolvency rules. It is unclear at the time of contracting which insolvency laws would be applied, and most importantly, whether these laws will give priority to the creditor/lender's claim. To compensate for this unpredictability, the lender ordinarily will increase the interest rate on the transaction in order to secure its credit, should the borrower enter into formal insolvency proceedings.

With the internationalisation of business transactions, increased interest rates can harm social welfare[29]. Firms' capital raising decisions are likely to be skewed because they are being charged for an inefficient insolvency regime that cannot cope with the globalisation of business activity[30]. Under such distortion, the principle of Universalism would provide the means to all lenders to treat all debtors equally, regardless of whether the latter primarily operate overseas[31], where their most valuable assets are located. On the contrary, when territorial principles apply to resolve multinationals' insolvency (as it is widely the case), the unequal treatment between creditors will persist because such a treatment will be solely based upon eventual outcomes in case of the debtor's insolvency and not upon the debtor's financial soundness and credit records *per se*. In sum, a Universalistic approach appears to be a way - if effectively implemented - to ensure a higher level of cooperation among the various forums involved in the insolvency of a

[29] Bebchuk A. Lucian & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Insolvency: Further Thoughts and a Reply to Critics, 82 CORNELL L. REV. (1997), E.B. Leonard and C.W. Besant (editors) Current Issues in Cross-Border Insolvency and reorganizations (1994), 37-39. "More expensive credit leads to a reduction in economic activity. The lower the amount of economic activity, the less jobs there will be in the country as a whole. Attempting to save jobs through an inefficient bankruptcy regime may therefore have the opposite of its intended effect." *See* Rasmussen, Economic Analysis, *supra* note 13 at 87.

[30] *See generally* Jay Lawrence Westbrook, Creating International Insolvency Law, 70 AMBKRLJ 563 (1996) [hereinafter Westbrook, Creating International Insolvency Law]. Neil Cooper, International Initiatives: INSOL., 6 International Insolvency Review 85 (1997).

[31] "The differences in insolvency law (both substantive and procedural) among nations create a serious problem in international credit transactions. In the context of a particular failed transaction, the differences among insolvency regimes create one more battlefield to be survived in the eventual allocation of the debtor's assets". *See* Neil B. Cohen, Harmonizing the Law Governing Secured Credit: The Next Frontier, 33 TEX. INT'L L.J. 173, 176 (1998); Marie T. Reilly, The Latent Efficiency of Fraudulent Transfer Law, 57 LA. L. REV. 1213, 1252 (1997) (establishing the relationship between interest rates and the availability of assets to secure creditor's claims); Thomas H. Jackson & Robert E. Scott, On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and The Creditor's Bargain, 75 VA. L. REV. 155, 157 -160 (1999) (argues that risk taking should be measured in a more comprehensive way among debtors, hence the importance of the decision making process that leads to the determination of interest rate).

multinational corporation. This would be true as all of the debtor's assets, wherever located, would be collected and distributed to the mass of its creditors[32], and none of these assets would be subject to individual lawsuits in multiple forums[33].

C. The Cost of Information

For illustrative purposes, consider an adjusting creditor[34] in country A that has entered into a commercial or financial transaction with a corporate debtor from country B. The latter has assets in countries B, C, D, and E. Given the predominant territorial approach of current domestic insolvency regimes and the necessity to measure risk-taking, the adjusting creditor from Country A will be compelled to gather all the relevant information on the competent courts, proceedings and, most critically, on the laws that will govern the insolvency of the debtor from country B. Under this scenario, the creditor from country A would inquire about the insolvency regimes in each of the countries B, C, D, and E. As a general proposition, adjusting creditors would have to conduct the arduous task of collecting information concerning each jurisdiction where the debtor has assets. Needless to say, such a task would require considerable research, which

[32] Liza Perkins, A Defense of Pure Universalism in Cross-Border, Corporate Insolvencies, 32 N.Y.U. J. INT'L L. & POL. 787, 803 -806(2000); Lynn M. LoPucki, The Case for Cooperative Territoriality in International Bankruptcy, 98 Mich. L. Rev. 2216, 2216 -2220 (2000) [hereinafter LoPucki, Case for Cooperative Territoriality]; Daniel M. Glosband & Christopher T. Katucki Symposium, Transnational Insolvency: A Multinational View of Bankruptcy "Claims and Priorities in Ancillary Proceedings under Section 304", 17 Brook. J. Int'l L. 477, 480 -482 (1991); Lynn P. Harrison *et al.*, Dealing with Secured Claims & Structured Financial Products in Bankruptcy Cases, 853 PLI/COMM 277, 285 -286 (2003); William L. Norton, Jr., Chapter 152. International Insolvencies: Fundamental Principles of Cross-Border Insolvencies in the United States, NRTN-BLP § 152:1(2003)

[33] Moreover, Universalism would prevent the most diligent creditors to take advantage over the less informed or the more limited ones. To a greater extent, this achieves one of the major preoccupations of the aforementioned principles of fairness and equality among creditors. The purpose of administration is to enable an insolvent corporate debtor to trade out of insolvency or to dispose of its assets on a more favourable basis than would be achieved in liquidation by allowing the debtor the benefit of a statutory moratorium (automatic stay of proceedings) on creditors' ability to enforce their rights. While the debtor is in administration, directors are suspended from their duties and a court-appointed administrator manages the financially distressed corporation. *See* Jay M. Goffman and Evan A. Michael, Cross Border Insolvencies: A Comparative Examination of Insolvency Laws of Industrialized Countries, 12 JBKRLP 5 ART. 1 (2003). "Perhaps the largest drawback of territorialism is that it encourages a race of the diligent around the world wherever creditors can find and seize assets belonging to the debtor. Thus, international insolvency proceedings involving one debtor and multiple creditors often run concurrently in a variety of states, with creditors competing with one another to seize a debtor's assets". *See* Sara Isham, UNCITRAL'S Model Law on Cross-Border Insolvency: A Workable Protection for Transnational Investment at Last, 26 BROOK. J. INT'L L. 1177, 1181 (2001) [hereinafter Isham, Workable Protection].

[34] The terms "adjusting" and "non-adjusting" creditors are borrowed from Bebchuk A. Lucian & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Insolvency, 105 YALE L. J. (1996)

can be time-consuming and costly[35]. In turn, this cost over expenditure would be reflected in the transaction itself as one of the most significant *ex-ante* costs of inadequate territorial insolvency laws.

If Universalism could find a concrete policy enactment and the "one court, one law" principle is realized, either through an international treaty or through "cooperation protocols" among courts[36], the cost of information would be significantly reduced[37]. Adjusting creditors' efforts in gathering the necessary information to tailor the terms of their transactions would be limited to the debtor's home country insolvency regime[38]. Additionally, reduced cost of information might give non-adjusting creditors the incentive to adjust their terms of credit and become adjusting creditors who might then wish to benefit from the unity of insolvency proceedings governed by one law under the auspices of one forum[39].

III. Insolvency Principles and *Ex Ante* Investment Decision-making

At first glance, insolvency laws and investment appear to have few commonalities. However, insolvency laws can significantly influence investment decisions. The costs created by the insolvency of a corporation are not only considered once a multinational has known financial distress or has filed for insolvency. Insolvency laws can have *ex-ante* effects on investment incentives, which can result in additional

[35] In association with what has been argued above, a more complete list of the costs of territorialism might include the administrative costs of multiple insolvency proceedings, which would oblige creditors to pursue their claims in many jurisdictions at the same time. In addition, attention should be given to the efforts of creditors regarding the attachment of assets, especially in jurisdictions in which insolvency has not yet been filed.

[36]E. Bruce Leonard, The Way Ahead: Protocols in International Insolvency Cases, 17-JAN AM. BANKR. INST. J. 12, 12 -39 (1999) (explains the increasing use of protocols to resolve cross-border insolvency cases, he also provides a list of cases where protocols between different courts have effectively limited the risks associated with assets dissemination); for a general discussion on the use of protocols *see* Evan D. Flaschen & Ronald J. Silverman, Cross- Border Insolvency Cooperation Protocols, 33 TEX. INT'L. L. J. 587, 593 (1998).

[37] *See* Westbrook, Creating International Insolvency Law, *supra* note 29.

[38] Nonetheless, the concept of home country can be subject to further criticisms and legal debates (treated in chapter II).

[39]*See* Andrew T. Guzman, In Defense of Universalism, 98 MICH. L. REV. 2177, 2201 (2000)

insolvency costs and can skew the investment decision-making processes of affected parties.[40].

These various costs - also known as *agency costs* - can be examined in three stages. Firstly, insolvency laws determine the principles according to which *loss sharing* between shareholders and creditors will be managed. As a result, shareholders incentive to invest will be dictated in light of their payoff in case of insolvency, and whether specific ex-ante investments will increase the value of their equity in the financially distressed corporation[41]. As it will be demonstrated, the incentive to invest will vary according to the insolvency regime in place and whether or not it applies an absolute priority rule[42]. Secondly, and contrary to traditional versions of the "*corporate veil*" doctrine, domestic insolvency laws may hold domestic corporations liable for the debts contracted by their subsidiaries overseas. As a result, multinationals may be reluctant to invest in a foreign country unless risk measuring guarantees a successful investment, something that the most careful feasibility study cannot ensure. Hence, the size of investments in the long run may decrease to the disadvantage of social welfare and development. Finally, under Territorial insolvency principles, multinationals may choose to invest and to borrow strategically, not according to the revenues expected in return, but

[40] "Insolvency law determines the allocation of a firm's assets when the firm cannot meet its obligations. This allocation in turn affects the investment decisions of the firm outside of insolvency". *See* Rasmussen Robert K., The Ex Ante Effects of Insolvency Reform on Investment Incentives, 72 WASH. U. L.Q. 1159, 1163 (1994) [hereinafter Rasmussen, Ex Ante Effects]

[41] *Id.*; *see also* Berkovitch, Eli, Ronen Israel, and Jaime F. Zender, An optimal insolvency law and firm-specific investments, European Economic Review 41, 487-497(1997).

[42] "An insolvency regime under which priority is respected would stabilize the costs associated with both debt and the division of ownership and control. However, in practice, creditors are never paid in full whereas shareholders continue to receive equity interests in the firm". *See* Rasmussen, Ex Ante Effects, *supra* note 39 at 67-72, (the author also envisages a legal regime according to which losses shall be equally shared between shareholders and creditors, *i.e.*, a regime that respects contractual priorities despite the author's pragmatic approach in designating the most appropriate legal regime and his reluctance in identifying that very regime, one can reasonably deduce that this regime is based on Universalism. In fact the author strongly stresses the importance of a single forum and a single law to deal with cross-border insolvency cases). In general *see* C. Kenneth White, Trading Claims in Bankruptcy; Trends, Issues and Investment Opportunities, 366 PLI Real Estate L. & Practice Course Handbook Series No. 9, (Jan.-Mar. 1991)

in virtue of the possibility to confer senior status to new creditors at the expense of old creditors, usually located in other jurisdictions[43].

A. **Absolute Priority Rule v. Loss-Sharing**

While the form of a better cross-border insolvency framework is the subject of ongoing discussions and disagreements among insolvency scholars and academics, there is a consensus on *ex-ante* insolvency costs and how they should be reduced to the advantage of the firm's stakeholders and society in general. It is therefore important to assess the role of domestic insolvency laws and their influence on investment incentives, as much as it is necessary to understand that these laws determine the payoffs of the corporation's shareholders in advance, if and when this corporation fails[44]. As such, the behaviour of those shareholders will be structured in light of the foreseeable outcome when the financially distressed entity is no longer able to honour its obligations[45]. These outcomes vary from one insolvency regime to another, especially if the liquidation system at stake respects an "absolute priority" rule.

By definition, an insolvency regime that respects an "absolute priority" rule is a system where shareholders cannot be paid the value of their equity unless debt holders are paid in full[46]. Moreover, shareholders cannot participate in reorganization plans (if any) of the distressed corporation unless creditors are fully paid, or at least a consensus on less than full payment is reached among the parties. As a result of this strict system,

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[43] *See* Caryn M. Chittenden, After the Fall of Maxwell Communications: Is the Time Right for a Multinational Insolvency Treaty?, 28 WAKE FOREST L. REV. 161, 179 (1993) (argues that the European Insolvency Convention would have to create a system that increases the security and predictability for both the company pursuing investment abroad as well as the domestic creditors funding such investment). *See* also American Bankruptcy Institute, Celebrating 20 Years of Service to Bankruptcy Professionals, 21-JUN AM. BANKR. INST. J. 52, 59 (a program titled, "Insolvency Risks Involved in Multinational Lending: Should Lenders to Multinational Borrowers Beware?")

[44] *See* Rasmussen, Ex Ante Effects, *supra* note 39, at 1165.

[45] Id. "the agency costs of asset substitution, underinvestment, and managerial entrenchment all stem from the payouts which the various parties receive when a given project fails"

[46] "When absolute priority is strictly followed, senior claims are paid in full before junior claims get paid at all. Of particular significance, strict adherence to absolute priority eliminates the equity claim because it is the most junior". *See* Alan Schwartz, The Absolute Priority Rule and the Firm's Investment Policy, 72 WASH. U. L.Q. 1213, 1214 (1994).

pre-insolvency[47] investment decisions are not taken in accordance with societal interests, as shareholders may want to increase the value of the firm's liquidation in the hopes of repaying all debt holders and at least a part of their equity value.

To illustrate this situation, consider a corporation (C) that has assets (A = 10) and debts (D = 12). Because C is insolvent[48], the shareholders equity value will be worthless after the full repayment of debt holders. On the other hand, consider that prior to the insolvency liquidation, the shareholders of C were presented with an investment project (P), with a cost of 10 and expected revenues of either nil or 14; with both possibilities being equally probable. The net present value of this project is –3[49]. The project's net value is negative and should not be undertaken by F's shareholders[50]. Nonetheless, where insolvency laws apply an absolute priority rule to the liquidation of corporations, shareholders will be motivated to undertake this investment project, although doing so does not serve the best interest of the indebted corporation. Indeed, absent the investment at stake, C Shareholders equity value is nil. With this investment project being undertaken, the value of their equity in the best case scenario (revenue from P = 14) will be 2, whereas the failure of the project would not affect their equity value, which would be nil regardless. Such an ex-ante investment decision disregards the corporation's interests because it only serves the shareholders' objectives of increasing their equity value.

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[47] This pre-insolvency period starts from the time a given corporation is facing financial distress that is likely to compromise its continuity. Although insolvency proceedings are not initiated by or against this entity, the activities of the latter are suspended or significantly reduced as a result of the lack of resources. During that period, transactions entered into by the management may be suspect and are often subject to special avoidance law rules.

[48] The concept of insolvency used in this context is "balance sheet insolvency", where a company is deemed insolvent when its balance sheet shows a net deficit, *i.e.*, when its liabilities exceed its assets.

[49] See Rasmussen, Ex Ante Effects, *supra* note 39, at 1183 (wrong cross reference). "The present value of an investment's future net cash flows minus the initial investment". If positive, the investment should be made (unless an even better investment exists), otherwise it should not.

[50] Lynn M. LoPucki & William C. Whitford, Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies, 141 U. PA. L. REV. 1497-98 (1993) (argues that "directors should pursue projects that have positive net present value to the company as a whole, and not just a positive effect on either debt or equity") [hereinafter Lopucki, Corporate Governance].

On the other hand, let us assume the same scenario illustrated above, however losses are now shared among the various stakeholders through a defined *pro rata* of the liquidation proceeds. If these insolvency laws were to attribute a portion of C's assets to its shareholders at least equal to 2, the shareholders would have had fewer incentives to undertake a project with a negative net present value. In this example, the loss sharing approach may have prevented an inefficient capital placement, while serving societal interests. However, this does not mean that loss sharing will always be preferred to absolute priority. In fact, only when the corporation is facing an outstanding debt will loss sharing be the better approach to liquidate the financially distressed entity and to prevent irrational investment decisions to be taken by its shareholders[51]. Yet the situation differs when the corporation in question is solvent, but is facing financial distress due to an inadequate capital structure.

In the previous scenario, we assumed that C had an outstanding debt of 12 and the value of its assets was only 10. Let us assume all the conditions in the example above remain constant, save that C owes only 8 to its debt holders. C is not insolvent, but its shareholders should quickly reinstate a better capital structure to the corporation. The same potential investment project is presented with its net negative value of-3. Absent this investment, and under a regime that respects absolute priority, C shareholders equity value will be 2. In the event the investment project is undertaken, the same equity value can be reduced to nil. Thus, the absolute priority regime will deter C's shareholders from pursuing this investment project for fear of value loss of their equities in the corporation. On the contrary, where a loss sharing approach is applied, the shareholders can disregard an eventual devaluation of their equities, as the prospects of value increase are higher and can motivate them to undertake defective investments, harmful to the corporation's interests[52]. In the present example, if the project fails, C's debt holders will share the

[51] Michael T. Maloney, Residual Claims in Bankruptcy: An Agency Theory Explanation, 37 JLECON 157, 159 (1994)
[52] *See* Betker, Brian, Management's Incentives, Equity's Bargaining Power, and Deviations from Absolute Priority in Chapter 11 Bankruptcies, Journal of Business 68, 161-163 (1995). See also Thomas H. Jackson & Robert E. Scott, On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors'

losses and allow C's shareholders to be paid a portion of their equity value (between nil and 2). However, if the project succeeds, C's shareholders equity value will significantly increase to 6, without sharing this surplus with creditors. In other words, when losses are incurred under this regime, creditors and shareholders jointly bear the cost; whereas only shareholders will reap potential benefits[53]. In this case, shareholders will have the incentive to invest in a net negative value project because insolvency laws, particularly distribution principles and the loss sharing system encourage this type of behaviour[54] when the corporation is facing financial distress without yet being insolvent. Needless to say that this distortion of capital placement can accelerate the decline of many firms, which might have been averted with diligent business decisions and investment choices.

While each approach encourages deficient investment decisions under specific circumstances, domestic insolvency regimes are neither *pro*"absolute priority" rule, nor *pro* "loss-sharing". Consequently, in a number of insolvency cases, poor investment decisions are taken to the detriment of social welfare. Furthermore, there is no compelling proof on a domestic level that firms will be better off under either of the two approaches, and it is not the objective of the present work to identify the most appropriate method to liquidate insolvent firms[55]. However, it is important to adhere to one approach

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Bargain, 75 VA. L. REV. 155 (1989); Mark J. Roe, Commentary on "On the Nature of Bankruptcy": Bankruptcy, Priority, and Economics, 75 VA. L. REV. 219 (1989).

[53] *See* Lopucki, Corporate Governance, *supra* note 49 at 753. See also Rasmussen, Ex Ante Effects, supra note 39, at 1185 (arguing that all downside risks are borne by the debt holders. "The larger the insolvency of the firm, the more likely it is that the firm will forgo projects which have a net present value". This makes the existence of a unified and predictable regime especially relevant in the context of multinationals, which are by definition large corporations). "Managers have an incentive to transfer wealth from debt to equity holders through excessive distributions to shareholders or excessively risky investment policies". *See* F.H. Buckley, The Termination Decision, 61 UMKC L. Rev. 243, 244 (1992).

[54] It is important however to highlight that not all negative net value investment projects are against social welfare. In some cases, a negative net value investment can bring a financially distressed firm closer to a state of solvency, enabling it to subsequently undertake similar projects that would save the firm and reinstate it to complete solvency. Nonetheless, investing in negative net project value projects is a sign of firms' decline and very often dissimulates the selfish incentive of shareholders to increase their equity value.

[55] *See* Rasmussen, Ex Ante Effects, *supra* note 39 at 1180 (favoring a contractual approach to guard against the insurance of debts. The author argues that the issue of the most appropriate liquidation system should be left to the agreement between creditors and shareholders).

so creditors may secure their rights against flawed investment decisions taken during the pre-insolvency phase.

In light of the above and the increasing number of multinational's creditors and shareholders located in various jurisdictions, such a unified approach to liquidation appears to be essential. Indeed, if global insolvency proceedings are to be foreseen in the future, differential treatment is likely to promote further inequalities, under-investment and poor capital placements[56]. This situation should multiply the disparity between creditors of the same class, while reducing the possibilities of restructuring of the multinational (*see infra*). Most importantly, this differing treatment should invite the various insolvency courts and professionals to conduct meticulous post-insolvency examinations of defective and fraudulent investment choices on both the domestic and international level[57].

Furthermore, corporations regulated by an insolvency regime that respects absolute priority will be able to attract more creditors and funding compared to firms where liquidation procedures allow loss sharing among creditors and shareholders. In order to lend to these firms where priority of payments is not guaranteed, creditors may wish to charge higher interest rates on their loans (*supra*) reflecting the risks they are prepared to take.

These two methods of liquidation bring forth the issue of priority claims among the insolvent corporation's stakeholders. While each domestic insolvency regime has its own methods to liquidate insolvent firms, and a specific order in which the various claimants are paid, common priority claims can be identified in most insolvency regimes.

[56] *See* Lopucki, Corporate Governance, *supra* note 49.
[57] As previously mentioned, a number of deceptive practices are subject to specific control such as investments made during the pre-insolvency periods, which are governed by contract avoidance law rules. On the notion of suspect period, *see* article 15 in The World Bank's report entitled Principles and Guidelines for Effective Insolvency and Creditor Rights Systems available at www.worldbank.org/gild (last visited March 2006).

This being said, it is believed that an international order of priority can hardly be established in the short or medium term, instead an international insolvency regime can help establish standards of supervision during the pre-insolvency phase for multinationals. Such a projection does not mean that the connection between insolvency laws and investment will dissipate. However, under a Universalist regime governing the insolvency of large multinationals, the interplay between financial default and investment incentives can be better understood and controlled so as to reduce the negative effects of inefficient capital placement. It will also enable multinational firms to borrow efficiently without bearing the cost of risk-taking by creditors (*supra*). Finally, it might allow debt holders to protect their rights in the best way possible.

B. Liability of a Parent Corporation for Insolvent Subsidiaries

Enterprise law regulates the relationship between a parent company and its subsidiaries. The traditional view of corporate principles regarding this relationship is that, subject to very narrow exceptions, the subsidiary is a separate legal entity from its parent. This principle is known as the doctrine of "*corporate veil*"[58], which basically separates for corporate legal purposes the liability of the parent company from that of its subsidiaries. Despite the considerable financial and managerial dependence of the subsidiary vis- à- vis its parent, corporate principles have long treated both companies as independent legal entities liable only for their respective commitments[59]. Although, domestic courts have occasionally, under differing theories to prevent fraud and substantial injustice, "pierced this corporate" veil[60] between the parent company and its

[58] Meeran, R., The Unveiling of Transnational Corporations: A Direct Approach, Kluwer Law International, 1999; Joseph H. Sommer, The Subsidiary: Doctrine Without a Cause?, 59 FORDHAM L. REV. 227, 237 (1990); Palmiter, Alan R., and Lewis D. Solomon. Corporations: Examples and Explanations. The Examples & Explanations Series. 4th ed. New York: Aspen Publishers, 2003; Presser, Stephen B. Piercing the Corporate Veil. Corporate Law Series; 4. New York, N.Y.: C. Boardman, 1991; Patrick C. Sargent, Bankruptcy Remote Finance Subsidiaries: The Substantive Consolidation Issue, 44 BUS. LAW. 1223, 1223 (1989)
[59] Kathryn R. Heidt, Environmental Obligations in Bankruptcy, BKRENVOB § 10:32 (2004) (argues that despite 'control' criteria used by courts, the overriding approach is to separate the two entities as regards their financial obligations).
[60] *See* Lubbe *et al.* v. Cape PLC and Related Appeals (2000) House of Lords (where the criminal liability of the parent company was at issue because of the tortuous conduct of its subsidiary located in another

subsidiaries, these are instances where the subsidiaries have been manipulated to effect a fraud or injustice on creditors and other third parties. Said differently, the corporate veil doctrine or the limited liability concept will apply to separate the parent from the liability of its subsidiary so long as no fraud or wilful misconduct has been committed. This is the same general principle that governs the liability regime of shareholders in a limited liability structure.

Because subsidiaries and affiliates are usually a "tool" for realizing the economic goal of the parent company in the overall operation of the group[61], an alternative practice was developed so as to treat a corporate group as a single entity that responds to the liability of the parent and its subsidiaries altogether. This practice is reflected in the concept of the "*enterprise*"[62] and recognizes the existence, as a single unity, of corporate groups for taxation and consolidated account purposes. For instance, taxation problems arising from transfer pricing and inter-group trades cannot be dealt with unless the overall corporate group is treated as a single corporate entity[63].

country); *see* also City of NY v. Exxon Corp., 112 BR at 553; Joslyn Mfg. Co. v. TL James & Co., 893 F2d at 83-84; United States v. Nicolet, Inc., 712 F. Supp. 1193 (ED Pa. 1989); American Bell Inc. v. Federation of Tel. Workers, 736 F2d 879, 886 (3d Cir. 1984); FruehaufCorp. v. Massardy (France), 5 INT'L LEGAL MATERIALS 476 (1966); Compagnie Européenne des Pétroles S.A. v. Sensor Nederland B.V. (Netherlands)(Holland), 22 INT'L LEGAL MATERIALS 66 (1983); Dow Jones& Co. v. Attorney General of Canada, 122 D.L.R.3d 731 (Fed. Ct.A pp.1981), aff'g, 113 D.L.R.3d 395 (Fed. Ct. 1980); Tahan v. Hodgson, 662 F.2d 862 (D.C. Cir. 198).

[61] *See* generally Berkovitch, Elazar, and Ronen Israel, Optimal insolvency law across different economic systems, The Review of Financial Studies 12, No.2, 347-357(1999).

[62] *See* P. Blumberg. The Law of Corporate Groups: Problems in the Bankruptcy or Reorganization of Parent Subsidiary corporations (1987) §§ 17.09.2, 17.16, 17.23.4). The new doctrine, suggested by Blumberg seeks to trace the decline of entity law and the emergence of enterprise law as the standard for application to corporate groups and their constituent corporations. Entity law, the view that each corporation is a separate legal personality, originally arose from philosophical roots. It was strongly reinforced by acceptance of the doctrine of limited liability in the early nineteenth century in the United States and several decades later in England. With the development of limited liability for shareholders, entity law became firmly established as the legal framework that preserved a strict line of demarcation between the corporation conducting the enterprise and the shareholders who owned the enterprise.

[63] *See* Vagts, Detlev F., The Multinational Enterprise: A New Challenge for Transnational Law, Harvard Law Review, 83, 94-96 (1970).

While for accounting and taxation purposes, a corporate group can be considered as a single entity, the insolvency of multinationals or corporate groups remains an area where the separate entity approach is the overriding principle. Therefore, as it will be further developed and discussed in the subsequent chapters of this thesis, the debtor's centre of main interests, presumably the debtor's place of incorporation, can be difficult to apply to corporate groups. Indeed, if the corporate group is formed by a number of subsidiaries, each incorporated in a different jurisdiction; there will be no such thing as a single court having overall jurisdiction over the insolvency of that group. In order to confer an overall jurisdiction to the parent's forum, probative evidence must be offered so as to reverse the presumption of the place of incorporation (as being the home country of each subsidiary) and to prove that the "real" centre of main interest of each subsidiary is located in the parent company's place of incorporation[64]. Doing so would ease the access to the subsidiary's, and possibly parent's assets (in instances of fraud), that are located in the parent's forum[65]. It is needless to say that the requirements to rebut the presumption of the place of incorporation may differ from one jurisdiction to the other.

As regards investment incentives, multinationals will be more reluctant to undertake projects or integrate markets where domestic insolvency laws allow claimants to easily turn against the parent corporation for the debts contracted by its subsidiaries[66]. Instead, an investment will be more favourably considered if it is governed by an insolvency regime(s) that is more stringent in shielding the parent company from claims

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[64] *See* Sandra Miller, Piercing the Corporate Veil Among Affiliated Companies in the European Community and in the US: A Comparative Analysis of US, German, and UK Veil Piercing Approaches, 36 AM. BUS. L.J. 73, 74 (1998).

[65] Muchlinski, P., Corporations in International Litigation: Problems of Jurisdiction and the United Kingdom Asbestos Cases' 50 International and Comparative Law Quarterly 1, 6 (2001).

[66] From a corporate governance perspective, a number of multinationals may actually rely on this fictive "corporate veil" to limit their liability in case their subsidiaries encounter financial difficulties. This overall interest of the "group" could encourage the parent company to circumvent creditors' rights. See Lynn M. Lopucki, The Death of Liability, 106 YALE L.J. 1, 20 -23 (1996) (argues that the parent-subsidiary relationship provides an effective strategy to shield the parent from liability); Henry Hansmann & Reinier Kraakman, Toward Unlimited Shareholder Liability for Corporate Torts, 100 YALE L.J. 1879, 1920 (1991); David W. Leebron, Limited Liability, Tort Victims, and Creditors, 91 COLUM. L. REV. 1565, 1613-14 (1991) ("A corporation can... limit its exposure to tort victims by segregating the business which causes injury into a separate corporate unit.").

resulting from the activities of its subsidiaries. In turn, jurisdictions that are strict as to the application of the corporate veil doctrine and offer little prerogatives to claimants to reverse the presumption of the centre of main interests (arguably the place of incorporation) are likely to attract more foreign investments than regimes that may allow claimants to seek the liability of the parent company[67].

With such a disparity, along with the absence of global standards to regulate the treatment of corporate groups - especially in times of financial distress - poor investment decisions may be taken to the detriment of social welfare, which will equally harm the interests of the corporation's stakeholders. This time, bad capital placements are not unproductive because of a negative net present value as previously explained. Instead, they are faulty because the motivation underlying these investments stem from a desire to limit the potential liability of the parent corporation, which often does not result in the most economically favourable investment. There is no doubt that corporations should meticulously calculate the risks they are prepared to take. Measuring risk taking however does not mean an integral exclusion of responsibility. The potential liability of the parent company should not deter managers and/or directors of corporations from undertaking promising investment projects, as this reluctance to invest may negatively affect social welfare and lead to a state of stagnation of commercial activities.

C. Privileged Creditors and Priority Claims

The issue of priority claims arises when a multinational debtor decides to borrow from and invest in other jurisdictions. In light of current territorial rules, already indebted multinationals may choose to invest and borrow strategically; not according to the

[67] Edward M. Graham, Global Corporations and National Governments, Washington DC: Institute for International Economics, 1996 (analyses the tensions between increasingly global corporations and the continuing national focus of governments and concludes that there is a strong need to enlarge and restructure the current foreign direct investment (FDI) regime by negotiating and implementing new international rules and institutional arrangements in this field.). *See also* Brewer, Thomas L. and Stephen Young, The Multilateral Investment System and Multinational Enterprises, Oxford University Press 45, (1998).

revenues expected in return, but according to the possibility of conferring senior status to new creditors at the expense of old privileged creditors[68]. This technique enables multinationals to reduce the cost of borrowing because these new lenders - located in a "virgin[69]" jurisdiction - can be granted "senior priority" on their credits, either by law or contractually. As a result, privileged creditors, who acquired their rights by virtue of previous dealings with the multinational, may see their privilege diluted. With an international insolvency regime that would control this questionable practice[70], and that would create binding norms "to supervise" the seniority of claims on a global basis, an overly manipulative multinational might likely to be deterred from pursuing this technique; hence, a more efficient capital allocation may be opted for. Under such an optimal system, the issue of priority claims would not influence multinational's choice to borrow and to invest in specific jurisdictions that are not the most profitable place for the business at stake.

With multiple priority claims differing from one jurisdiction to another[71] and the limited possibility for cross-filing[72], a global insolvency regime could also afford the protection needed to foreign creditors. Indeed, most insolvency laws are now drafted according to a rather territorial approach, and this creates an incentive for firms to skew their investment choices[73], while diluting creditors' rights. Such an inefficient capital

[68] *See* Rasmussen, Ex Ante Effects, *supra* note 39 at 1172 (the author argues that a insolvency regime under which priority rule is respected would stabilize the costs associated with both debt and the division of ownership and control. However, in practice creditors are never paid in full whereas shareholders continue to receive equity interests in the firm.)

[69] This term refers to a jurisdiction where the multinational in question has no creditors and where it does not conduct any commercial activity.

[70] *See* Peter Muchlinski, Multinational Enterprises and the Law, Oxford, Cambridge MA: Blackwell Publishers, 1995.

[71] "Although most countries treat similarly situated creditors similarly, not all countries use the same criteria to determine what makes creditors similar". *See* Martin N. Flics & Michael J. Ireland, Bankruptcy and the Problems of Multi-Jurisdictional Workouts, 592 PLI/COMM 415, 424 (1991)

[72] On the concept of cross-filling and universal cross-priority, *see* Westbrook, Universal Priorities, *supra* note 18 at 29 -31 (argues that the predominant territorial approach of domestic insolvency laws does not recognize - in the majority of cases - the status of foreign creditors, far less allow them to lodge their claims according to the priority they would have enjoyed before their domestic court and pursuant to their domestic insolvency law).

[73]*See* Isham, Workable Protection, *supra* note 32 at1177. *See* Westbrook, the ALI Principles, *supra* note 4 at 30 (argues that "it seemed apparent that closer integration and cooperation in the insolvencies of

allocation tends to be pricier than the administrative costs of insolvency per se, as argued by Michelle White[74]. In sum, not only do insolvency laws affect the financially distressed corporation, but they also affect all corporations before they face financial distress insofar as such entities may be better off by implementing more lucid and economically successful investment choices, had it not been for a defective insolvency framework. This distortion of capital allocation is also harmful to social welfare and can be avoided, according to Bebchuk and Guzman, by opting for a universal system of supervision[75].

In sum, the *ex-ante* effects of insolvency laws are important in appreciating the desirability of an international insolvency framework[76], particularly as insolvency laws exercise considerable *ex-ante* effects on investment incentives, and can act as a source for the success or failure of a business.

IV. Insolvency Precepts and *Ex Post*-Insolvency Effects

Ex- ante effects of insolvency laws are not the only elements to consider in assessing the need for an international insolvency regime. Insolvency laws produce various effects once a given corporation has formally entered insolvency proceedings. Among other solutions to this state of financial distress, some insolvency systems may permit the rescue of the distressed corporation by creating efficient restructuring tools at the disposal of shareholders and creditors. Needless to say, with more corporations being rescued, further economic and social gains should be expected[77]. Along with this corporate rescue option, insolvency principles should also ensure that the distressed entity is heading in the right direction, led by competent management. Therefore, a global

multinational companies were essential to full realization of the free flow of investment contemplated by the NAFTA").

[74] See Michelle J., The Costs of Bankruptcy, *supra* note 24.

[75] *See supra* note 28. *See also* Weiss, L, Insolvency Resolution: Direct Costs and Violation of Priority of Claims, Journal of Financial Economics, 27, 285-288 (1990).

[76] Fletcher Ian F., Insolvency in Private International Law, Oxford University Press 1997, 56-60.

[77] Jean Braucher, Bankruptcy Reorganization and Economic Development, 23 CAP. U. L. REV. 499, 499 (1994) (argues that the rescue option for corporations would increase economic benefits).

insolvency system could be argued to be a vehicle for reform with respect to corporate governance matters in the context of multinationals. And finally, an effective insolvency system should encourage private initiatives to resolve insolvency cases, thus reaching more market-oriented solutions in the failure of multinationals. Out of court settlements and informal workouts take place in "the shadow" of insolvency laws and should be addressed by forthcoming insolvency reforms either domestically or on a global level.

A. Multinationals' Reorganizations

Despite the negative perception of insolvency in commercial environments, a number of insolvency laws do not necessarily seek the termination of a financially distressed corporation or business[78]. In some cases, insolvency laws aim at availing a "fresh start[79]" to the indebted corporation, so as to maximize its economic value[80]. Indeed, under a number of domestic insolvency regimes, two alternatives may stem from insolvency proceedings: liquidation or reorganization.

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[78] *See* Gertner, Robert, and David Scharfstein, A theory of workouts and the effects of reorganization law, Journal of Finance 46, 1189-1222 (1991). Aside from regional insolvency arrangements such as the EU Regulation on Insolvency Proceedings that favours reorganization over liquidation, a number of European countries recognize this rescue option on the domestic level. See for instance The Insolvency Act of 1986 (UK) (provides for reorganization-oriented procedure that vests management control in one or more court-appointed administrators). A number of other countries (such as France, Italy, Japan, China, and Egypt) realize the economic benefits resulting from this rescue option and have accordingly started the reforms of their domestic insolvency regimes so as to limit the number of liquidations. The US model (chapter 11) has had a considerable impact on these domestic legal reforms efforts.

[79] Robert E. Scott, Sharing the Risks of Bankruptcy: Timbers, Ahlers, and Beyond, 1989 COLUM. BUS. L. REV. 183, 189 -190 (1989).

[80] Alan Schwartz, A Contract Theory Approach to Business Bankruptcy, 107 YALE L.J. 1807, 1847 (1998) (argues that a bankruptcy system' function is to maximize the monetary value of the insolvent estate). A number of commentators have addressed the general question of the desirability of maximizing a bankrupt firm's value as a goal of bankruptcy law. *See also* Elizabeth Warren, Bankruptcy Policy, 54 U. CHI. L. REV. 775 (1987); Douglas G. Baird, Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren, 54 U. CHI. L. REV. 815 (1987); Donald R. Korobkin, Rehabilitating Values: A Jurisprudence of Bankruptcy, 91 COLUM. L. REV. 717 (1991). This assumption would invite the managers of an insolvent or financially distressed corporation to exercise due care during the pre-insolvency phase in order to maximize the value of the indebted corporation's estate. Otherwise, the liquidation of the latter would produce little to repay creditors and the rescue alternative would be uncertain. *See* J. Ronald Trost, Roger G. Schwartz & Sidley & Austin, Fiduciary Duties of Directors of Insolvent Corporations, SD24 ALI-ABA 87, 87-104 (1998).

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In the first instance, the company in question has experienced severe financial distress[81] and its debts largely exceed the value of its assets. In turn, these assets will be sold off - either as a going concern[82] or piecemeal - to satisfy the corporation's debts and obligations towards its various creditors and shareholders. The second alternative calls upon the partial or entire remodelling of the corporation in question, which is usually believed to have the potential to generate profits. This rescue option is known as restructuring or reorganization and this process is especially designed to allow the recovery of greater value, compared to when the corporation is simply liquidated. Beyond the purely economic value that may result from the reorganization of a corporation, the legislator may simultaneously seek other social objectives[83].

In 1986, Baird defined reorganization as the equivalent to a going concern liquidation in which the existing claimants are the purchaser[84]. In reality, this purchase is nominal, since the corporation in question is sold in exchange of existing claims and interests. In other words, creditors and sometimes a number of shareholders will be the new owners of the corporation. Yet reaching a consensus among shareholders and creditors to reorganize can be difficult[85]. When the firm's value is approximately equal to its debts, creditors may push for its liquidation, whereas shareholders would opt for

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[81] Liquidation procedures are generally opted for once there is no economically reasonable possibility of rehabilitation. Some legislation allows liquidation procedures only if all attempts to reorganize have failed.
[82] Lucian Arye Bebchuk, A New Approach to Corporate Reorganizations, 101 HARV. L. REV. 775 (1988) (argues that a liquidation as a going concern may be viewed as a special case of the reorganization process in which new capital equal to the going concern value of the corporation's assets is contributed and then distributed to the creditors in order of their priority).
[83] In the US for example, the reorganization policy promotes the restructuring of a business to preserve jobs, to pay creditors, to produce a return for owners, and to obtain the fruits of American enterprise for the nation. *See* Johnson Gordon, Insolvency, Reorganization and Restructuring, World Bank working paper (2001), 4.
[84] Douglas G. Baird, The Uneasy Case for Corporate Reorganizations, 15 J. LEGAL STUD. 127, 145 (1986).
[85] For instance, Cramdown provisions enable a bankruptcy court to confirm a plan of reorganization over the objections of some classes of creditors. See Omer Tene, Revising the Creditors' Bargain: The Entitlement to the Going-Concern Surplus in Corporate Bankruptcy Reorganizations, 19 BANKR. DEV. J. 287, 287 -290 (2003); David A. Skeel, Jr., Markets, Courts, and the Brave New World of Bankruptcy Theory, WIS. L. REV. 465, 515 -518 (1993).

reorganization, as they will be able to profit from the continuity of the corporation's operations[86].

Because the choice between whether to reorganize or to liquidate is difficult, under various legislations, corporations' profitability tests take place at an early stage of their insolvency proceedings[87]. For instance, in the United States, regulations have been issued that allow the court to approve a reorganization plan under the rehabilitation "chapter 11" of the federal Bankruptcy Act, despite the fact that the support required from creditors as a condition for court approval was obtained through a vote that occurred prior to the actual commencement of the formal rehabilitation proceedings[88].

On the domestic level, these laws should allow this rescue option because giving a "second chance" to financially distressed corporations will encourage the creation of an entrepreneurial class, while involving the private sector in the resolving of financial crisis. On the international level, a potential cross-border insolvency framework should achieve the same objectives stated above with respect to multinational corporations. Nonetheless, the reorganization of multinationals can entail further challenges that must be addressed[89].

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[86] Edward M. Keech, Problems in the Liquidation and Reorganization of International Steamship Companies in Bankruptcy, 59 TUL. L. REV. 1239, 1249 (1985) (argues that "Creditors seldom make the decision to reorganize, however; management files for reorganization first and consults with the creditors later").

[87] Courts where the rescue option is available by law adopt a test that permits reorganization only when local creditors are better off under such procedures. This approach is adopted by the former 11 U.S.C. § 304, and is essentially the enquiry undertaken by the courts In re Toga and Liverpool Ltd. v. Certain Freights of the M/V Venture Star, 102 B.R. 373(D.N.J. 1988).

[88] *See* Gordon W. Johnson, The World Bank's Role in Developing Global Principles and Strengthening Capacity in Developing Countries, 112901 ABI-CLE 207 (2001).

[89] Id. On the difficulties of reorganizing a multinational corporation on an international scale, such as the determination of the competent forum and the priority of claims, *see* In re The Singer Company N.V., No. 99-10578 (Bankr. S.D.N.Y., filed Sept. 13, 1999). *See also* Arnold M Quittner, Cross-Border Insolvencies-Ancillary and Full Cases: The Concurrent Japanese and United States Cases of Maruko Inc, 4 INT'L INSOLVENCY REV. 171 (1995).

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Indeed, cross-border insolvency cases usually involve large multinationals that are likely to opt for reorganization[90], if such an option were available. This decision can result in complex proceedings, as multinationals' assets must be collected in an orderly fashion to ensure their productivity. To achieve this, it is believed that the reorganization of multinationals would be better administered by as single forum insofar as the "*location of the assets affects the reorganization decision to the extent that their location affects the debtor's business*"[91]. In addition, as argued by Westbrook, in the reorganization of multinationals, "*interim financing and supervision of the company's management are only two of the delicate functions that are difficult to carry out by cooperation between distant judges*"[92].

On the contrary, reorganization will be difficult or even impossible if a common decision to reorganize is awaited to be taken by several jurisdictions in which the debtor possesses assets[93]. For this purpose, it should be understood that reorganizing a multinational corporation requires a centralized procedure only afforded the "one court, one law" principle. While Universalism may facilitate the reorganization of multinationals, Territoriality would encourage their liquidation when reorganizing them would be more valuable for stakeholders. In turn, an effective cross-border insolvency

[90] Data are taken from Elizabeth Warren & Jay Lawrence Westbrook, Financial Characteristics of Business in Insolvency, 73 AM. BANKR. L.J.499, 524 TBL.2A (1999).

[91] *See* Arnason Jon Yard, Insolvency Law in the International Context, METRO. CORP. COUNSEL. 15 (1996).

[92]*See* Westbrook J. Lawrence, A Global Solution to Multinational Defaults, 98 MICH. L. REV. 2276, 2285 (2000). More recently, Professor Westbrook argued that such reorganization plans "cannot be achieved unless a court can bind all stakeholders to the reorganization plan, including dissenters. Only a system that conclusively resolves all stakeholders' legal rights can produce a financial restructuring that gives existing and future parties, including financiers, investors, and employees, a sufficient guarantee of legal certainty. Without such assurances, a reorganization plan cannot go forward. Such a system must be symmetrical to the market". E. Bruce Leonard & R. Gordon Marantz, International Bankruptcies: Developing Practical Strategies, 628 PLI/COMM 439, 443 (1991) (argues that the wave of cross-border insolvencies requires a formal structure or framework to provide for an efficient reorganization or disposition of assets among creditors...this would be impossible without any international mode of co- operation in place to ensure the equitable treatment of creditors in different jurisdictions or to at least enhance the possibility of achieving that goal).

[93] Most importantly, the laws of each of these jurisdictions must avail the option of reorganization. This would seem difficult if the jurisdiction where important assets are located does not favor reorganizations, and believes reorganization is inappropriate in a specific case, or simply feels that its domestic creditors would be satisfied out of local assets.

framework would facilitate multinationals' restructuring by availing the rescue option[94]. This seems difficult to achieve under the current Territorial approach.

B. Multinationals' Failure and Corporate Governance

The financial distress known by corporations can be the result of many factors, such as the application of a poor business model, an inadequate capital structure or deficient management or a combination of factors[95]. On the other hand, the rescue option, also known as reorganization or restructuring, requires good management in order to help these corporations overcome the period of financial uncertainty and distress[96]. While most reorganization plans are largely concerned with re-establishing a sound financial structure, little attention is paid by insolvency proceedings to corporate governance issues[97]. This lack of attention can be costly in the long term. Indeed, despite the financial restructuring that firms undergo, good management is essential in order to ensure their survival and competitiveness in the market[98].

In this sense, an explicit link between insolvency laws and corporate governance should be established. Many believe that reorganization plans - a component of insolvency proceedings - should include unambiguous references to the corporation's

[94] *See* Caryn M. Chittenden, After the Fall of Maxwell Communications, *supra* note 42 at 165, (argues that although a number of cross-borer insolvency did not require an international treaty to partly reorganize the multinationals at stake, "the implementation of such a treaty would have reduced the cost and time involved and would have potentially promoted reorganization over liquidation")

[95] *See* In re Maxwell Communication Corp., No. 91-B-15741 (Bankr. S.D.N.Y. 1991). *See* generally Evan D. Flaschen & Ronald J. Silverman, The Role of the Examiner as Facilitator and Harmonizer in the Maxwell Communication Corporation International Insolvency, Current Development in International and Corporate Insolvency Law 621 (Ziegel ed. 1994); Leonard Hoffmann, Cross-Border Insolvency: A British Perspective, 64 FORDHAM L. REV. 2507 (1996).

[96] Berkovitch, Eli, Ronen Israel, and Jaime F. Zender, The design of insolvency law: A case for management bias in insolvency reorganizations, Journal of Financial and Quantitative Analysis 33, 41-43 (1998).

[97] Although issues pertaining to corporate governance can be analyzed at two different stages (pre-insolvency and post-insolvency), the present part will address the effects of insolvency laws on corporate governance once the firm has entered insolvency proceedings.

[98] Holly J. Gregory, The Globalisation of Corporate Governance, World Bank Working Paper (2000), 24.

good governance and its improvement[99]. To this end, an effective insolvency framework is one where the approval of a restructuring plan by the competent forum is conditioned upon the replacement of directors, or at least upon their close supervision[100]. With recent scandals such as Enron[101], WorldCom and others, insolvency laws have become an important vehicle to establish standards and principles for good corporate governance.

Better corporate governance would translate into better monitoring, improved managerial accountability and enhanced performance[102]. Practically speaking, the management of any given corporation is vested with powers to conduct the latter's operations in the best possible way. The board of directors and its various committees (*e.g.*, an audit committee) stand as the primary overseers against managerial indiscretion and opportunism [103]. When the board fails to perform this legally mandated supervisory task, the monitoring of corporate activity becomes especially relevant in the context of insolvency. The link between sound corporate governance, insolvency reforms and quality and transparent financial reporting highlights the amendments domestic insolvency laws well might undertake[104].

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[99] David A. Skeel, Jr., An Evolutionary Theory of Corporate Law and Corporate Bankruptcy, 51 VAND. L. REV. 1325, 1325 (1998) (argues that corporate governance and corporate bankruptcy complement one another. "Changes in firms' characteristic approach to corporate governance in any given country will provoke changes in corporate bankruptcy, and vice versa").

[100] In this respect, one has to distinguish between two approaches to corporate reorganization. The first is the US reorganization model (chapter 11) according to which the management of the insolvent corporation may remain in charge of administering the insolvent entity. Other countries, such as the United Kingdom, follow another approach because they are more protective of creditors' interests. Therefore, English courts for instance would replace the management of an insolvent corporation by appointing an official administrator.

[101] *See* The Enron Power's Report available at www.chron.com/content/news/photos/02/02/03/enron-powersreport.pdf (last visited March 2005).

[102] LoPucki, L. and W. Whitford, Corporate Governance in the Insolvency Reorganization of Large, Publicly-Held Companies, mimeo, University of Wisconsin (1998), 38.

[103] William M. Hannan, The Independent Director - An Investor's Watchdog, 2 No. 26 ANCORPCLR 3 (2004) (argues that "well-run corporations have a board that is independent enough to not only review the decisions made by management but question those decisions. To accomplish this goal, a board must be truly independent"); see Harold L. Kaplan, Health Care Enters the Zone of Insolvency, 21-OCT Am. BANKR. INST. J. 32, 33 (2002) (argues that the role incumbent on the board of directors is to exercise strict control on the operations of the corporation. This board should be diligent when the corporation in question is facing financial difficulties).

[104] *See* Peter F. Coogan et al., Panel Discussion: The Problems of the Sinking Ship, 31 BUS. LAW. 1371 (1976); Lewis U. Davis et al., Corporate Reorganization in the 1990's: Guiding Directors of Troubled

Furthermore, the restructuring of corporations often requires the injection of capital in the form of additional equity or bonds. The incentive of those who are willing to invest can be affected if the mismanagement of the rescued corporation persists[105]. This could create a pattern of distrust regarding the restructuring of corporations' management and also highlight the inadequacy of insolvency principles to improve the managerial structure of financially distressed entities. A weak governance structure could negatively affect the future availability of interim financing, thus reflecting poorly on the objectives of the legislator in providing for a rescue option to corporations.

As much as domestic insolvency laws play a major role with respect to the efficiency of restructuring plans and the improvement of the managerial structure, a prospective cross-border insolvency system should pursue similar objectives with respect to multinationals. Indeed, the restructuring of multinationals requires both a unified decision making process and a good administration at all levels of the corporate group. While mega-scandals of bad corporate governance, such as that of the magnitude of Enron[106], are viewed by some commentators as isolated and rare, it is likely that similar cases will occur, where the dynamics between insolvency laws, corporate governance and

Corporations Through Uncertain Territory, 47 BUS. LAW 1 (1991); Laura Lin, Shift of Fiduciary Duty upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors, 46 VAND. L. REV. 1485 (1993); Stephen R. McDonnell, Geyer v. Ingersoll Publications Co.: Insolvency Shifts Directors' Burden Form Shareholders to Creditors, 19 DEL. J. CORP. L. 177 (1994)

[105] *See* Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 109- 44 (1991) (argues for the role that takeovers would play in subsequent corporate governance); for an anticipation of the interplay between corporate governance and takeovers see Henry Manne, Mergers and the Market for Corporate Control, 73 J. POL. ECON. 110 (1965); John C. Coffee, Jr., The Rise of Dispersed Ownership: The Role of Law in the Separation of Ownership and Control, 111 Yale Law Journal 1, 3-5 (2001). Berkovitch, Eli, Ronen Israel, and Jaime F. Zender, The Design of Insolvency Law: A case for management bias in insolvency reorganizations, Journal of Financial and Quantitative Analysis 33, 444, (1998).

[106] "The Enron failure demonstrated a failure of corporate governance, in which internal control mechanisms were short-circuited by conflicts of interest that enriched certain managers at the expense of the shareholders". *See* Andrews Enron Litigation Reporter, ISDA Blames Officers, Not Derivatives for Enron Collapse, 1 No. 7 ANENRON 12 (2002).

financial performance must be handled carefully[107]. Corporate governance and corporate restructuring are issues that should be addressed by an international insolvency framework because such issues can affect the international financial architecture.

C. Informal Workouts

Not all insolvent corporations go through formal insolvency proceedings provided by the law. A number of financially distressed entities try to find a solution in the shadow of the law through negotiation between shareholders and creditors. This process is known as "informal workout" or "out of court bargaining or settlement" and consists of raising creditors' and debtors' interests without necessarily liquidating the distressed entity, nor entering into complex reorganization plans before courts[108]. Very often, whether the corporation's stakeholders will resort to such a workout will depend on a comparison between the transaction cost of bargaining in a workout situation and the costs associated with formal proceedings[109].

Other than cost factors, informal workouts present many advantages compared to formal insolvency proceedings. Frequently, the financial difficulty of corporations requires early intervention and quick remedies that are not available under formal bankruptcy proceedings[110]. In addition, *informal workouts* allow the company's

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[107] Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 American Journal of Comparative Law 329, 330-31 (2001).

[108] The informal process essentially involves bringing together the debtor and creditors. Someone has to initiate this process, as there are no laws to facilitate it, which can present a difficulty. A debtor may not be willing to have a dialogue with creditors. Among creditors, some will be concerned for their own position and may not want a collective process. "A workout is required when a debtor company is confronted with difficulties that will not respond to short-term adjustments and finds that it is difficult or impossible to meet its contractual obligation in the normal course of business. The workout under these circumstances involves all parties with an interest in the company. Considerable time and negotiation are required to develop a workable plan whereby the respective interests will be balanced so that creditors and investors ultimately will come as close as possible to a realization of their original goals and expectations". *See* Business Workouts Manual, Buswork TOC (2003).

[109] Jay Alix ET. al., Financial Handbook for Bankruptcy Professionals, FINBKRPROF § 3.5 (2003) (argues that bankruptcy is expensive and can be more time consuming than a workout, and therefore it is usually a last resort).

[110] Id., (argues that it is often difficult to recover a firm's losses after it has reached the threshold of balance sheet insolvency).

management to reach a more market-based solution because they create a suitable atmosphere for discussions with creditors. This flexibility increases the chances of rescuing the financially distressed entity at stake[111]. And finally, informal workouts can take place without the occurrence of negative publicity that usually accompanies formal insolvency proceedings. The confidential character of the process can facilitate the informal reorganization of the distressed corporation while conveying the participation of new rescuers (lenders or new shareholders) to save it.

Often, when domestic insolvency laws are inefficient and costly, the managers of a financially distressed corporation might prefer informal workouts to decide the future of the corporation[112]. This is not by itself a negative alternative, however, one has to consider that deficient insolvency laws are usually the result of a weak institutional environment, where creditors' claims before domestic courts are not satisfied in a timely manner, nor enforced. As a result, creditors' claims and decisions taken within an informal workout process are even less likely to be enforced by the domestic judicial system. In essence, informal workouts should be supported by the appropriate legal infrastructure as much as formal insolvency proceedings[113]. That is, fair and predictable insolvency principles implemented by an expedient, impartial and cost effective judiciary system. In the absence of this pre-requisite, informal workouts may simply be used by unscrupulous shareholders in order to dilute creditors' rights[114]. On the contrary, when domestic insolvency laws duly regulate the process of informal workouts, the latter may

[111] Id. "Under certain circumstances, out-of-court settlement proves to be a very viable and preferable option for those involved in problem credit situations". "This form of financial settlement has the advantage of not being saddled with the rigid procedures and rules encountered in the courtroom. Because of this flexibility, the parties are given an opportunity to develop a realistic repayment schedule". *See* Stewart E. Bland, Insolvency in Farming and Agribusiness, 73 KY. L.J. 795, 797 (1994)

[112] Gilson, S., Managing Default: Some Evidence on How Firms Choose Between Workouts and Chapter 11, Journal of Applied Corporate Finance, 4, 6-7 (1991).

[113] *See* Johnson Gordon, Principles and Guidelines for Effective Insolvency and Creditors Rights Systems, World Bank working paper; (2001), 53 (argues that "An informal process is far more likely to be sustained where there are adequate creditor remedies and insolvency laws"). *See* Tamar Frankel, Securitization: Structured Financing Financial Asset Pools, and Asset-Backed Securities § 21.20.1 (1991); Steven L. Schwarcz, Structured Finance: A Guide to the Principles of Asset Securitization 16-17 (2d ed. 1993); Claire A. Hill, Securitization: A Low-Cost Sweetener for Lemons, 74 WASH. U. L.Q. 1061, 1062 (1996).

[114] Gilson, S., Managing Default: Some Evidence on How Firms Choose Between Workouts and Chapter 11, Journal of Applied Corporate Finance, 4, 7-9 (1991).

serve as a useful supplement and alternative to formal insolvency proceedings[115]. This argument is true especially in regimes where corporate insolvency is frequent and may lead to systemic risks, hardly manageable by the domestic court system.

Commonly, informal workouts enable small creditors to fully recover their debts. The debtor then submits a restructuring/reorganization plan[116] for the remaining creditors. This plan has to be approved by the unanimity of creditors. One shortcoming is that the debtor has no powers to abide by the dissenting creditors except that it can defer to the courts for formal insolvency proceedings[117], and the reorganization plan is binding to all creditors, including dissenting ones. This procedural parallel highlights once more that informal workouts – as useful and expedient as they may be- take place in the "shadow of insolvency laws". Without these laws, informal workouts can prove inefficient and most importantly, may be abused to the advantage of indebted corporations.

When a multinational encounters financial distress, such informal workout procedures can be appropriate due to the impressive size of multinationals and the sums at stake. Nevertheless, few domestic insolvency regimes provide a reliable institutional framework where informal workouts can be relied upon to resolve multinational's insolvency disputes. This disparity between domestic insolvency laws calls upon the adoption of international norms and enforceable principles that facilitate a smooth

[115] *See* Scott, Sharing the Risks, *supra* note 78 at 54 "Well-established and widely used creditor remedy and insolvency law regimes can be used to influence the commencement and progression of an informal workout. The invitation to commence a dialogue should rarely be refused. If the opportunity is declined, the debtor faces the prospect that individual creditor remedies or formal insolvency proceedings will be pursued".

[116] This plan is not different from the one presented before courts, had the financially distressed firm entered into formal insolvency proceedings.

[117] W. Homer Drake, Jr. and Christopher S. Strickland, Chapter 2. Systems of Debtor Relief, CH11REORG § 2:7 (2003) (argues that a workout has several disadvantages which may make it unrealistic. If, for example, the largest creditors do not unanimously agree with the proposed settlement, the workout will likely prove impossible to achieve. Likewise, it must be remembered that workouts offer no forced moratorium or injunction against seizures or foreclosures by rogue creditors).

process of informal workouts[118]. This international framework should enable creditors and debtors to quickly reach a consensus on the future of the distressed multinational[119]. This framework should also ensure a sufficient degree of security to worldwide creditors in order to encourage them to resort to this technique when it is more cost efficient to do so. Finally, this will empower domestic insolvency regimes to better address the issues related to multinationals' insolvency while improving the legal infrastructure (effective insolvency principles and solid judicial system) necessary to support out of court settlements.

V. Conclusion

As illustratively explained above in this Chapter, many of the fundamental issues that arise when a multinational corporation encounters financial difficulty, particularly in the context of impact on a range of significant cost and decisional factors, leads to the logical and practical conclusion as to the implementation of international insolvency standards so as to reduce the cost of financial distress *ex-ante* and *ex-post*. Although many international corporate insolvency cases currently are resolved, on an *ad hoc* basis, through the agreement on protocols among individual courts, most complex resolutions are not entirely satisfactory and there is still a considerable amount of *ad hoc* unpredictability pertaining to the content of such protocols. This unpredictability sustains the threat to the international financial infrastructure because it obscures the expectations and planning/decision-making of creditors, debtors and other parties with legitimate interests- still resulting in higher operational/contracting/investment costs.

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[118] International efforts to establish standards for informal workouts have taken place. In October 2000, INSOL international released a "A Statement of Principles for a Global Approach to Multi-Creditor workouts", which espouses eight best practices for multi-creditor workouts. The principals are fundamental to informal multi-creditor workouts and are a useful guide for developing effective practices and procedures in this area.

[119] Kent Pen, Corporate Workouts: A UK perspective, Bank of England, (1997) 19 (argues "the ideal mechanism for coping with international workouts would be an international insolvency procedure. That is something to aim for and the work of UNCITRAL and others is invaluable in this field. It is only realistic however to recognize that this is likely to take many years to achieve. The efforts of the INSOL Lenders Group to draw up internationally acceptable principles to be followed when conducting cross-border workouts are intended to bridge this gap").

Chapter One.

Presently, there is a growing consensus[120] that effective internationally oriented insolvency regimes are essential to strengthen the international financial and economic architecture. As much as domestic insolvency laws affect the economic life of domestic corporations, an international insolvency system is needed to oversee the commercial activity of large multinationals, especially during periods of financial distress. Despite extensive debates regarding the creation and implementation of such an international framework, the institutional dimension has often been neglected. As it will be argued in the subsequent Chapter Five, institutional vehicles are essential to provide for competent entities that ensure the implementation and enforcement of potential cross-border insolvency standards. Nevertheless, before treating the institutional/enforcement aspect of a potential cross-border insolvency framework, one has to decide what type of substantive and procedural laws and standards should be created.

In this regard, *arguendo,* a case could be made in favour of *Universalism,* which, at least in theory, appears to be an efficient approach in dealing with a number of fundamental issues (including the issues raised in this Chapter). Indeed, Universalism has been recognized by many scholars to offer the most appropriate solution to deal with the consequences of international insolvency proceedings, such as the changes in the debtor's capital structure, management and the day-to-day operations. Its widespread implementation also well might prevent the unnecessary waste of resources between several jurisdictions to the advantage of the mass of creditors. It further might provide for a good level of predictability while enabling multinationals to make more fruitful investment decisions. Finally, a True Universalist approach might provide, within a transparent environment, for an equal treatment to creditors on equal footing regardless of their location, which again consolidates the objectives of fairness and equality. Yet the

[120] The importance given to insolvency regimes by the IFI's consolidates this view. The World Bank has been developing principles and guidelines on Insolvency and Creditor Right systems, selecting the most important components, criteria and best practices for building effective insolvency systems, by focusing on a system-wide approach to insolvency reforms. *See* World Bank publication "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems" 2000. On the other hand, and as a result from the Asian Financial Crisis, the International Monetary fund undertook its own initiative to encourage and assist member countries to design orderly and effective insolvency systems. *See* IMF publication "Orderly and Effective Insolvency Procedures" 1999.

many proposals for its implementation seem rather wanting and do not take the step of genuinely establishing a universal and viable cross-border insolvency regime (Chapter Two).

Rather, international insolvency practice appears to comprise more of a blurry fusion between Territoriality and Universalism theories, militating for the time being, for some form of modified approach, which will be the foundation for the presentation and development of my modest thesis for interim, international insolvency reform in the case of multinationals' default. Admittedly such a modest, interim approach would not address satisfactorily a number of the issues raised in this Chapter and probably only a True/Pure Universalist framework would, but there needs to be a "practical" start-point that can be incrementally enhanced and perfected over time. In this author's view, however, the current "either-or", "all-or-nothing" debate is impractical and counterproductive to meet the corporate insolvency needs of an increasingly globalising environment.

Chapter Two.
The Universalistic Account: Uncertain Prospects for a Cross-Border Insolvency System

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I. Introduction

As suggested in the previous Chapter, "Universalism", in a theoretical context, portrays itself as an effective methodology to deal with certain of the insolvency problems facing large multinationals. On its face, the selective problems raised in Chapter Two that stem from the financial distress of these corporate entities would be better addressed and resolved by a single court and/or by the implementation of one set of legal principles/rules/approaches to better assist worldwide claimants. As further suggested, this should achieve a higher degree of predictability and transparency whilst promoting more equitable treatment of creditors on a global level. On the economic and financial level, Universalism theoretically should reduce the transactional cost, augment the availability of credit and increase the value of the distressed multinational to the

advantage of its various stakeholders[1]. In addition, it could be well-argued that Universalism should facilitate the reorganization of multinationals when it is more beneficial and more cost-effective to do so.

Despite these theoretical advantages, Universalism has not known any concrete policy or legislative enactment to date; while multinationals' failures multiply and continue to have considerable financial and legal effects beyond the boundaries of sovereign states. Before understanding the reasons underlying such a paradox, one should consider what Universalism entails in its various possible forms.

A tenuous and perhaps currently the most unrealistic form of Universalism is known as "True" or "Pure" Universalism[2]. This version proposes that a single international court (or court system[3]) that is in charge of implementing an international insolvency law should be in charge of adjudicating multinationals' default. This system would automatically transfer the competence from domestic courts to a supranational judicial entity having priority to adjudicate the financial distress of large multinationals[4] on a worldwide basis or at least, on a regional basis[5]. Although this approach would

[1] Barry E. Adler, Finance's Theoretical Divide and the Proper Role of Insolvency Rules, 67 S. CAL. L. REV. 1107, 1111-1112 (1994); Richard V. Butler & Scott M. Gilpatric, A Re-examination of the Purposes and Goals of Bankruptcy, AM. BANKR. INST. L. REV. 269, 269 (1994); Charles W. Adams, An Economic Justification for Corporate Reorganization, 20 HOFSTRA L. REV. 117, 117-118 (1991).
[2] The term "True Universalism" is borrowed from Professor Westbrook. *See* Westbrook J. Lawrence, A Global Solution to Multinational Defaults, 98 MICH. L. REV. 2276, 2328 (2000) [hereinafter Westbrook, Global Solution]. It refers to an international insolvency system built simultaneously on a single international insolvency court and a single international insolvency law. This form of Universalism is not to be confused with what is commonly referred to as "pure Universalism", which attributes competence to the forum of the debtor's home country to adjudicate the entirety of the debtor's estate (*infra*). On the definition of pure Universalism, *see* Liza Perkins, A Defense of Pure Universalism in Cross-Border Corporate Insolvencies, 32 N.Y.U. J. INT'L L. & POL. 787, 789 (2000); Jay Lawrence Westbrook, Choice of Avoidance Law in Global Insolvencies, 17 BROOK. J. INT'L L. 499, 514 (1991) [hereinafter Westbrook, Choice of Avoidance Law]. *See also* Todd Kraft & Allison Aranson, Transnational Bankruptcies: Section 304 and Beyond, COLUM. BUS. L. REV. 329 (1993) [hereinafter Aranson, Transnational Bankruptcies].
[3] *See* Westbrook, Global Solution, *supra* note 2, at 2328.
[4] Gaillard Emmanuel & Westbrook J. Lawrence, Four Models for International Bankruptcy, AM. J. COMP. L. 27, 355-357(1993).
[5] *See* Westbrook, Global Solution, *supra* note 2, at 2328.

appear to allow significant improvements compared to the prevalent domestic embrace of "Territoriality", it is often perceived to be unfeasible in the short or medium term because of the substantial and procedural differences that exist between the various domestic insolvency laws, not to mention the political compromises such an undertaking would entail[6]. In the impossibility to realize this model, there are primarily two possible interim solutions that are defined under Universalism umbrella, and that might fulfil some of the objectives of True Universalism.

One interim, mid-term version is the "single-court"[7] Universalism, according to which the creation of an international sovereign court may still be required; however, such a court will apply the domestic insolvency laws of the countries involved in a given cross-border insolvency case. Indeed, this framework would not require the enactment of a substantive insolvency law and/or principles. The advantage of this arrangement would be that the application of domestic insolvency laws would neither entail unusual insolvency proceedings nor different social objectives from those pursued by domestic social policies. Yet, for such a framework to function harmoniously, it should be associated with effective choice-of-law provisions so as to avoid the conflict that may arise between the applications of several domestic insolvency laws. In addition, the prospects of creating an international insolvency court to adjudicate cross-border insolvency cases seem rather bleak as it would require the negotiation and ratification of a multilateral treaty and the creation of a new international institution, neither of which is favored by the major world governments today. Thus far, there have been no governmental proposals to create such a judicial authority.

A second form of lesser Universalism is the "single-law" Universalism, which would require the international community to reach a consensus on an international

[6] *Id.*
[7] *Id.* at 2315.

insolvency law[8] (ideally pursuant to a treaty). It would then leave the implementation of this international instrument to domestic courts to apply. This system is, according to Westbrook, "*the mirror image of the "single-court" system*"[9]. Among other possible suggested advantages, such a framework might circumvent the necessity of creating a supranational sovereign court to adjudicate the financial default of multinationals'. Insolvency proceedings would then be administered by a single domestic court (located in the debtor's home country) that has overall and exclusive jurisdiction over the debtor's assets wherever located. The opening of parallel or ancillary proceedings[10] would not be permitted under such a regime. As much as the "single-court" system requires effective choice-of-law rules, the instant framework would require an undisputed criterion to determine the debtor's home country (*infra*). When authors and scholars refer to Universalism, they often imply the lesser form of this theory represented by the "single-law" Universalism.

It is frequently claimed that Universalism has not been implemented due to its political implausibility and the difficult compromises sovereign states must make to reach an international consensus on the choice of a single forum and/or a single set of legal principles. The impracticality on a political level further highlights the difficulties that arise from the diversity of public policies within different jurisdictions. For instance, and notwithstanding that domestic insolvency laws are pro-debtor or pro-creditors with varying degrees, the protection of domestic creditors has always been a major concern for insolvency legislators and judges[11], especially when the debtors' local assets, a significant guarantee to domestic creditors, are transferred to other forums.

[8] This law (or treaty) would include substantive and procedural rules. These rules would define the threshold of insolvency, determine the commencement of insolvency proceedings, establish a universal order for priority claims, *etc.*
[9] *See* Westbrook, Global Solution, *supra* note 2, at 2329.
[10] On the distinction between these two types of proceedings, *see* Westbrook, Global Solution, *supra* note 2, at 2300.
[11] *See* Unt Lore, International relations and international insolvency cooperation: liberalism, institutionalism, and transnational legal dialogue, LAW AND POLICY AND INTERNATIONAL BUSINESS VOL.28, 4-6 (1997) [hereinafter Lore, International Insolvency Cooperation].

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Others have argued that agreeing upon an international insolvency framework based on Universalism would entail the export of domestic social policies from one forum to another and this could undermine the objectives pursued by the legislator in each forum[12], thereby rendering such a framework rather impossible to achieve. This being said, Westbrook addresses this critique by referring to the United States' bankruptcy regime; he states "*Experience in the United States and elsewhere demonstrates that a national, market-symmetrical law can largely accommodate local policies*[13]". The analogy to the U.S. federal legal system and largely homogeneous and integrated economic and financial market, however, is difficult to apply on a much more fragmented global environment.

Clearly, no definite evidence exists as to what extent a Universal insolvency framework would impinge on domestic policies. The dissimilarities between domestic insolvency systems, their procedural arrangements and overall objectives appear however to be incompatible[14]. As a result, the diverse "academic" proposals for the creation of a truly international, binding and universal insolvency framework have failed, producing a rather pessimistic vision towards the achievement of such a project.

Aside from the political and social objections to Universalism, there are a number of legal concerns as to the definition and feasibility of this framework. Indeed, according to Universalism, the administration of multinationals' insolvencies is handled by one court, traditionally located in the home country of the debtor. Yet to realize such a model, one has to determine what the home country of a multinational is, and what criteria

[12] *See* Lynn M. LoPucki, The Case for Cooperative Territoriality in International Bankruptcy, 98 MICH. L. REV. 2216, 2216 (2000) [hereinafter LoPucki, Cooperative Territoriality].
[13] *See* Westbrook, Global Solution, *supra* note 2, at 2277.
[14] *See generally* Campbell Dennis, International Corporate Insolvency Law, Butterworth (1992); Francis Hilliard, A Treatise on the Law of Bankruptcy and Insolvency, 2nd ed. Clark, N.J.: Lawbook Exchange, 2003; Vanessa Finch, Corporate Insolvency Law: Perspectives and Principles. Cambridge; New York: Cambridge University Press, 2002.

should be taken into account. That is to say, the very definition of Universalism may give rise to extensive legal debates because the benchmark for the determination of the debtor's home country varies from one insolvency regime to another. Even assuming that a predictable method may be used to that end, the current ad-hoc system of recognition and enforcement of foreign insolvency judgments may present another significant impediment to Universalism. It is therefore important to understand how these various legal issues practically affect the creation of an insolvency framework based on Universalism under any of its forms.

In sum, this Chapter will consider various social, legal and political objections to Universalism. This should further our understanding of why such a framework that could render many benefits has not been created. This Chapter will also serve as an introduction to the concept of "modified universalism", which regional implementation among EU countries will be more fully covered in Chapter Three and subsequent chapters.

II. Universalism and Creditors' Rights

In 1944, Professor Nadelmann asserted that "*in most of the countries, delivery of local assets...is refused at least if opposed by local creditors*"[15]. This assertion remains largely true to this day. Even under the most "universalistic" insolvency regime, courts invariable will refuse the delivery of assets in order to protect domestic creditors[16]. Numerous national insolvency systems are disposed to territoriality precisely to protect these creditors, who often are small and medium size enterprises. Herein stems one of the major reasons why Universalism has not yet known any concrete policy enactment, or

[15]Kurt H. Nadelmann, International Bankruptcy Law: Its Present Status, 5 U. TORONTO L.J. 324, 351 (1944).

[16] For instance, section 304 of the U. S. Federal Bankruptcy Code, as in existence at September 2005, permits a U.S. court to order, among other things, the turnover of a bankruptcy estate's property to a foreign jurisdiction. See 11 U.S.C. § 304 (c). A number of American courts have used § 304 over the years. There is a set of cases that grant the application of § 304 (c) liberally. Nevertheless, these are cases where the turnover of assets would not have harmed directly or indirectly the interests of domestic creditors. *See* In re Gee, 53 B.R. 891 (Bankr. S.D.N.Y. 1985) & In re Culmer, 25 B.R. 621 (Bankr. S.D.N.Y. 1982) (where the court decided to transfer assets to a Bahamian court only after ensuring that basic rights such as equity and due process would be respected in the foreign proceedings).

even implicit recognition. This judicial protectionism of domestic claimants further elucidates why some creditors may be better off under a strictly territorial approach, and how Universalism can distort capital allocation and risk taking by lenders. At last, Universalism is also criticized to affect distribution priorities set by domestic insolvency laws to the detriment of the social policies the legislator pursues.

Before treating the prejudicial effects of Universalism on creditors' rights, one must distinguish the various types of creditors and why they are so categorized. This step is essential to comprehend how Universalism can constitute a threat to certain categories of claimants, especially to strongly non-adjusting creditors[17].

A. Types of Creditors

According to Bebchuk and Fried[18], creditors can be classified into two categories, adjusting and non-adjusting creditors. Adjusting creditors are those who systematically adjust the terms of their loans to offset the negative effects of risk taking. Usually, these creditors are "sophisticated" and well informed about the different aspects of insolvency laws and are able to enter into many contracts with the utmost security. Thus, the term *adjusting creditors* reflects their ability to properly measure risk-taking in light of the potential insolvency of one or many of their debtors[19]. As a result, adjusting creditors are more prepared to face the insolvency of their debtor(s) than the second category of creditors: non-adjusting creditors[20]. The latter are those creditors whose credit nature does not allow any adjustment, such as tort creditors, trade creditors, and taxation authorities, to name just a few. They do not take into account the risk associated with

[17] The terms "adjusting" and "non-adjusting" creditors are borrowed from Bebchuk Lucian A. & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 Yale L. J., 866(1996).

[18] *Id.*

[19] Among others, this category encompasses the active players of capital markets where the terms of lending are adjusted to reflect the potential risks.

[20] Although known as non-adjusting creditors, this category of creditors may also be perceived as at least partially adjusting creditors. Such creditors may, for instance, refuse to lend to debtors who are considered too much of a credit risk. In addition, creditors may voluntarily be non-adjusting because it would be costly to measure risk taking for each transaction they enter into. *See* Steven L. Harris & Charles W. Mooney, Jr, Measuring the Social Costs and Benefits and Identifying the Victims of Subordinating Security Interests in Bankruptcy, 82 CORNELL L. REV.1349, 1372 (1997).

their transaction with the debtor, including the risk of non-payment. It is important to note that non-adjusting creditors may voluntarily be strongly non-adjusting creditors[21] like credit card companies who, for example, find it too costly to calculate interest rates on a transactional basis[22]. They may also be involuntarily strongly non-adjusting creditors like tort creditors, due in part to an accident or injury. These latter creditors could not have negotiated the terms of their credit as these terms are judicially determined, and are not subject to any bargaining by the parties.

Guzman[23] further deepens the classification scheme by arguing that non-adjusting creditors can be separated into two sub-categories, strongly non-adjusting and weakly non-adjusting creditors. The former have no recourse to adjust their credit on any terms, neither on a case-by-case basis nor according to their credit portfolio, thus stressing the importance of the insolvency regime to be applied. The second sub-category - weakly non-adjusting creditors - can adjust their overall credit portfolio in order to face non-payment risks, although such adjustments do not take place on a case-by-case basis.

Clearly, when Universalism is criticized to produce hardship to domestic creditors when local assets are to be transferred, it is understood that such hardship is primarily felt by strongly non-adjusting creditors, i.e. usually individuals and small/medium size corporations. In contrast, adjusting creditors' transactions are usually well studied and secured that even if the debtor's assets were insufficient for a complete recovery, they would not be prejudiced as much as strongly non-adjusting creditors. In fact, for adjusting creditors, insolvency rules are roughly deemed as equivalent as regards credit recovery. Nevertheless, they may prefer a framework based on Universalism because

[21] *See* LoPucki Lynn M, The Unsecured Creditor's Bargain, 80 VA. L. REV. (1994); Bridge Michael & Robert Stevens, Cross-Border Insolvency and Security, Oxford University Press, 2001.
[22] There are nonetheless more sophisticated approaches with respect to credit card companies. Although these corporations do not tailor the terms of their lending on a debtor-by-debtor basis, they may decide to charge different rates to different categories of cardholders.
[23] Andrew T. Guzman, International Bankruptcy: In Defense of Universalism, 98 MICH. L. REV. 2177, 2182 -2183 (2000).

such a system can entail great savings off the debtor's assets, thus rendering the total repayment of all creditors all the more likely.

B. Non-Adjusting Creditors under Universalism

The above presentation of the various types of creditors leads us to explore the types of problems strongly non-adjusting creditors may face under Universalism, and how these impediments are commonly used to discard Universalism and opt for Territoriality. There are in fact two arguments why the position of non-adjusting creditors under Universalism should be carefully considered. This section will address the particular position of strongly non-adjusting creditors and how an insolvency framework based on Universalism can affect their rights.

As explained above, strongly non-adjusting creditors fail to tailor the terms of their transactions so as to offset risk taking. As a result, the mass of borrowers will collectively support the burden of risk, regardless of their financial soundness and structure. This means that low-risk borrowers will borrow too little and high-risk borrowers will borrow too much. This encourages inefficient borrowing decisions and biased capital placements.

With an insolvency framework based on Universalism, where domestic courts are not always in charge and domestic laws do not necessarily apply, further capital distortion may occur. Indeed, a domestic non-adjusting creditor dealing with a foreign MNC subsidiary would carefully reconsider the terms of the transaction if aware that the potential insolvency of his debtor could entangle it in lengthy insolvency proceedings held before a foreign court (the debtor's home country), where unfamiliar insolvency laws are applied[24]. Thus, in this situation, it could be argued that the merits of

[24] In contrast, *see* Aranson, Transnational Bankruptcies, *supra* note 2, at 350 (arguing that "creditors presumably know of the potential for bankruptcy and its attendant complications when they decide to do business with foreign companies"). Even assuming that this statement is founded, it does not legitimise the

Universalism are refuted, as causing harm to the interests of domestic strongly non-adjusting creditors by increasing the unpredictable risks at stake.

In the alternative, one might argue that the insolvency framework has no effects on strongly non-adjusting creditors. By definition, these creditors do not rely on any legal regime because they do not calculate the risks they are prepared to take. Admitting that a greater capital distortion would occur to their detriment under Universalism presumes that strongly non-adjusting creditors have deliberately chosen the territoriality of insolvency proceedings and have taken the latter into consideration when contracting with a foreign subsidiary. Although this argument raises the lack of reliance on the insolvency regime to be applied, strongly non-adjusting creditors may have implicitly, to a certain extent, taken into account the prospects of insolvency proceedings in case of non-payment. Indeed, if the transaction with a foreign subsidiary were concluded in a domestic environment, it would seem reasonable to expect that the risks resulting there from will equally be governed by the domestic court system and domestic laws. Although non-adjusting creditors do not measure risk taking *per se*, to assume a complete non-reliance on the insolvency regime would violate their minimal expectations regarding the competence of the domestic judicial system. Furthermore, non-adjusting creditors' acceptance of risks takes place on a domestic level. With the implementation of a Universalistic framework entailing either the competence of a foreign court or the application of a foreign law, such an acceptance may be unwontedly extended beyond the domestic context[25].

breach of creditors' rights in case of insolvency. It is believed that creditors' awareness or expectations should not constitute a waiver of their rights.

[25] This is particularly relevant when, according to Universalism, local assets may be transferred to other forums. While non-adjusting creditors did not calculate the value of these assets, it does not imply that they were oblivious as to their existence and location. *See* Daniel M. Glosband & Christopher T. Katucki, Claims and Priorities in Ancillary Proceedings under Section 304, 17 BROOK. J. INT'L L. 477, 481-482 (1991).

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The further argument discrediting Universalism stems from the protection given by judges and legislators to small domestic creditors[26]. In fact, a number of arguments have been posited in favour of Territoriality, under which no return of local assets may be required and therefore more protection can be extended to domestic creditors[27]. To argue against this premise, supporters of Universalism have found subterfuge behind the "Rough Wash" argument, according to which the losses of domestic creditors will "*be evened out by foreign deference of local assets in other cases*"[28]. Despite the strength of such an argument, most multinational corporations do have their home country in the developed industrialized world, *i.e.*, colloquially referred to as the " North". This is likely to lead to a situation where in the majority of cross-border insolvency cases, the same jurisdictions - located in the North - will demand the transfer of assets located in the developing world, *i.e.*, colloquially referred to as the "South." Therefore, it might be argued that one should differentiate between the domestic creditors in the North and the ones conducting their businesses in the South. For the latter, the "Rough Wash" argument seems less veracious as courts in developing countries would be more frequently asked to defer to foreign proceedings than they would be asked for the transfer of assets[29]. As a result, a Universal approach to insolvency could be criticized that it will produce unequal results between creditors located in developed countries and those located in less developed countries[30].

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[26] Section 304(c) of the U.S. Bankruptcy Code, prior to its amendment in late 2005, provided that the U.S. court may consider, in deciding whether to grant the foreign representative relief, "the protection of claim holders in the United States against prejudice and inconvenience." *See* 11 U.S.C. § 304(c)(2) (existing at September 2005).

[27] *See* Jay M. Goffman & Evan A. Michael, A Comparative Examination of Insolvency Laws of Industrialized Countries, 050503 ABI-CLE 11 (2003) [hereinafter Goffman, Comparative Examination] (arguing that "many countries will only agree to the designation of a home court if they are confident that the foreign court will provide protection to both domestic and foreign creditors, and many countries are skeptical that this will occur").

[28] *See* Jay Lawrence Westbrook, Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum, 65 AM. BANKR. L.J. 457, 464-465 (1991) [hereinafter Westbrook, Theory and Pragmatism].

[29] *See* Ulrik Rammeskow Bang-Pedersen, Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests, 73 AM. BANKR. L.J. 385, 426 (1999)[hereinafter Rammeskow, Predictability and Protection].

[30] To further elaborate this observation, the incentive to establish a universalistic insolvency regime will considerably vary from one country to another. Countries that are the home country of many multinationals will be more eager to adopt Universalism because their local courts will benefit from a higher number of cases that are deferred from non-home forums.

C. Universalism and Priority Claims

The issue of creditors' rights and their classification brings forth additional legal complexities pertaining to the implementation of an insolvency framework predicated on Universalism. It is common that national insolvency laws aim at protecting domestic creditors in general and specific social groups in particular. The legislator usually pursues these objectives by granting a high priority of distribution off the liquidation proceeds to specific categories of claimants[31].

Because Universalism urges domestic courts to defer to foreign proceedings where different priority arrangements apply, the social objectives pursued by the domestic legislator may be undermined. Should a foreign court apply its domestic insolvency law and its ensuing priority rules of distribution to the mass of creditors, the protection sought by the legislator in other forums may be hindered. Certain social groups that are domestically well protected may not be able to maintain the priority of their claims under a foreign insolvency system. In this respect, Universalism is often criticized as changing domestic distribution priorities, thereby limiting the reach of national policies. Critics of Universalism, such as Lopucki[32], often use this argument to question the feasibility of Universalism, as benefits would be extended to a handful of creditors and countries rather than to all participating nations[33]. Furthermore, Lopucki advocates the current state of Territoriality over any form of Universalism, as the "grab rule" of Territoriality secures at least a portion of the debtor's assets which proceeds can be distributed according to the domestic social objectives pursued by the legislator in each forum.

[31] *See* Lore, International Insolvency Cooperation, *supra* note 11, at 15.
[32] *See* LoPucki, Cooperative Territoriality, *supra* note 12, at 2219.
[33] This argument refers to the necessary distinction between the North and the South, and the unlikely incentives of developing countries to opt for Universalism.

Professor Westbrook attempts to address these concerns by raising two pertinent arguments[34]. First, he refers to the interplay between state and federal bankruptcy laws in the United States. Despite the existence of federal bankruptcy laws enacted by the Congress, state laws prevail in all domestic cases to the extent that local priority rules of distribution are respected. By analogy, Westbrook stretches by presuming that an international bankruptcy regime may leave some leverage to national bankruptcy arrangements. He further proffers that the reconciliation between the diverse domestic insolvency systems would be eased because certain categories of creditors recurrently receive priority of distribution under most (but not all) insolvency laws[35].

The second argument brought forth by Westbrook is that an international bankruptcy regime would solely address the financial distress of large multinationals and their subsidiaries. Such a regime would not replace domestic judiciaries to adjudicate the financial distress of medium size and small enterprises. This repartition of competence, he argues, would enhance the possibility of establishing an international bankruptcy regime based on Universalism. Certain categories of domestic creditors would be able to maintain their priority of distribution granted by their domestic bankruptcy laws as far as the debtor satisfies the criteria for the application of that domestic law. According to Westbrook, if the size of the debtor were greater and included several subsidiaries and branches located in multiple forums, distribution priorities will follow an international priority order, which would - to the greatest extent possible - embrace the main priorities of domestic bankruptcy systems.

While it is credible that Universalism may be able to accommodate the priorities set by domestic bankruptcy laws on the long-term, creating an immediate international order of priority that retains most domestic customary practices seems highly difficult as

[34] *See* Westbrook, Global Solution, *supra* note 2, at 2322.

[35] *See* Jay Lawrence Westbrook, Developments in Transnational Bankruptcy, 39 ST. LOUIS U. L.J 745, 756 (1995) (stating that "most systems favour employees and governments in determining priorities in distributions").

a practical endeavour. Such a task would suggest that significant efforts of harmonization among the diverse domestic insolvency regimes are well underway[36]. Unfortunately, this is not the case and it further appears that the international community may have decades ahead before reaching a consensus in that area[37]. Westbrook's comments are certainly valuable and inspiring as to the matter discussed. Yet, such arguments pre-suppose a global insolvency system marked by the maturity of and full compliance with international law. At present, these longer-term solutions can hardly be relied upon to resolve the issues that arise from the default of multinational corporations.

III. The Home Country Standard

According to Universalism, managing cross-border insolvency proceedings requires the identification of a single forum that will decide a particular case. This forum is, by definition, the debtor's home country. As easy as this task may sound, the difficulties encountered can be paramount because one has to decide what criteria to use in identifying the debtor's home country, and subsequently attribute judicial competence to that specific forum. Before accepting deterministic criteria however, one should understand the elusiveness of the home country concept and its various definitions: this will be considered in sub-section A immediately below. Sub-section B to this Part III will emphasis the place of incorporation as it has known greater popularity by domestic insolvency laws. At last, the debtor's home country concept engenders considerable controversies as regards corporate groups. Then, sub-section C will analyze the legal issues that might arise from the determination of a multinational's home country.

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[36] *See* Westbrook, Theory and Pragmatism, *supra* note 28, at 468 (arguing "the second prerequisite to obtaining the benefits of universalism is general similarity of laws. Similar laws about distributions, avoidance, and the like are not in principle necessary to the acceptance of universalism, but in practice *similarity is very important*").

[37] *See* James Garrett Van Osdell, The Transnational Insolvency Dilemma: Congress Should Emphasize Comity of Nations, 49 S.C. L. REV. 1327, 1334 -1335 (1998) (arguing that because nations must overcome immense cultural, political, and philosophical differences, an international treaty structure that could effectively address complex multinational insolvency situations will likely take many years to adopt and enact).

A. Vagueness of the Concept

The indeterminacy of the debtor's home country primarily stems from the different definitions given to it by the diverse laws, treaties, and international conventions. There are mainly three different approaches that define the debtor's home country, which indeterminacy may be another shortcoming of Universalism[38].

One approach would provide that the debtor's home country should be determined by its place of incorporation (domicile). The advantage of this definition is the predictability according to which the competent forum can be chosen. Furthermore, the effortless identification of the place of incorporation could well minimize the cost of information to the advantage of creditors during the pre-contractual phase. The country of incorporation criteria presents an additional advantage in that it is in line with the path followed by the UNCITRAL Model Law on Cross-Border Insolvency and the EU Regulation on Insolvency Proceedings[39]. It is likely that such an alignment would enable, over time, further harmonization of domestic and international insolvency standards. However, the criterion of the country of incorporation is argued to be ineffective, as it could be subject to manipulations and could encourage forum shopping (*discussed below*).

A second approach would recognize the "principal place of business[40]" as the debtor's home country. This latter approach is criticized as being unstable and subject to constant changes. Indeed, even excluding the bad faith of a corporate debtor that may be

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[38]Lynn LoPucki & William Whitford, Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies, WISC.L.REV. 11, 17-19 (1991) (arguing that the indeterminacy of the debtor's home country constitutes an important impediment to Universalism thus jeopardizing its feasibility and maintaining its study to the theoretical stage) [hereinafter Whitford, Forum Shopping].

[39] Council Regulation N°. 1346/2000 on Insolvency Proceedings available at http://Europa.eu.int/eur-lex/en/lif/dat/2000/en_300R1346.html (last visited September 2005).

[40] *See* Martin N. Flics & Michael J. Ireland, Bankruptcy and the Problems of Multi-Jurisdictional Workouts, 553 PLI/COMM 175, 180 (1990) [hereinafter Ireland, Multi-Jurisdictional Workouts]. This criterion presupposes that the enterprise has an obvious center of its activities in one country; where the business of the enterprise is substantially related to several countries, arguments about expectations and fairness of course lose some of their force. As a general rule, where there is no obvious principal place of business, the choice could sensibly be the place of incorporation if it were also a place of substantial business.

motivated to mislead its creditors[41], the principal place of business is often prone to modifications as the debtor's business expands. The unpredictability of such a method is striking within a global commercial world, where multinationals are constantly evolving in order to thrive in the international market. However, the principal place of business was widely accepted and relied upon in the past[42]. As a result, a number of scholars are more favourable to such a method in determining the debtor's home country. For instance, Trautman argues that the principal place of business would be the most effective compared with other definitions, since debtors would be deterred from manipulating the location of their *center of gravity* due to the high cost of such an operation[43]. While it is true that the costs of displacing the principal place of business could be financially burdensome, the issues at stake should not be underestimated. Indeed, if displacing the center of gravity (principal place of business) would grant the distressed corporation a better chance to be rescued, reorganized or simply liquidated pursuant to more advantageous rules to shareholders and/or managers, it is unlikely that the cost of such an operation would deter the corporate debtor from so doing.

The place of incorporation and the principal place of business are commonly used by domestic courts. Nevertheless, a third approach deserves a brief mention. This most contestable approach defines the debtor's home country as the place where most of its assets are located. Needless to say, this criterion is pre-disposed to manipulation by corporate debtors, who can easily transfer assets, to the detriment of their creditors[44].

[41] *See* Whitford, Forum Shopping, *supra* note 38, at 19 (arguing that the principal place of business can be subject to manipulations).
[42] Commonwealth of Puerto Rico v. Commonwealth Oil Refining Co. (In re Commonwealth Oil Refining Co.), 596 F.2d 1239, 1244-45 (5th Cir. 1979) (where the court's opinion is a reminder that "the principal place of business, though later joined by location of principal assets, was the only venue available to a corporate debtor"). See Robert M. Fishman & Brian L. Shaw, Business Bankruptcy Venue-Past and Present Courtesy Of In Re Peachtree Lane Associates, Limited, No. 11 NRTN-BLA 4 (1998).
[43]Donald T. Trautman, Foreign Creditors in American Bankruptcy Proceedings, 29 HARV. INT'L L.J. 49, 56-57 (1988). *See also* Charles D. Booth, Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts, 66 AMBKRLJ 135 (1992).
[44] "Nowhere in the world is location of the principal assets used (or accepted) as basis for assumption (or recognition) of bankruptcy jurisdiction. The definition is misleading. It has led to confusion already". See Kurt H. Nadelmann, Bankruptcy Jurisdiction: News from the Common Market and a Reflection for Home Consumption, 56 AMBKRLJ 65 (1982).

Moreover, the transfer of assets is likely to be less troublesome and costly than the transfer of headquarters. In other words, this method would simply give the debtor the upper hand in deciding which forum shall decide its case. It would appear that the inefficiency of this last approach increases considerably under Territoriality as the transfer of assets could mislead various creditors to believe they are facing a favourable bankruptcy regime. In turn, creditors would constantly have to exercise strict control upon the debtor's activity thus committing more resources than necessary[45].

What is important is that the legal debates regarding the debtor's home country determination are primarily concerned with the best approach to adopt. The one that is likely to resolve judicial competence issues in all cross-border insolvency cases. In reality, a more pragmatic solution may call for a less stringent approach. Indeed, any of the first two methods above described could be suitable to determine the debtor's home country, because the aim of harmonizing domestic insolvency laws and thereby increasing the possibilities for the creation of an international insolvency system is to improve predictability for creditors, not to seek perfection. What is more, there will always be cases where the principal place of business and/or the place of incorporation are inappropriate to attribute jurisdiction to a specific forum[46]. In short, either method, most probably, would be appropriate, as long as there is an international consensus on its definition and implementation.

[45] *See* Gilson Stuart, Transactions Costs and Capital Structure Choice: Evidence from Financially Distressed Firms, 52 J. OF FINANCE, 567 (1997).

[46] *See* Westbrook, Choice of Avoidance Law, *supra* note 2, at 502 (arguing that under either criterion there will be circumstances that will exist in which determination of the home country of a corporation will be difficult).

Chapter Two.

B. The Place of Incorporation

Lopucki argues that the use of the place of incorporation to determine the debtor's home country will lead to Forum Shopping[47] and to the manipulation of the place of incorporation. These contentions bring forth two sets of arguments.

1. Risks of Forum Shopping

"Forum shopping" has always been perceived as a negative practice to the extent that, on the domestic level, it provides for a quasi-irrefragable presumption of bad faith against its perpetrator[48]. This is particularly true when there is only one court that should decide a specific case and filing a petition before another court would simply be construed as a breach of the obligation of bona fides in trade and commercial dealings. However, fearing forum shopping in cross-border insolvency cases may well be treated and perceived differently.

By definition, transnational insolvencies are too broad to be captured and subjected to only one jurisdiction. In most - if not all cases - there usually is more than one forum that can reasonably assert jurisdiction to adjudicate the insolvency at stake. Against the multiplicity of the proceedings before these different courts, the common law doctrine of "forum non-conveniens[49]" could serve as a deterrent against unscrupulous

[47] *See* LoPucki, Cooperative Territoriality; *supra* note 12, at 2219 (arguing "as Delaware competes as a "haven" for domestic bankruptcy cases, Bermuda, Luxembourg, and the Cayman Islands stand ready to compete as havens for international bankruptcies. One easily could imagine a Universalist world of the near future in which over half of all large multinational bankruptcy cases are filed in Bermuda...The Bermuda legislature would set the relative bankruptcy priorities of creditors throughout the world").

[48] *See* In re Silberkraus, 253 B.R. 890, 36 Bankr. Ct. Dec. (CRR) 995 (Bankr. C.D. Cal. 2000) (the court decided that "it constitutes bad faith for Chapter 11 debtor to file bankruptcy to impede, delay, forum shop, or obtain a tactical advantage regarding litigation ongoing in a non bankruptcy forum, whether that nonbankruptcy forum is a state court or a federal district court"). *See also* William Thomas Thurman & Brett P. Johnson, Bankruptcy and the Bad Faith Filing, 10-DEC UTAH B.J. 12, 17-17 (1997). It is also noteworthy to mention that the negative perception of Forum Shopping may be subject to discussion. *See* Joseph H. Sommer, The Subsidiary: Doctrine Without a Cause?, 59 FORDHAM L. REV. 227, 253 -254 (1990) (arguing that Forum Shopping can render a number of economic benefits and could also result in a higher degree of fairness to the benefit of the parties at trial).

[49] This doctrine was developed to counter a plaintiff's ability to forum-shop and holds that a court may resist imposition upon its jurisdiction even when the letter of a general venue statute authorizes jurisdiction.

plaintiffs (either creditor or debtor). This approach will be restrictive of forum shopping while it encourages closer cooperation among courts located in different countries[50].

Furthermore, the ultimate aim of an eventual international insolvency framework would be most likely to agree upon a common method (substantive and procedural) to clearly determine where the debtor's home country is located, rather than seeking irreproachable criteria to determine the same. In reference to Lopucki's observations[51], it would not necessarily be an aberration if Luxemburg courts were to decide a significant number of cross-border insolvency cases according to their domestic insolvency laws so long as basic procedural rules are observed[52]. Even if the laws applied by these courts allow lower recoveries than any other place, the most important element at stake, according to Lopucki, is predictability. Creditors would be aware that lower recoveries are imminent under the laws of certain jurisdictions and would thus contractually protect themselves[53] against such divergences[54]. This, of course, assumes these pre-insolvency contractual assurances would be upheld and enforced post-bankruptcy by the forum court.

Forum non-conveniens is a relevant consideration only when both jurisdiction and venue are proper. *See* William L. Norton, Jr. International Law and its Influence on Cross-Border Insolvencies, NRTN-BLP § 152:21 (2003).

[50] In making a discretionary decision on whether or not to hear a case on *forum non-conveniens* grounds, a court should be guided by both the private interests of the litigants and the public interests of the two forums involved. This is likely to foster the application of "international comity" and cooperation in cross-border insolvency cases. This approach has been relevant in a number of insolvency/comity decisions. *See* In re Banco Nacional de Obras y Servicios Publicos, 91 B.R. 661 (Bankr. S.D.N.Y. 1988) (emphasizing the role of comity in a cross-border insolvency proceedings); Interpool Ltd. v. Certain Freights of M/V Venture Star, 102 B.R. 373, 377 (D.N.J. 1988). However, the notion of forum non-conveniens is a controversial notion in and of itself and often practically falls within judicial discretion.

[51] *See* LoPucki, Cooperative Territoriality, *supra* note 12, at 2219.

[52] This assumption would entail similar concepts to due process under US law, or other guarantee of fairness and impartiality under other legal systems. *See* Douglass G. Boshkoff, Some Gloomy Thoughts Concerning Cross-Border Insolvencies, 72 WASH. U. L.Q. 931, 941 (1994). *See* Campbell, In Search of Uniformity, *supra* note 41, at 45 (arguing that U.S. courts have deferred to foreign insolvency proceedings in the Bahamas, Bermuda, Canada, the Cayman Islands, Hong Kong, and Sweden after finding the foreign law was similar or *"provided fundamental standards of procedural fairness"*).

[53] This assumption rules out non-adjusting creditors who are likely to run greater risks under an international insolvency system predicated on universalism.

[54] *See* Alan Schwartz, Contracting about Bankruptcy, 13 J.L. ECON. & ORG. 127, 127 - 131 (1997).

Nevertheless, the fears stemming from forum shopping are not only related to the substance of the various insolvency laws and the priority claims they entail. But equally relate to concerns over the unreliability of certain judicial systems that may come to adjudicate significant cross-border insolvency cases in favour of domestic creditors, national interests, or pursuant to other personal interest domestic judges may have[55]. Thus, the opinion of Lopucki and other like-minded scholars[56] relates to the observance of the fundamental principles of justice and fairness in insolvency proceedings.

However, a traditional solution possibly may address these concerns. For courts that are reputed for their incompetence, bias or lack of transparency, a convenient solution may be found on the grounds of the denial of recognition and enforcement of the very decisions rendered by these courts. The role of a cross-border insolvency framework would be to define minimum standards granting fair and transparent insolvency proceedings. These standards would preserve the rights of the parties in international insolvency litigations and insure that unfair judicial practices produce minimal legal effects against the prejudiced party. To this end, decisions rendered by unscrupulous courts would be denied recognition by other jurisdictions and would hence lose their overall objectives.

In sum, there seems to be remedies against forum shopping in cross-border insolvency cases. Yet, the most intricate issue - aside from the vulnerability of non-adjusting domestic creditors under Universalism - is how an eventual cross-border insolvency framework should be designed to best address the problems that arise under forum shopping.

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[55] In this regard, the risk of bribery and corruption in a number of judiciary systems should be taken into account, especially when the sums involved in the insolvency proceedings are considerable.
[56] *See* J.H. Dalhuisen, International Insolvency and Bankruptcy (MB) § 1.01 [1] (1986) (arguing that under Universalism, domestic courts are likely to confer a preferential treatment to domestic creditors); *see also* Robert K. Rasmussen & Randall S. Thomas, Timing Matters: Promoting Forum Shopping by Insolvent Corporations, 94 NW. U. L. REV. 1357, 1381 (2000)

2. Manipulation of the Place of Incorporation

As further argued by Lopucki, the place of incorporation also can be subject to manipulations by debtors in order to mislead creditors. After a given corporation has accumulated substantial debts, it could voluntarily change its place of incorporation, thus conferring a senior creditor status to new creditors, to the disadvantage of previous lenders. This argument elicits a number of comments. First, changing the place of incorporation is certainly possible but would be quite complex. Indeed, changing the place of incorporation of an established and operating corporation is an extraordinary decision that most probably would require the vote of a qualified majority of shareholders, not a simple task. The decision to transfer the place of incorporation is rather difficult to reach, and cannot be dealt with as a routine corporate decision of shareholders. Secondly, in contrast with changing the principal place of business due to business expansion without any procedural requirements[57], transferring the place of incorporation may oblige the concerned entity to notify all its creditors before transfer procedures begin. This would allow existing creditors to report their grievances and alternatively seek more guaranties to secure their rights[58]. Finally, creditors could secure their rights contractually in various ways. One of them would be to stipulate that credits and/or loans would be considered to have reached maturity if the debtor is about to change its place of incorporation. These measures are usually construed as a deterrent to firms from changing their place of incorporation, thus adding more stability and predictability to the latter concept.

Above all, opting for the place of incorporation could overcome the important issue of asset removal. Insofar as the place of incorporation is the benchmark for attributing jurisdiction to a single and specific forum, the removal of assets from one

[57] *See* LoPucki, Cooperative Territoriality, *supra* note 12, at 2225 (favoring the principal place of business as a method in determining the debtor's home country. The author argues that changing a company's place of business is not burdensome. He uses the example of BCCI and Dreco Energy that moved their principal place of business on the eve of bankruptcy).

[58] For instance, it is suggested that a change of registered office from one EU-state to another can only take place if the creditors and other holders of rights in respect of the company either consent or are granted adequate security for their claims/rights. *See* the European Union Corporate Directive No. 14, Art. 8.

jurisdiction to another may seem a trivial issue[59], although it may affect the possibility of reorganization at a later stage, especially under a Territorial insolvency system[60]. Yet still, the place of incorporation would attribute jurisdiction to a single forum. While the principal place of business may be subject to transfer resulting from business expansion, and while assets may be subject to removal from one location to another, a corporate debtor is necessarily incorporated in only one forum. In turn, this would encourage deference to this competent forum, not on the grounds of comity and cooperation[61], rather on the basis that no other forum is competent to adjudicate the insolvency at stake.

In light of the above, the place of incorporation may be the most effective and predictable method in determining the debtor's home country on the domestic level[62]. It may however present a number of problems when applied to multinational corporations, especially under Universalism. Therefore, it is necessary to stress the flaws of such a method when the corporate debtor is composed of several subsidiaries each incorporated in a different forum.

C. The Home Country of a Multinational Corporation

The determination of a multinational's home country has always been controversial. The very nature of multinational corporations has engendered many problematical issues not only in the course of bankruptcy proceedings, but also in many other areas[63]. As previously explained, one such issue is the question of how multinationals are legally defined. One approach is to define the latter as networks of

[59] Where the place of incorporation is the benchmark to attribute jurisdiction, the emplacement of assets will not be probative of the debtor's home country.

[60] *See* Chapter One demonstrating that under Territoriality, the removal of assets is a rather important element that is hardly controlled and unlikely prevented, much to the detriment of creditors.

[61] *See supra* note 49.

[62] *See* Ireland, Multi-Jurisdictional Workouts, *supra* note 40 at 181 (arguing that most countries generally require a company to have its place of incorporation within the country to qualify for bankruptcy within the jurisdiction).

[63] *See generally* Meeran, R., The Unveiling of Transnational Corporations: A Direct Approach, Kluwer Law International, 1999; Joseph H. Sommer, The Subsidiary: Doctrine Without a Cause?, 59 FORDHAM L. REV. 227, 237 (1990); Patrick C. Sargent, Bankruptcy Remote Finance Subsidiaries: The Substantive Consolidation Issue, 44 BUS. LAW. 1223, 1223 (1989).

parent corporation and *several subsidiaries*, each incorporated in a specific country, each have it own limited liability shield and each subject to its laws and courts. Conversely, one may also consider that the financial and legal relationships between several subsidiaries create a *single* entity governed by the laws of the parent's place of incorporation. In fact, these issues have been long identified and debated for over three decades. Whether or not the laws of a given country deal with the issue using the single entity approach[64], the insolvency process of multinationals can cause further difficulties under Universalism[65].

Lopucki similarly argues that the very nature of corporate groups poses an enormous problem affecting the credibility of a Universalistic regime[66]. Insofar as the home country of multinationals remains difficult to identify, Universalism does not seem capable of progressing past the theoretical stage. He adds that the criterion of the place of incorporation may be satisfactory so long as the competent forum is where the distressed subsidiary is incorporated, regardless of where its parent is incorporated. This Territorial approach - founded on the separate entity perception of multinationals - is argued as increasing predictability in commercial and financial transactions, and providing a certain level of protection to domestic non-adjusting creditors.

These arguments are relatively well-founded and highlight some beneficial aspects of Territoriality. Unlike Universalism, Territoriality affords domestic non-adjusting creditors a better chance to be paid off the liquidation of the debtor's assets located in the forum of opening. As previously explained, domestic social policies would

[64] *See* Chapter One. According to this approach, corporations are treated as one legal entity. When insolvency proceedings are then initiated against this entity, all its assets are liquidated and all its worldwide creditors can lodge their claims in those proceedings that take place before one forum. Therefore, the single entity approach is best suited to the objectives of Universalism.
[65] However, it is noteworthy to mention that the difficulty encountered in administering the insolvency of corporate groups does not stem from Universalism or Territoriality, but rather from the very nature of corporate groups itself. The conflict between the separate entity approach and single entity approach underlie the conflict between a territorial insolvency system and a system predicated on Universalism.
[66] *See* LoPucki, Cooperative Territoriality, *supra* note 12, at 2228.

often prefer this method because there will be at least a share of the debtor's liquidation proceeds that are distributed according to the domestic order of priority, thereby providing a certain level protection to vulnerable social classes. In addition, these non-adjusting creditors may - if permitted by foreign insolvency laws - lodge their claims in secondary or parallel proceedings held before foreign jurisdictions so as to recover additional portions of their claims. Insofar as a single entity perception of multinationals - along with the application of Universalism to their insolvency process - does not provide that same level of protection, a separate entity approach will be the favoured choice of most nations. This would in turn encourage maintaining the *status quo* of Territoriality in managing multinationals' insolvency proceedings[67].

In addition, if the parent's forum (*i.e.*, the parent's place of incorporation) were to determine the insolvency of the entire group, further unpredictability will incur. Regardless of whether certain subsidiaries are financially distressed or not, the court in the parent's home country would collect their assets for the purposes of liquidation (or reorganization). This method could prove ineffective as regards independent subsidiaries that are financially sound. It would invite the latter to respond to the debts contracted by their parent to the detriment of their financial soundness. It could also mislead diligent creditors who might have closely followed the sound financial performance of their debtors (subsidiaries) and who might have relied upon it to collect on their claims.

To address this indeterminacy, an alternative method has been proposed by several commentators to decide the home country of a multinational corporation. This

[67] Conversely, under the separate entity approach, two consequences are inevitable. First, it will render the reorganization (when possible) of the insolvent subsidiary more difficult, particularly if significant assets necessary to its operations are located in other jurisdictions over which the court in charge has no power. Second, this approach would allow firms that are part of the same corporate group to file for bankruptcy strategically. Indeed, the order in which firms file for bankruptcy can have tremendous effects on the benefits that can be reaped off the debtor's assets. In sum, the risk of manipulating the bankruptcy of a corporate group seems easier under the separate entity approach or territoriality.

method suggests that through an *integration test*[68], one can identify the subsidiaries whose operations are directly inter-connected and hence attribute jurisdiction to the forum of the "controlling" subsidiary. Put another way, the corporate group will be segmented into smaller conglomerates inside which the subsidiaries' activities are inter-dependent. This solution is neither a territorial nor universal approach based and should be thought of as a compromise aiming to conciliate two incompatible theories. However, this solution does not enhance the *ex-ante* predictability for creditors because it seems rather difficult for a third party to evaluate the degree of integration of the subsidiary to its parent's operations. Furthermore, this approach is likely to give non-negligible discretionary powers to the court in assessing the degree of integration provided for under a potential integration test. Thus, the international community may witness different standards of integration depending on the forum in charge. Needless to say that such a disparate method may not satisfy the objectives of predictability and fairness necessary within an international insolvency framework. Even considering that integration can be measured according to more objective and uniform criteria, such as the ownership by the parent of at least 50% of its subsidiary, this will not overcome the instability resulting from this method because equity interests are in constant variation throughout the life of any given corporation, therefore the *ex-ante* predictability for creditors is not much improved.

The various arguments brought forth in favour of Territoriality considerably weaken the case for Universalism. In this respect, considering multinational corporations as a network of separate legal entities may, in a number of instances, improve the *ex-ante* predictability in commercial and financial transactions. Importantly, it would palliate one significant deficiency of Universalism, that is, the vulnerability of domestic non-adjusting creditors.

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[68] *See* Wilson Chu, Avoiding Surprises Through Due Diligence, Business Law Today, Jan. /Feb. 1997, at 8; *see also* Jonathan M. Landers, A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy, 42 U. CHI. L. REV. 589, 630 (1975).

IV. Recognition and Extra-Territorial Jurisdiction

Universalism advocates the resolution of multinational's default by a single forum that has an overall and primary jurisdiction over the debtor's assets wherever located. Such a scheme may be difficult to implement if it is not associated with a viable regime to ensure the recognition and enforcement of foreign insolvency judgments[69]. Indeed, absent such a pre-requisite, the adjudicating forum may be powerless to administer the debtor's assets that are beyond its territorial reach, thus rendering their collection and liquidation rather impossible.

Recognition, however, has evolved in a substantive way with the surge of international conventions aiming at easing the recognition of judgments in civil and commercial matters[70]. Unfortunately, most of these developments have systematically excluded insolvency from their scope of application[71], thereby acknowledging the exclusivity of insolvency proceedings and further highlighting that a state's sovereignty and policy choices can be represented - or at least expressed - within its insolvency system. As a result, the recognition of foreign insolvency judgments is handled

[69] *See* Ulrich Huber, Creditor Equality in Transnational Bankruptcies: The United States Position, 19 VAND.J.TRANSNAT'L L. 741, 744 (1986) (arguing that because Universalism prescribes broad competence to the adjudicating forum, non-adjudicating forums will have to recognize foreign judicial decisions so as to enable a proper implementation of Universalism). *See also* Michael P. Bigelow, Public Policy Concerns Prevent Application of Comity to Foreign Bankruptcy Proceedings that Discriminate against Tax Obligations Owed to the United States Government. Overseas Inns S.A.P.A. V. United States, 24 VAND. J. TRANSNAT'L L. 571, 584-585 (1991).

[70] On the international level, *see* Hague Convention on International Jurisdiction and Foreign Judgments in Civil and Commercial Matters available at www.hcch.net/e/workprog/jdgm.html (last visited July 2005); *see also* Procedures Regulation - An Act Respecting the Convention between Canada and the United Kingdom of Great Britain and Northern Ireland Providing for the Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters, n.b. reg. 88-206, available at http://www.canlii.org/nb/regu/crnb/20040210/1988r.206/ (last visited September 2005); on the European level, *see* Council Regulation (EC) No 44/2001, of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters [official journal l 12 of 16.01.2001].

[71] *See* Hague Convention, *supra* note 70, article 1(5) (excluding from its scope of application questions of bankruptcy, compositions or analogous proceedings, including decisions which may result therefrom and which relate to the validity of the acts of the debtor); *see* Council Regulation (EC) No 44/2001 article 2(b) (the regulation does not apply to "bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings").

domestically and is subject to different level of scrutiny from one forum to the other[72]. While a number of jurisdictions are more flexible to recognize the insolvency judgments rendered by other forums, most nations attempt to limit the legal effects these judgments may produce domestically. This non-uniformity among national practices raises a number of questions as to the feasibility of Universalism. Perhaps, a more sensitive solution to this problem may be to advocate alongside Universalism, a general system of recognition that would best serve the purpose of the "single court, single law" principle. Even assuming that such a system is politically feasible, it still would not be exempt from criticisms. Indeed, a quasi-automatic system of recognition as vindicated by Universalism is often condemned because it would occasionally implicate the exporting of social policies from one forum to another. This would, in turn, undermine the very concept of judicial and legislative sovereignty[73].

This Part IV will address the various challenges the recognition of foreign insolvency judgments presents, and how the latter affect the feasibility of an international insolvency system predicated on Universalism.

A. <u>Recognition and Nexus Tests</u>

When applied to the insolvency of a multinational corporation, Universalism might be seen to lead to situations where the debtor's operations are totally unrelated to its home country. This would contradict the legal requirements and conditions for the recognition of foreign judgments set by most, if not all, nations[74]. As a result, judicial

[72] *See* Shoichi Tagashira, Intraterritorial Effects of Foreign Insolvency Proceedings: An Analysis of "Ancillary" Proceedings in the United States and Japan, 29 TX. INT. L. J. 12 (1994) (arguing that the most practical problem of the international effect of insolvency proceedings is whether and to what extent each country is willing to cooperate with principal foreign proceedings).
[73] John K. Londot, Handling Priority Rules Conflicts in International Bankruptcy: Assessing the International Bar Association's Concordat, 13 BANKR. DEV. J. 163, 196 (1996) (highlighting the difficulty of reconciling pure universality with the "sovereign beast").
[74] While states vary in their requirements for the recognition of civil judgments, each invariably requires that the rendering court have jurisdiction over the defendant-judgment debtor. *See* Von Mehren Arthur & Donald T. Trautman, The Law of Multistate Problems, Sweet & Maxwell, 73, 1965 (arguing that "in Anglo-American law recognition of foreign judgments turns basically on the question whether in the view

requirements of connectivity (or nexus) in civil and commercial matters are frequently not met under Universalism, and far less so under the debtor's home country assertion of competence. Therefore, scholars such as Tung[75] have argued that under Universalism, the "*exporting of social policy*" from one country to another is more likely to take place[76].

The rationale to this argument is that domestic insolvency systems are different in many respects. Their substantive and procedural rules, priority of claims and social objectives are, in fact, often dissimilar[77]. It is therefore understood how the substantive degree of fairness and predictability they equally seek may practically call for different measures and processes. Therefore, it could be understood how these variations from one insolvency system to another embody and underlie specific social policy considerations. If a global system were to render foreign insolvency judgments readily recognized and enforced in other forums - as encouraged under the patronage of Universalism - domestic social policies will be easily transferred from one jurisdiction to another and foreign laws and courts might contestably determine the rights of local subjects.

Because Universalism is not viewed as effectively addressing these national concerns, its study is often characterized as being "theoretical". In addition and so long as

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of the recognizing court the rendering court had adjudicatory jurisdiction in the international sense"). *See* Alan Reed, A New Model Of Jurisdictional Propriety For Anglo-American Foreign Judgment Recognition And Enforcement: Something Old, Something Borrowed, Something New?, INT'L & COMP. L. REV. 243, 243 -247 (2003); Martiny, Recognition and Enforcement of Foreign Money Judgments in the Federal Republic of Germany (Paper presented at the XIIth Congress of Comparative Law, Australia, Aug. 1986).

[75]Frederick Tung, Skepticism about Universalism: International Bankruptcy and International Relations, Berkeley Olin Program in Law & Economics, Working Paper Series. Paper 43 (2002) [hereinafter Tung, Skepticism about Universalism] (referring to the concept of "state's courts exporting social policy", the author notes that "the jurisdictional test for recognition of foreign judgments can be understood as a mechanism to deter such ambitions"). *See also* Lopucki Lynn M., Cooperation in International Bankruptcy: A Post-Universalist Approach, 84 CORNELL L. REV. 696, 759 (1999) [hereinafter, Post Universalist-Approach] (arguing that "an involuntary claim is the direct product of some country's social policy and to require a second country to reorganize that claim exports the social policy of the first").

[76] Id.

[77] *See* Goffman, Comparative Examination, *supra* note 27 (arguing the diversity of domestic systems in realizing the same objectives). Adversely, one can argue that material and procedural differences may be reconcilable since most if not all insolvency laws pursue the same objectives. As a result countries' social policies with respect to insolvency matters may be convergent to a greater extent than one may think.

cross-border insolvency cases are unequally distributed between developed and least developed countries, a reciprocity based argument according to which the recognizing forum will be able - in some cases - to "export" its own social policies[78] may be misleading. The enactment of Universalism on a global level may hence require significant concessions on behalf of each forum to accept and to enforce insolvency precepts different from those that apply domestically. Unfortunately, current international law, international relations and state practices have not sufficiently matured to enable practical reliance on such assumptions.

Although these arguments elucidate in part the reluctance of nations to adopt Universalism, one may alternatively argue that the essence of recognition is to "accept" foreign judgments so long as the latter were rendered under fair proceedings by professionally competent and impartial courts. Otherwise, the fear of "exporting social policy" would imply that the recognition of foreign insolvency judgments should be granted only if both forums (adjudicating and recognizing) engage in exactly the same social policies and use identical means to realize them. Not only would this situation probably stimulate a crisis in international judicial relations as recognition will seldom be granted, but it might also give rise to the rhetorical question of why would the recognition of foreign judgments be a pre-requisite to enforcement if all social policies must initially be one and the same?

Another significant impediment to the recognition of foreign insolvency judgments is domestic tendencies to assert exorbitant adjudicatory powers. In this respect, Tung argues that, although a corporation may be incorporated in a given state, this is not sufficient to confer on that State's courts a "*jurisdictional reach that is internationally recognized*"[79]. He subsequently notes, "*While this state [the rendering state] might claim such exorbitant jurisdiction for its courts, such an approach is*

[78] *See* Westbrook, Theory and Pragmatism, *supra* note 28, at 469.
[79] *See* Tung, Skepticism about Universalism, *supra* note 75.

typically condemned by other states"[80]. This observation stresses that the debtor's home country may not present sufficient ties to the debtor's insolvency. The very definition of Universalism is argued to further these inconsistencies because in a number of cases, the debtor's home country may not closely relate to the debtor's activities. Although this lack of connectivity between the debtor's operation and its home country often motivate the denial of recognition in a number of forums, one may wish to express further thoughts with respect to the specificity of insolvency proceedings and judgments, especially in the context of multinational corporations.

It is true, regardless of whether a commercial transaction or a criminal offense, that judicial competence is usually assessed and asserted according to unequivocal nexus tests. However, the aim of insolvency proceedings is neither to administer nor to resolve one transaction or one incident. Instead, these proceedings seek to adjudicate the overall financial activity of a given corporation throughout its life period. Therefore, undisputed ties to a specific forum can be difficult to establish as the insolvency of a corporate debtor encompasses all the financial and commercial activity that the debtor entity may have engaged in across a number of jurisdictions. As a result, one may need to opt for more objective criteria that are predictable and stable. The place of the debtor's incorporation for instance may provide for such a benchmark to attribute jurisdiction to a single forum. In addition, it would not be legally incoherent to admit that corporations ought to be created and liquidated (or reorganized) in the same forum, regardless of the place where they have conducted most of their activities.

Because domestic legal systems are not ready to follow such progressive principles, the uneasy recognition of foreign insolvency judgments continues to be a major impediment to the implementation of Universalism.

[80] *Id.* (arguing that while a unified administration of insolvency proceedings might make economic sense, it would require "drastic assertion of cross border jurisdiction").

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B. Domestic Practices and the Exhortations of Universalism

The common method to recognize foreign judgments in general is often viewed as twofold. First, there must be a relevant link between the rendering court and the matter disputed in order to grant such recognition (discussed above). Second, the private international laws of many jurisdictions require that foreign judgments be considered for recognition, unless this recognition should be denied on the grounds of *public policy*[81] or other similar considerations. Alongside these rules, the recognition of foreign judgments is often conditioned upon reciprocity of treatment among forums. Indeed, the lack of abiding global rules to govern recognition has led to a situation where a given court that systemically refuses to recognize foreign judgments is less likely to see its own decisions given full legal effect in other states. This setting is further consolidated by the broad lines of the Hague Convention on International Jurisdiction and Foreign Judgments in Civil and Commercial Matters[82].

While the above reflects most domestic practices to recognize foreign judgments in general, insolvency judgments are weighed differently for recognition and enforcement purposes. Such a distinction should have been expected considering that the financial default of any given corporation affects not only the rights of creditors, but also all entities and/or individuals who may hold an interest, financial or otherwise, in the proceedings.

In this regard, foreign insolvency judgments are often recognized on the grounds of International Comity[83]. As defined in the Hilton case[84], this doctrine is - in a legal

[81] The concept of public policy can be extremely vague and consequently gives domestic courts significant discretion to decide what shall be considered part of public policy. *See* Belinfante Frères, La Codification du Droit International de la Faillite, La Haye 138, 1895 (arguing that in France for instance, the extent of courts' discretion and the praetorian role of the judge in insolvency cases has been subject to many legal controversies and debates for several decades). On the elusiveness of the concept of Public Policy, *see also* Jonathan H. Pittman, Note, The Public Policy Exception to the Recognition of Foreign Judgments, 22 VAND. J. TRANSNAT'L L. 969, 970 (1989).
[82] *See* Hague Convention, *supra* note 70.
[83] *See* Stuart A. Krause *et al.*, Relief Under Section 304 of the Bankruptcy Code: Clarifying the Principal Role of Comity in Transnational Insolvencies, 64 FORDHAM L. REV. 2591 (1996); The Chaos of

sense - "*neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other*". Although international comity is frequently invoked in cross-border insolvency and other transnational cases, its definition is ambiguous at best. This ambiguity results from the introduction of a hybrid concept in the legal literature within which, a duty should either exist or it does not. Adversely, international comity neither prescribes a duty to recognize foreign judgments nor provides for a mere discretion to grant foreign judgments legal effects[85]. As a result, a number of non-uniform applications of this doctrine and inconsistent outcomes have swelled across cases[86]. This disparity does not improve the *ex-ante* predictability for creditors who may have relied on the judgments issued by their domestic court to dispose of the debtor's assets located in foreign jurisdictions. There is indeed little confidence whether a court will recognize a foreign insolvency decision. It is certain that this ad-hoc system of recognition is not suitable to Universalism and its exhortations.

In the United States for instance, the US federal Bankruptcy Code (section 304), as it existed as of September 1st, 2005[87], adopts a different approach in recognizing proceedings initiated before a foreign jurisdiction. American courts do not automatically recognize the findings of such proceedings, far less so when the debtor has considerable assets located within the US. Instead, section 304 allowed foreign representatives to file for bankruptcy in the US according to less stringent rules. In other terms, the simplified

International Insolvency--Achieving Reciprocal Universality Under Section 304 or MIICA, 6 TRANSNAT'L LAW. 373, 374 (1993); Stacey Allen Morales & Barbara Ann Deutcsh, Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity, 39 BUS. LAW. 1573 (1984).

[84]*See* Hilton v. Guyot, 159 U.S. 113 (1895). For particular insights on the application of International Comity to cross-border insolvency cases see In re Linneas Areas de Nicaragua, 13 B.R. 779 (Bankr. S.D. Fla. 1981); In re Toga Mfg. Ltd., 28 B.R. 165, 170 (Bankr. E.D. Mich. 1983); In re Linneas Areas de Nicaragua, 13 B.R. 779 (Bankr. S.D. Fla. 1981); Cunard S.S. Co. v. Salen Reefer Services AB, 773 F.2d 452, 458 (2d Cir. 1985); In re Koreag, Controle et Revision S.A., 130 B.R. 705, 712 (Bankr. S.D.N.Y. 1991); In re Gercke, 122 B.R. 621, 631 (Bankr. D.C. 1991).

[85] *See* Aranson, Transnational Bankruptcies, *supra* note 2, at 329 (arguing that rules of International comity are not satisfactory when applied to cross-border insolvency cases. "Judicial discretion... has made the comity doctrine unworkable. The doctrine simply gave the courts too much leeway, allowing them to grant recognition sometimes, and other times not, without adhering to intelligible principles".)

[86] *See* supra note 84.

[87] Chapter 15, which is based on the Model Law, since replaced section 304 of the US Federal Bankruptcy Code.

procedure opens up two options to the foreign administrator, either liquidating the debtor's assets in the US or seeking their reorganization. Thus, recognition in the US is not to be understood under its common meaning (*i.e.*, recognition of a final judgment on the merits of the case), rather recognition aims at acknowledging the proceedings initiated before a foreign competent court. Although this approach may seem restrictive with respect to the scope of cooperation among bankruptcy courts, very few jurisdictions follow such simplified procedures as the US Bankruptcy regime does. As it will be discussed in the subsequent chapters, even with the enactment of the UNCITRAL Model Law on Cross-Border Insolvency, many countries are still reluctant to provide for a full-fledged system of recognition and enforcement of foreign insolvency judgments[88].

C. Extra-Territorial Reach of Domestic Insolvency Laws

The term "recognition" usually refers to the acknowledgment and acceptance of foreign judgments. The various examples of domestic or international instruments cited above attest that recognition has different meanings depending on the jurisdiction and regime in question. For instance, under the U.S. Federal Bankruptcy Code, recognition only indicates that bankruptcy proceedings initiated before a foreign court are accredited. It does not mean however that the judicial decision on the merits of a given bankruptcy case, such as the reorganization of the indebted corporation or its liquidation, is recognized. While a quasi-automatic system for the recognition and enforcement of foreign insolvency judgments is argued to benefit the international community, it should be noted that certain forums are already prone to exporting or imposing their judgments beyond their territorial boundaries.

[88] Judge Tina Brozman, former Chief Judge of the Bankruptcy Court of the Southern District of New York noted: "Enormous waste and damage to creditors due to jurisdictional battles and territorial approaches which have impaired the possibility of saving viable enterprises and jobs"; Jonathan Flexer, United States Senate Subcommittee Hold Hearings on UNCITRAL Cross-Border Insolvency Proposal (INSOL WORLD, London), March 1998 (quoting Professor Jay Westbrook, speaking before a Senate Subcommittee meeting in December 1997).

For instance, the U.S. federal Bankruptcy Code allows greater cooperation among U.S. and foreign courts than other legal systems. However, this Code appears to contain contradictory provisions with respect to US courts' extra territorial competence. Indeed, according to 28 U.S.C. 1334[89], US courts may be allowed to assert full jurisdiction in rem over the debtor's assets wherever located. Such grounds of exorbitant jurisdiction are not surprising for mainly two reasons. First, protecting local creditors has always prevailed in bankruptcy cases before US courts and elsewhere. Second, this practice follows a long-standing tradition in the US judicial system according to which US long-arms statutes are to be applied unconditionally and universally whenever justice and fairness require such a course of action. While US courts would merely recognize the initiation of bankruptcy proceedings before foreign courts (*see* section 304 as existing at September 2005), they would assert jurisdiction beyond their boundaries so as to protect their domestic creditors.

Similarly, and despite the recent break through in the area of cross-border insolvency[90], a number of EU member states possess national laws allowing local forums to assert international jurisdiction in civil and commercial matters. Not surprisingly, these different provisions are waived within the European context. In other words, European courts can use these provisions in order to assert jurisdiction beyond their boundaries, only if no other EU member state is involved directly or indirectly in the litigation at stake. These various domestic practices highlight how difficult it is to agree on an international setting within which, creditors - located in different jurisdictions - can be equally treated.

[89] 28 U.S.C 1334 reads, "d) the district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, *wherever located*, of the debtor as of the commencement of such case, and of property of the estate."

[90]A number of different international bankruptcy initiatives and projects were undertaken to fill the gap in International law, such as the UNCITRAL Model Law on Cross-Border Insolvency, the Cross-Border Insolvency Concordat, and the Model International Insolvency Cooperation Act (MIICA).

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Additionally, Federick Tung[91] argues that the Hague Convention on Jurisdiction and Foreign Judgments *"forbids the application of a rule of jurisdiction provided for under the national law of a Contracting State . . . if there is no substantial connection between that State and the dispute, and more particularly forbids exercise of jurisdiction based solely on the domicile, habitual or temporary residence, or presence of the plaintiff in a particular State"*. He further comments *"The concept of habitual residence under this convention is approximately the same as the home country concept under universalism."* Thus, unilateral and deliberate extra-territorial jurisdiction of certain forums can produce negative effects and impede the creation of an international bankruptcy regime predicated on Universalism. Perhaps, the latter's flaw is to seek the creation of an idyllic international bankruptcy system, rather than attempting to establish greater predictability *ex-ante* and to reduce the various costs of bankruptcy *ex-post.*

V. Political Implausibility of Universalism

As one can see, cross-border insolvency cases involve numerous issues. For many, the implausibility of creating an international insolvency regime predicated on Universalism is also due to the complexity of the subject and its encompassment of elements outside the scope of the law. The impracticability of such a regime is usually perceived as the simple manifestation of State's sovereignty[92] and how states are reluctant to come to terms with the idea that domestic insolvency cases (involving domestic creditors) can be decided by foreign courts pursuant to foreign social policy objectives. Alongside these impediments, Tung explains what he refers to as "the

[91]Tung Frederik, Is International Bankruptcy Possible, 23 MICH. J. INT'L L. 31 (2001).

[92]It is believed that such a mechanism would constitute a partial concession of their sovereignty. *See supra* note 76, on the issue of social policy and its susceptibility of exportation under Universalism. See also Jay Lawrence Westbrook, Universal Priorities, 33 TEX. INT'L L.J. 27, 37-38 (1998) [Hereinafter Westbrook, Universal Priorities] (arguing that state sovereignty along with governmental priority of claims constitute a "bright line" as to whether courts will cooperate or not in cross-border insolvency cases). In addition, the "Act of State" doctrine has received little or no application in cross-border insolvency cases. That is to say, for a number of jurisdictions, foreign acts and laws shall have no effect on the domestic level and far less so when insolvency matters are in question. *See* Remington Rand Corporation-Delaware v. Business Systems, Inc., 830 F.2d 1260, 4 U.S.P.Q.2d (BNA) 1355 (3d Cir. N.J. 1987) (where the court states that Acts of foreign bankruptcy trustees should not be afforded deference under act of state doctrine, as trustees' acts do not rise to dignity of acts of foreign sovereign)

Prisoner's Dilemma"[93] according to which, reaching an international consensus on the issue may be difficult due to the failure of many countries to reciprocate deference to foreign courts.

The following sub-sections A and B of this Part V aim at highlighting the different political challenges to Universalism. Although these challenges will be discussed and weighed from different perspectives, it seems undeniable that the failure to achieve Universalism to date further testifies to its political implausibility. The last sub-section C will focus on the necessity of an institutional framework to reach an international and enforceable consensus among several countries.

A. Incentives for Non-Deference in Least Developed Countries

Tung[94] argues against the feasibility of a cross-border insolvency regime built upon Universalism. He stresses that Universalism is unlikely to be achieved due to what is known as the Prisoner's Dilemma mentioned above[95]. He further contends that one of the primary reasons why countries will not have the same incentive to reciprocate and to defer to foreign insolvency proceedings is that "*least Developed Countries (LDCs) would find themselves far more often deferring to industrial country bankruptcy regimes, rather than seeing their own domestic regimes applied extraterritorially*"[96]. He argues,

[93] *See* Tung, Skepticism about Universalism, *supra note* 75.
[94] Tung Frederick, Fear of commitment in International Bankruptcy: The Political Implausibility of Universalism, 33 GEO. WASH. INT'L L. REV. 555, 580-581(2001)[hereinafter Tung, Fear of Commitment].
[95] *Id.* (arguing that the reciprocity in deferring to foreign bankruptcy proceedings between states would be impeded by the fear of non-reciprocity in other cases). *See* Jack Hirshleifer, Practice Theory and Application 287 (6th ed. 1998) (asserting that "when state A is put to the choice of cooperation or defection, it will already have observed state's B earlier strategy choices when state A was the home country requesting State's B cooperation. Whether players move sequentially or simultaneously, or which player moves first in the sequential game, does not affect the equilibrium of the prisoner's dilemma game")
[96] *See* Tung, Fear of Commitment, *supra* note 94, at 587 (explaining that since far more multinational firms are headquartered in industrial countries, those countries-and not LDC's-would more often be the home country for multinational corporations).

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"Multinational debtor's assets will be disproportionally distributed across jurisdictions relative to the amounts of local creditor's claims in each jurisdiction"[97].

While it is true that - under Universalism - LDCs will defer more often to foreign proceedings, the resulting unequal treatment among foreign and domestic creditors should not be imputed to Universalism. Indeed, if the adjudicating forum were to favour domestic creditors arbitrarily, it would then achieve the opposite intended objectives of Universalism. Contrary to Tung's assumptions, a mere deference to foreign proceedings does not necessarily achieve an application of Universalism. Indeed, one should differentiate between Universalism and "Unity"[98]. Under the latter concept, proceedings would be held before one court where the local priority of claims is preserved. Although foreign creditors might have the right to cross-file[99] their claims, they would not enjoy cross-priority[100] under the concept of Unity. As a result, foreign creditors would be excluded - or paid last at best - from the insolvency proceeds. Such inequality of treatment between foreign and domestic creditors, as argued by Tung, would systematically take place under such a system. In contrast, Universalism advocates the competence of a single court before which the primary proceedings are held and where equal treatment between foreign and domestic categories of creditors may be insured through the application of cross-priority to foreign claims. It is undisputed that under any of its forms, Universalism would require that foreign creditors be treated in the same way domestic creditors are. Absent this principle, cross-border insolvency cases would be adjudicated on the basis of cooperative territoriality at most, and not Universalism.

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[97] *Id.*

[98] On the distinction between the two concepts, *see* Cameron Gilreath, Overview and Analysis of How the United Nations Model Law on Insolvency Would Affect United States Corporations Doing Business Abroad, 16 BANKR. DEV. J. 399, 408 (2000).

[99] "Cross filing...means that foreigners (with the possible exception for tax claims) are allowed to file in the local proceeding". See Rammeskow, Predictability and Protection, *supra note* 29, at 387.

[100] Professor Westbrook developed the cross priority theory. It means "granting non-local creditors the same priority as is given to the class of local creditors to which the non-local creditor belongs". *See* Westbrook, Universal Priorities, *supra* note 92, at 57.

In spite of this distinction[101], it is reasonable to accept the second argument advanced by Tung that LDCs would forfeit control of multinational insolvency proceedings to industrialized countries[102]. It would be misleading however to deduct from that situation an automatic favouring of domestic creditors. As explained, it is conceivable that a single court can be in charge of adjudicating a multinational default, while treating all creditors (foreign and domestic) equally; thus realizing the objectives of Universalism. If this were the case, one can rightly question why LDCs would oppose the enactment of Universalism, if their domestic creditors were assured to receive equal treatment and a fair share of the multinational debtor's proceeds under this system.

Perhaps, the main issue that arises in this context would be the sort of guarantees the adjudicating forum can, *a priori*, extend to deferring forums so as to ensure equal treatment of foreign creditors. Although an international instrument, such as a treaty, may provide for a plausible solution to this problem, one may doubt countries' degree of compliance with their commitments. This uncertainty may be further increased if these commitments are not effectively enforced on a global level. Rightfully, Tung questions the feasibility of Universalism because states have no means to ensure reciprocal cooperation. He further adds that "*no supranational sovereign exists to force states by their commitments and that even an International Treaty does not create its own coercive enforcement authority*"[103].

[101] Tung himself acknowledges this subtle distinction between the two regimes. *See* Tung, Fear of Commitment, *supra* note 94, at 583 (arguing that "National treatment of foreign creditors - treatment of foreign creditors on a par with local creditors - appears to be the *formal rule in jurisdictions* and may ameliorate this problem to some extent")

[102] Id. Tung alternatively argues that Universalism has a slim chance to be implemented between states that have similar commercial relations. He asserts "the prisoner's dilemma model seems appropriate among countries for which mutual advantage from Universalistic cooperation would seem to exist". In making this statement, Tung underestimates the importance of foreign investment to LDCs and how the latter may find the incentive to comply with international standards so as to attract foreign multinationals. The pre-requisite of similar commercial relations however may be the subject of a further study.

[103] *Id.*

Indeed, the absence of an effective enforcement mechanism renders the compliance with an international treaty on cross-border insolvency unlikely. Because of the social concerns that arise from the insolvency of a multinational, domestic courts will often find a way to protect and favour their domestic creditors. Nonetheless, one should consider that the current state of international law, along with the intervention of international institutions, well might enable the enactment of a binding international treaty to administer the insolvency of large multinationals. In fact, during the last decade the international community has observed many areas in which regulation through international organizations and/or instruments has been successful and binding upon member nations[104]. Perhaps the possibility of creating an international insolvency regime, with binding effects and enforcement mechanisms, may not be possible at present. However, in light of the fast developmental pace of international law and the increasing pressure of globalisation, this solution should not be discarded out of hand in the longer term future[105].

Despite their shortcomings, Tung's remarks are useful because they retrieve and consolidate some of the major impediments to the implementation of Universalism. Achieving Universalism does not only require an international consensus, but also yearns for the institutional and judicial infrastructure to enforce it. While the fulfilment of this requirement may seem difficult for the moment, the effect of globalisation and international efforts to promote stability in many fields through regulatory convergence and minimum standards (including insolvency and creditor rights[106]) impel the international community in that direction.

[104] *See for instance*, the Dispute Settlement Understanding (DSU) under the WTO (www.wto.org); "without enforcement, the rules-based system would be worthless. The WTO's procedure underscores the rule of law, and it makes the trading system more secure and predictable".

[105] *See* Westbrook, Global Solution, *supra* note 2, at 2296 (making the analogy between the TRIP's agreement and the DSU of the WTO. He adds that linkages of that sort might be used to "develop other international commercial regimes, like a bankruptcy law, that can similarly claim a close connection to encouragement of truly global trade and investment... The WTO is a global forum with real teeth").

[106] The World Bank, Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, 2001; available at http://www4.worldbank.org/legal/ (last visited June 2006).

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In sum, Tung has provided considerable comments regarding the feasibility of Universalism, and remains rather skeptical on the immediate possibility of creating an international insolvency regime based upon the "one court, one law" principle. One has also to admit that there are other elements to take into account in order to form a more objective opinion on the feasibility of Universalism. Among the issues that should be examined is the question of reciprocity and its likelihood to push countries into adopting Universalistic principles.

B. Reciprocal Commitments and Effective Enforcement Mechanisms

As asserted by Tung, "*costs and benefits associated with compliance and cheating vary, so does the likelihood of compliance*"[107]. In connection to this argument, it is important to understand the role of reciprocity and its effects on courts' decision to defer to foreign insolvency proceedings. Arguably such a decision depends on how courts will assess the benefits and losses from not complying with a prospective international insolvency system predicated on Universalism. Contrary to what is argued by Tung, a well-grounded rationale can be presented that reciprocity may, in fact, be used to ensure the success of this international system if the latter provides for enforcement mechanisms and possibly economic sanctions against non-complying states. This would create a situation where a given court's unwillingness to defer to foreign proceedings - when required to do so - might engender greater costs than benefits.

A major flow of the "Prisoner's Dilemma" metaphor used by Tung is that it purports to forecast reciprocity and compliance tendencies between only two countries. The conclusion it reaches, however, may be different if it were applied to a larger pool of participants. As an illustration, let us assume that the world is comprised of five countries, A, B, C, D and E. They all play a role in the global economy, without necessarily possessing the same level of commercial, financial and industrial power. Where an eventual international insolvency system promotes close cooperation and

[107] *See* Tung, Fear of Commitment, *supra* note 94, at 587.

deference between these forums so as to adjudicate multinationals' default more effectively, country E persists on using its purely territorial approach. That is to say, E's courts repeatedly fail to defer to foreign proceedings when they are required to do so. As a *riposte* to E's territorial and uncooperative behaviour, the other countries will reciprocate this non-deference when E is in charge of conducting the main insolvency proceedings of a multinational incorporated on its territory. So far, these projections are not different from the assumptions of the "Prisoner's Dilemma". Yet, while E may have benefited from its non-deference to the advantage of E' creditors in a number of cases, the cumulative effect of A, B, C and D non-deference to E is likely to outweigh benefits previously sustained by E. Even assuming that country E is a powerful industrial country; it will incur significant losses due to its uncooperative behaviour. On the whole, although E' choice of non-deference would accrue immediate benefits, it cannot be a viable long-term policy. Thus, one may consider that reciprocity can either constitute a motive for non-deference[108] or can be used as a compliance catalyst[109]. While it could be difficult to achieve complete and unconditional reciprocity in cross-border insolvency cases at first, it would not be surprising if reciprocity were to act as a feedback mechanism, and ensure compliance among countries once the system is effectively built[110].

Assuming that reciprocity is used coercively and entrenched within an effective enforcement mechanism, it could - based on the above illustration - serve as the compliance instrument necessary to achieve an international consensus on cross-border insolvency. In contrast, when the costs/benefits balancing test is applied between only two countries, non-deference will be the expected and most profitable choice for courts. Yet the costs and benefits of non-compliance should be envisaged among more than 180

[108] This is mainly the "Prisoner's Dilemma" model used by Tung.

[109] *See* Westbrook, Theory and Pragmatism, *supra* note 28, at 467 (advancing the "critical mass reciprocity" argument where there is "an extent of multilateral cooperation sufficient to convince each cooperating state that enough other states have joined in reciprocal relationships to ensure the obtaining of the benefits expected to flow from a particular sort of cooperation". Unlike the illustration above, Westbrook does not presume the existence of an effective enforcement mechanism. However, his argument stresses the importance of the multilateral approach - and not bilateral - to the reciprocity problem).

[110] *Id.*

countries, each of which has its own interests, policies and fears of retaliatory measures from either a group of countries or a given institution[111].

The illustrative example[112] of the "Prisoner's Dilemma" brings forth another aspect of effective enforcement mechanisms. Indeed, not only the creation of an international insolvency system requires a certain level of commitment on behalf of countries, but may also require the use of economic sanctions sufficiently elevated so as to deter individual nations from acting unilaterally[113]. To ensure compliance via sanctions, on the other hand, calls for a viable institutional framework - possibly an international judicial authority[114] - that would ensure that countries abide to their commitments. So long as such a framework is unavailable for transnational insolvency purposes, Universalism cannot be achieved[115].

A more difficult question however is what type of institutional framework would be best suited to an international cross-border insolvency system. Based on other

[111] For instance, the Dispute Settlement Understanding on Rules and Procedures Governing the Settlement of Disputes under the WTO GATT stipulates in article 2 "... the Dispute Settlement Body shall have the authority to establish panels, adopt panel and Appellate Body reports, maintain surveillance of implementation of rulings and recommendations, and authorize suspension of concessions and other obligations under the covered agreements."

[112] *See* Tung, Fear of Commitment, *supra* note 94, at 584 (illustrating the prisoners' dilemma by the following example "two individuals agree to swap vacation homes for the summer. They each agree to care for the other's home, including certain regular maintenance chores. While on vacation, however, maintenance is time consuming, expensive, and boring, so there is an incentive to avoid doing so. The standard prisoner's dilemma model predicts that neither party will honour their promise to care for the other's home.")

[113]*See* Tung, Fear of Commitment, *supra* note 94, at 584 (adding to the example illustrated above that "If... the agreement is enforceable, then a party that fails to do so must pay damages. If the damages are *high enough*, both parties can be induced to carry out the promised maintenance. The prisoner's dilemma is solved by the addition of a penalty for the party that fails to honor its obligation. In other words, law changes the payoffs received by the parties. To change the equilibrium, the penalty must change the payoffs enough to make cooperation a dominant strategy for each party"). Applying the same rationale however to sovereign courts and states is impossible without a sovereign and impartial institution that oversees the fairness of such a process. *See* Lore, International Insolvency Cooperation, *supra* note 11, at 8 (arguing that in contrast to the domestic sphere, in which a state's bankruptcy law can be centrally imposed to regulate the conduct of that state's creditors, in the international system there is no sovereign to create order out of anarchy of self interested state actors)

[114] The Dispute Settlement Understanding mechanism under the WTO may be a suitable model to follow in order to enforce cross-border insolvency arrangements against defaulting nations. *See* Westbrook, Global Solution, *supra* note 2, at 2331.

[115] *See* Lore, International Insolvency Cooperation, *supra* note 11, at 9.

experiences in the area of international law, the idea of an international forum to adjudicate multinationals' default is becoming more plausible.

C. <u>The Institutional and Judicial Framework: Reality or Utopia?</u>

Among the issues treated in this volume is the role of an institutional and judicial framework to achieve an international consensus in the area of cross-border insolvency. Although this issue will be more fully covered in subsequent Chapters, it may be helpful, at this point, to provide a brief overview of this issue. Using an institutional-based approach to resolve legal issues on the global level is not a novel approach[116]. There are, in fact, various models whereby nations may be conveyed into agreeing upon and implementing uniform standards and codes.

For example, the institutional framework can be illustrated by the regulatory and advisory powers of certain entities. A number of international institutions nowadays enjoy a broad mandate to regulate given areas of the law by the creation of norms, standards and codes to which states may choose to abide[117]. Regardless of the field in question, this mechanism usually involves extensive consultation and analyses of domestic practices, social policies, and local infrastructure in various countries. Frequently however, these supra-national regulators and standard setters are not endowed with effective enforcement mechanisms. Their effectiveness relies on the willingness of nations to follow their recommendations and their advice is valuable insofar as these nations unilaterally apply their guidelines. Nonetheless, they are able to offer useful technical assistance on sensitive issues to many countries.

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[116] *See* The International Labor Organization chart and the issuance of "Standards and Fundamental Principles and Rights at Work", available at www.wto.org (last visited July 2005). The ILO's standards take the form of international labor Conventions and Recommendations. The ILO's Conventions are international treaties, subject to ratification by ILO member States. Its recommendations however are non-binding instruments - typically dealing with the same subjects as Conventions -, which set out guidelines to orient national policies and actions.

[117] For instance, the Basel Committee on Banking Supervision, available at www.bis.org (last visited September 2005). The committee does not possess any formal supranational supervisory authority, and its conclusions do not, and were never intended to, have legal force. Rather, it formulates supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements - statutory or otherwise - which are best suited to their own national systems.

On the other hand, the creation of an international consensus on cross-border insolvency will probably require the issuance of standards, recommendations, guidelines and identification of best practices in this field. In this respect, a solution to the transnational insolvency dilemma may lie between the hands of specialized international bodies that would be in charge of harmonizing domestic insolvency systems via a purely advisory method. Under this approach however, no enforcement mechanisms would be created and there would be far less coercive powers exercised against non-complying states. The primary question remains though as to whether such a regulatory/advisory approach would be deemed sufficient to create a suitable international system to deal with the financial default of multinational corporations?

In light of the problems that arise from cross-border insolvencies and the need for effective enforcement mechanisms to resolve the latter, one may answer the above question in the negative. Additionally, experience in the area of insolvency would seem to confirm this opinion. Indeed, efforts towards "harmonization" in the field of insolvency have already begun, but only advisory texts have resulted, such as the UNCITRAL Model Law[118] on Cross-border Insolvency or even the World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems[119]. It is true that these various international efforts have taken a step forward towards the identification of "best practices" in the area of domestic and cross-border insolvency. Their most valuable contribution, however, is to demonstrate that for the adoption of an effective insolvency framework, mere regulatory and/or advisory measures may be inadequate if not associated with enforcement tools. Despite the extensive work and research underlying the aforementioned instruments, most countries did not implement them[120]. And those who did enact the Model Law, for instance, expectedly chose to

[118] *See* UNCITRAL Model Law on Cross-Border Insolvency, U.N. Commission on International Trade Law, U.N. Doc. A/52/17 (1997), available at www.un.org (last visited September 2005).
[119] Available at http://www4.worldbank.org/legal/ (last visited September 2005).
[120] *See* E. Bruce Leonard *et al.*, A New Milestone in Cross-Border Insolvencies, 16-AUG AMBKRIJ 20 (1997); *see also* Alastair & Smith André Boraine, Crossing Borders into South African Insolvency Law:

exclude certain provisions deemed too detrimental to their interests. This sporadic and erratic implementation of standards and model laws could hardly be relied upon to achieve any consensus on cross-border insolvency matters, and far less so to implement Universalism on a global level.

As such, one is left with the recourse to institutions that can fulfil a judiciary role. An unlikely scenario only a decade ago, some institutions can now adjudicate cases in various areas of the law[121]. Their adjudicatory powers are most commonly driven from the creation of binding norms that are implemented upon their constituency. This judiciary role is often combined with the regulatory power as its main enforcement mechanism[122]. The question of whether the creation of an international insolvency regime may require this sort of judicial intervention[123] is one of the focuses of this thesis. This issue will be treated through the identification of the institutional and legal underpinning to the European insolvency system.

More generally and despite the critiques of Universalism, one can observe the growing evolvement of international law in the past decade to various arenas, such as trade, taxation, money laundering, banking and investment, just to name few. This

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From the Roman-Dutch Jurists to the UNCITRAL Model Law, 10 AM. BANKR. INST. L. REV. 135, 138 (2002) (arguing that few countries have enacted the Model Law in their national systems).

[121] For instance, the International Centre for Settlement of Investment Disputes provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. Recourse to ICSID conciliation and arbitration is entirely voluntary. However, once the parties have consented to arbitration under the ICSID Convention, neither can unilaterally withdraw its consent.

[122] "Understanding how to encourage participation in Dispute Resolution Procedures sheds light on the role of International Organizations. These bodies have an important role because they can be used to coordinate international interactions in such a way as to increase the likelihood that states will submit themselves to the authority of Dispute Resolution Bodies. The obvious example of this sort of behavior is seen at the World Trade Organization. Although certainly not a flawless process, the WTO is able to resolve disputes among members and impose sanctions closer to the optimal level". *See* Guzman Andrew T., International Law: A Compliance Based Theory, 90 CAL. L. REV. 1823, 1829 (1999).

[123] Clearly, an international tribunal in the area of cross-border insolvency will be required according to the definition of the "single -court universalism" (*supra)*. This tribunal will require supranational powers that are available to international courts (which settle cases of international public law) in order to enforce its decisions on an international level. Concurrently, it will handle the settlement of disputes between multinational debtors and their various creditors (*i.e.*, subjects of private international law). This hybrid nature may seem rather unrealistic and may create further difficulties in implementing Universalism.

growing "internationalization" of the law has led to the empowerment of a number of international institutions, enabling them to play custodian to numerous conventions. This may present a potential opportunity to implement Universalism. In spite of this global movement, however, and the birth of supranational entities capable of enforcing legal standards on an international scale, critics still contend Universalism to be unrealistic and politically implausible. Though the current cooperative and discretionary approach has proven unpredictable and inefficient, little has been done to test the universalistic approach under its various forms.

In addition, it has been argued "*to solve the coordination problems present in international insolvencies, one should explicitly consider the underlying demands of bankruptcy policy and of the international system. Universalism only considers the former*"[124]. As such, the international system should consider including not only self-interested nations in pursuit of implementing their national and social policies, but should also should consider encompassing international institutions and sovereign entities that have a significant impact on the development of international law. These institutions possible might bring original solutions to the transnational insolvency problem. Put simply, they might come to offer, on the long term, the necessary institutional components or foundation for a binding, comprehensive cross-border insolvency framework.

VI. Conclusion

Critics of Universalism have attacked and weakened the plausibility and practicability of this theory in various ways, such as with respect to its definition, pre-requisites and most importantly its political impracticability. In summary, Universalism is deemed difficult to achieve in the absence of three pre-requisites.

[124] *See* Tung, Fear of Commitment, *supra* note 94, at 594.

Chapter Two.

First, Universalism appears to require core similarities between domestic insolvency systems. Because of the insufficient degree of harmonization among domestic laws, the adoption of "Pure" or "True" Universalism as an international model is often discredited. The problems that stem from the priority of claims and the protection of domestic creditors are only two indicators of the divergence that exists between jurisdictions. Although non-negligible efforts of harmonization have already begun, insolvency systems remain - to a great extent - territorial in scope and seldom allow foreign courts to decide the insolvency of a domestically incorporated debtor.

Second, Universalism can hardly be adopted unless countries have similar level of economic development. Insofar as the efficiency of universalism is conditioned upon its collective implementation, all nations must have equal or at least analogous incentives to adopt it. The fulfilment of this requirement seems rather difficult because most multinationals have their "home" in developed countries. This would create a situation where less developed countries will more often defer to foreign insolvency proceedings. As a result, an international insolvency system built on Universalism might be detrimental to their domestic creditors. Although certain mechanisms may be developed so as to ensure equal treatment between domestic and foreign creditors, the incentive of developing countries to implement Universalism remains questionable at best.

Third, the implementation of Universalism must be associated with an effective institutional framework to ensure enforcement. Experience in international law has frequently demonstrated that sovereign states do not abide by their commitments. In the area of insolvency, this assumption is reinforced due to the benefits that accrue on the domestic level from the non-deference to and non-cooperation with foreign courts. In order to address this problem, effective enforcement mechanisms and possibly even economic sanctions may be necessary to implement True Universalism. There is little doubt that specialized international bodies will have to have a significant role to play in this process. So long as there is no supranational judicial authority to monitor and

supervise domestic judiciaries in the insolvency process of multinationals, Universalism will be difficult to achieve.

Because these various pre-requisites are difficult to fulfil, the United Nations Commission on International Trade Law issued in 1997 the UNCITRAL Model Law on Cross-Border Insolvency. Although the Model Law is non-binding by its nature, it remains the only truly international instrument that suggests a pragmatic approach based on moderate choice of forum/law provisions (and not on substantive law) and aimed at improving cooperation through the establishment of an easier system for the recognition of foreign insolvency proceedings. While the Model Law has a number of significant merits that could serve as a foundation for a more rational international corporate insolvency framework, it falls short of the broader expectations a minimally acceptable international insolvency system should fulfil. In parallel, a significant regional insolvency arrangement in the form of the European Union Council Regulation (1346/2000) on Insolvency Proceedings (the Regulation) has recently been enacted[125]. While the Regulation is also based on a choice of law/forum approach with recognition and

[125] It is important to note however, the lengthy and uncertain historical events that led to the adoption of the Regulation some 40 years after the creation of the European Union. In 1960, at a time when a general convention on jurisdiction and the enforcement of judgments in civil and commercial matters was taking shape, a committee of experts was designated to agree upon and draft an insolvency convention within the European Union. Their work resulted in a 1982 text, which was never signed by member states and was officially abandoned in 1985. In light of the objectives of the treaty establishing the European Economic Community (the Treaty) and the difficulties that arose from a number of cross-border insolvency cases, EU member states re-launched the insolvency project in 1989. After several years of negotiations, they reached a regional proposal in 1995 in the form of a EU convention on insolvency proceedings. The text - including 55 articles and three annexes - was signed by all member states except the UK. Short of this signature, the convention was never ratified. It is only after the Treaty of Amsterdam, which urged closer "cooperation on justice and home affairs", that this EU convention was converted into an acceptable Regulation to govern insolvency proceedings within the Community. The Regulation applies to insolvency proceedings initiated after the 31st of May 2002 and does not operate retroactively. *See* in *Re* Finoper S.A. (Tribunal de Luxembourg, 12.11.2004 (II No.1190/04)). Furthermore, potential conflicts between the Regulation and previous legislative instruments within the EU are not imminent. Indeed, the Brussels Convention, which was the key convention on judicial cooperation and recognition within the EU, does not apply to insolvency proceedings. It should be noted however, that according to the Preamble, the Regulation only applies when the debtor's centre of main interests (*infra*) is located in one of the EU countries. The Regulation incorporates some of the objectives of the treaty of Amsterdam in maintaining and developing "the Union as an area of freedom, security and justice". It further secures the goals stipulated in article 65 of the same treaty and facilitates judicial cooperation by harmonizing and simplifying the recognition and enforcement of insolvency proceedings initiated within the territories of member countries.

enforcement mechanisms, it provides for a more complete and predictable approach in dealing with the insolvency of large multinationals within the European Community.

To more fully develop the primary theme of this thesis, the subsequent chapters will identify what lessons can be learned from the EU Regulation and when combined with certain elements from the UNCITRAL Model Law, a better cross-border insolvency framework may be found.

Chapter Three.
Forum of Competent Jurisdiction: Lessons from the EU Insolvency Regulation

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I. Introduction

The prior Chapters of this thesis focused on the various implications of the insolvency of multinationals and uncovered why the creation of a global insolvency regime built on "Pure Universalism" is thought to be difficult to implement, at least in the near and medium term future. This and the next Chapter will identify and examine the lessons that can be learned from the European Union Regulation on Insolvency Proceedings[1] (the EU Regulation or Regulation), which may in turn serve to enhance the

[1] The EU legislation on cross-border insolvency was consolidated by the issuance of the Council Regulation N°. 1346/2000 on insolvency proceedings. Available at http://europa.eu.int/eur-lex/en (last visited July 2005). The Regulation retrieves to a great extent the provisions of the non-ratified EU Insolvency Convention, in connection to which an official explanatory report was issued. Most of the comments and underlying policy considerations contained in that report remain valid to elucidate the purpose and objectives of the newly adopted Regulation. *See* Miguel Virgos & Etienne Schmit, Report on the Convention on Insolvency Proceedings, available at http://aei.pitt.edu/archive/00000952/ (last visited July 2005) [hereinafter the Virgos Schmit Report]

provisions of the UNCITRAL Model Law on Cross-Border Insolvency[2] (the UNCITRAL Model Law or Model Law).

As the EU Regulation opts for a coherent choice of forum and law to resolve multinationals' insolvency, its provisions may provide further guidance on how the international community could channel narrower and more effective cross-border insolvency reforms through the Model Law. More specifically, the European model may shed light on certain potential improvements and desired additions to the Model Law with respect to the choice of forum, choice of law, access to foreign representatives and recognition matters.

Some authors have argued the EU Regulation offers little to base an international insolvency system on beyond the boundaries of a relatively "small" community[3]. However, the Regulation well may offer some key lessons that might be used by the international community to reach a more viable international insolvency arrangement. Indeed, the Regulation has addressed the same issues and concerns as those treated under the Model Law[4], but in a more complete manner. Although the Regulation may be the result of closer legal, judicial and market integration among EU member states[5] and while the overall European insolvency regime may not be implemented elsewhere in its

[2] The UNCITRAL Model Law on Cross-Border Insolvency, U.N. Commission on International Trade Law, U.N. Doc. A/52/17 (1997). Available at www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997 Model.html (last visited September 2005)

[3] *See* Ian F. Fletcher, The European Union Convention on Insolvency Proceedings: An Overview and Comment, With U.S. Interest In Mind, 23 BROOK. J. INT'L L. 25, 48 (1997) [hereinafter Fletcher, The European Union Convention] (arguing that the European Insolvency model anticipated by the adoption of the 1995 convention, may not serve as a "blueprint" for other groupings of states. The author further adds "what is considered to be almost a matter of necessity for such a closely coordinated and coalescent group of sovereign states as those comprising the EU may well seem totally impractical to states less deeply committed to the principles of *supranational integration*.")

[4] These issues were exposed in the first and second chapter of this thesis. Mainly, the determination of the debtor's home country, the forum entitled to open insolvency proceedings against this debtor, creditors' ranking of claims, and the law to be applied in course of such proceedings.

[5] Such an achievement is often regarded as the result of the institutional infrastructure already present within the European Community. While mutual efforts of creating a common market, along with established and shared institutional traditions have undoubtedly facilitated the adoption of the Regulation, one may ask - based on the European experience - what degree of legal and judicial integration is necessary to achieve Modified Universalism on a global level. Although treating such a question is beyond the scope of this thesis, this could be the basis of a further study in the area of cross-border insolvency.

entirety, there are nonetheless some useful approaches that could be transmitted to the Model Law, thereby making the latter more responsive to the demands of domestic social policies, creditors, debtors, and the insolvent multinational's stakeholders in general.

For instance, the first set of issues the Regulation had to address was related to rather general, yet vital concerns such as creditors' rights, equity, fairness[6] and expediency[7]. Although a perfect insolvency regime that entirely satisfies the claims of all parties involved does not exist, some systems are considered more predictable than others and can facilitate insolvency proceedings and meet the expectations of the parties to a greater extent. In this regard, the Regulation may be considered a breakthrough in terms of enhancing predictability, equality among creditors and judicial cooperation[8].

The second set of issues dealt with under the Regulation stems from traditional legal uncertainties and primarily pertained to the scope of the Regulation, the rules governing the choice of law and forum, recognition and enforcement of foreign insolvency judgments[9]. Because the Regulation addressed these concerns in a comprehensive and clear manner, its study may suggest a number of improvements to the Model Law, increasing the prospects of its adoption by a greater number of countries[10]. This, however, does not imply the replication of the Regulation, nor its projection onto the global level; rather the Regulation illustrates that despite significant differences

[6] *See* Article 21 of the Preamble: "a creditor should be able to keep what he has received in the course of insolvency proceedings but should be entitled only to participate in the distribution of total assets in other proceedings if creditors with the same standing have obtained the same proportion of their claims".

[7] *See* the Model Law' guide to enactment where the UNCITRAL commission stressed that one of the primary objectives of the Model Law is to increase expediency in the resolution of cross-border insolvency cases. Available at www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997/Model.html (last visited September 2005) [hereinafter Guide to Enactment].

[8] Bob Wessels, Primer on the New European Insolvency Framework, 17-AUG AM. BANKR. INST. J. 12, 12 (1998) [hereinafter Wessels, The European Insolvency Framework].

[9] *See* Regulation at article 8.

[10] Insofar as each country has no obligation to enact the Model Law, the latter's success or failure would greatly depend on the number of countries that have deliberately adopted it. In this regard, the UNCITRAL commission has made every effort to render the Model Law more appealing and flexible in order to accommodate domestic constraints in each country.

between the domestic insolvency laws of EU member countries[11], a binding and importantly, predictable regional insolvency system could be created.

In parallel, the Regulation fashioned a realistic compromise between the Universality and the Territoriality of insolvency proceedings[12] through a simple conflict of laws approach (and not substantive insolvency laws), something the international community has not yet achieved; not even through the Model Law, which provisions are rather wanting in many respects. As a result, the European insolvency regime may be thought of as a "pilot system" on cross-border insolvency that yields certain advantages of both theoretical approaches. Such a pragmatic approach could inspire the international community into upgrading the Model Law by including more effective and functional provisions with respect to the competent forum, the applicable law, and recognition of foreign insolvency judgments. To this end, a thorough and comparative analysis of the Regulation and the Model Law could prove constructive and stimulating to the protagonists of a more adequate global solution to multinationals' default.

This Chapter will focus on choice of forum provisions and their effects, under both the Model Law and the Regulation. Although the EU Insolvency Convention was an important source of inspiration to the UNCITRAL working group[13], and the Model Law and the Regulation follow the same standards in identifying the forum entitled to open

[11] Article 11 of the preamble stipulates that because of the "*widely differing substantive laws*" between member states, the Regulation could not provide for a single set of universal proceedings. "Why didn't Europe devise a single exclusive universal form of insolvency proceedings for the whole of the community? The answer is this: diversity. It was considered too difficult to implement a universal proceeding without modifying, by the application of the law of any state of its opening of proceedings, pre-existing rights created before the insolvency under the different national laws of the member states". See Bob Wessels, Principles of European Insolvency Law, 22-SEP AM. BANKR. INST. J. 28, 28 (2003) [hereinafter Wessels, Principles of European Insolvency Law].

[12] *See* Anne Nielsen *et. al.*, the Cross-Border Insolvency Concordat: Principles to Facilitate the Resolution of International Insolvencies, 70 AM. BANKR. L.J. 533, 534 -535 (1996) (arguing Modified Universalism to be the most appropriate approach to combine the benefits resulting from both the Universalistic and Territorial theory while discarding many of their respective disadvantages) [hereinafter Nielsen, Cross-border Insolvency Concordat].

[13] It should be noted that the Regulation contains the same provisions of the EU Insolvency Convention (1995), which was not ratified. *See* Andre Berends, The UNCITRAL Model Law on Cross-border Insolvency: A Comprehensive Overview, 6 TUL. J. INT'L & COMP. L. 309, 320 (1998) [hereinafter Berends, Comprehensive Overview].

insolvency proceedings against the multinational debtor[14]; their purpose, objectives and effects greatly differ from each other. Part II of this Chapter will highlight how the scope of main insolvency proceedings is much broader and uninhibited under the Regulation than it is under the Model Law. Whether the Model Law could follow the Regulation's approach by enabling the forum of main proceedings to have overall jurisdiction over the debtor's assets, including those located in jurisdictions where non-main proceedings cannot be initiated, will be considered. This could prove more effective in creating a cheaper and more expedient process to administer the multinational debtor's estate, while increasing the chances of reorganizing the multinational debtor.

In contrast, domestic proceedings, whether known as secondary or non-main proceedings[15], are more restricted under the Regulation. This provides more viable protection to domestic creditors by enabling the latter to apply for specific types of relief in order to secure their credit. Part III of this Chapter will therefore identify what the advantages are of such a restricted approach, and how the Model Law falls short of realizing these benefits by conferring an undefined reach to non-main proceedings. Part IV will consider the interesting aspect of the Regulation with respect to the relationship it establishes between main and secondary proceedings. Indeed, the primacy of main proceedings over secondary proceedings under the Regulation realizes some important advantages of Universalism. Although the Model Law modestly implies such a primacy, the ensuing benefits remain subject to courts' discretion and are contingent upon whether an ad-hoc understanding could be reached among the various courts involved in a cross-border insolvency case.

[14] The Model Law however is only concerned with recognition matters, and not with the determination of criteria allowing a given forum to open insolvency proceedings against the debtor.
[15] The term "non-main proceedings" is used under the Model Law to denote that no hierarchy between the scope of such proceedings and main proceedings exists. In contrast, the Regulation uses the terms main and secondary proceedings, the latter being limited to the territory of opening and could only consist of winding up proceedings (*infra*).

Chapter Three.

II. Main Proceedings and the Debtor's Centre of Main Interests

Rather than engaging in lengthy discussions on the most appropriate criteria to determine the debtor's home country, the Regulation has established a rebuttable presumption as to where such a place is located, thus giving courts the upper hand in deciding difficult cases. Indeed, the debtor's centre of main interests, synonymous with the debtor's home country, is presumably the place where that debtor is registered. After all, the determination of the debtor's home country seems more a question of fact, where courts should have the final word in light of the circumstances surrounding each case.

In reality, this presumption only reverses the burden of proof and gives a procedural boost to creditors who have taken into account the laws of the forum where the debtor is registered[16]. Therefore, the first part of this section will study the definition and purpose of the debtor's home country as spelled out under the Regulation. Although the UNCITRAL working group follows the definition of the debtor's centre of main interests contained in the Regulation, the second part will explore how the concept of the debtor's centre of main interests fulfils a significantly restricted purpose under the Model Law than it does under the Regulation. The third part will highlight how the Model Law approach differs from that of the Regulation, and how the latter achieves higher predictability and unity with respect to the scope of main proceedings. The final part of this section will explain the underlying policy choices that led each instrument to follow a different approach and whether a change in the Model Law policies is desirable.

A. The EU Regulation

In order to achieve a substantive degree of unity in insolvency proceedings, the Regulation prescribes an innovative methodology to determine the forum that is entitled to decide the debtor's insolvency within the EU. Pursuant to article 3.1 of the Regulation, there is a single forum that has exclusive jurisdiction over the entirety of the debtor's estate. Such proceedings - known as the main proceedings- take place where the debtor

[16] This presumption applies in the case of an adjusting creditor who has measured risk taking before entering into a transaction with the multinational debtor. *See* Chapter Two on the difference between adjusting and non-adjusting creditors.

has the centre of its main interests. While the Regulation does not give a rigid definition of this centre, it provides for certain guidelines in order to determine - with substantial certainty - where that centre is located. Indeed, article 3.1 establishes a rebuttable presumption according to which the centre of main interests is located at the *"place of the registered office"*. This indication would, in most cases, prove useful to decide where the main proceedings could be opened.

Although this criterion fails to give clearer guidelines in cases where the debtor has registered several of its offices, the preamble of the Regulation, which should be construed as a complementary instrument to the Regulation and thus binding[17] upon member states, provides further guidance regarding the interpretation of the debtor's centre of main interest. It stipulates in article 13 that this centre is presumed to be the place *"where the debtor conducts the administration of his interests on a regular basis and therefore ascertainable by third parties"*.

This rather flexible approach of defining an important concept can clearly be open to criticism[18]. According to some scholars[19], the indeterminacy of the debtor's centre of main interests could affect the predictability necessary in insolvency proceedings[20]. Although the registered office of the debtor is easily identifiable, it is argued that the language of the Regulation may encourage creditors to reverse this presumption to their advantage. A given class of creditors might benefit from privileged priority claims under

[17] In this regard, it is important to mention that traditionally common and civil law countries perceive the preamble differently. Generally, this preamble has an executory force in civil law countries and provides for mere non-binding guidelines to common law courts. *See* Ian F. Fletcher, The European Union Convention on Insolvency Proceedings: Choice-of-Law Provisions, 33 TEX. INT'L L.J. 119, 119 -120 (1998) [hereinafter Fletcher, the European Union Convention].
[18] *See* James H.M. Sprayregen et. al., International Issues: Are You Ready for the New European Union Regulations?, 041802 ABI-CLE 287 (2002) (arguing that the "EU Insolvency Regulation leaves many questions unanswered, and itself gives rise to many questions and uncertainties")
[19] *Id.*
[20] Jack Weinberg, What Are U.S. Creditors' Rights?, 20 No. 7 BKRST 3 (2003) (as regards the 1995 European convention on insolvency proceedings, which contains the same provisions as the EU Regulation to determine the debtor's centre of interest, the author argues that the convention "failed because it did not provide sufficient predictability to creditors attempting to determine which of the jurisdictions involved in a cross-border bankruptcy will be the forum for the main proceeding. Obviously, that inability was critical because creditors could not predict which state's laws would govern their claims.")

the rules of the forum they seek to establish as the debtor's centre of main interest. To achieve this, those creditors may try to establish the fictiveness of the place of registration, thereby extending the process with all its ensuing costs. If these creditors were to succeed in assigning the jurisdictional competence to another forum[21], less sophisticated creditors may face a less favourable insolvency regime. This could create a certain inequality among creditors, especially when there has been a reliance on the debtor's place of registration as indicated by the Regulation.

Despite these critiques, the flexible definition of the debtor's centre of main interests can be an advantage, if not a necessity. Indeed, 14 member countries ratified the Regulation[22], each with its own domestic insolvency laws and differing underlying policies. These differences translate into diverse legal principles, objectives and purposes that domestic insolvency proceedings[23] seek to achieve. A flexible definition of the debtor's centre of main interests presents the advantage of coping more easily with the requirements of each domestic insolvency law. It can further facilitate the implementation of the Regulation between member states, without the need to amend domestic laws.

On the other hand, the presumed location of the debtor's centre of main interests could enable domestic courts to handle situations where the registered office is not relevant, or when creditors have relied on a fictive and misleading centre, irrespective of the debtor's good faith. Indeed, the Regulation affords creditors the right to claim that the

[21] Forum Shopping is argued to present a high risk under the Regulation. A recent decision by the French court of Appeals of Versailles testifies to that risk. *See* In Re ISA Daisytek SAS, available at http://www.iiiglobal.org/country/european_union.html (last visited July 2004). *See* also Roland Montfort & Lefevre Pelletier, European Law on Cross-Border Insolvencies: Status of French Practice after the E.U. Regulation, 23-APR AM. BANKR. INST. J. 28, 73 (2004) [hereinafter Pelletier, European Law] (arguing that the court of appeals' decision in Re ISA Daisytek SAS may be considered as a "confirmation of possible dangers, including the risks of forum and/or law shopping toward the member state whose insolvency laws would be more favourable to specific interests. It is likely that the trend of forum and law shopping when applied to insolvency cases will become even stronger when the E.U. Regulation on the European Company becomes effective in October 2004"

[22] All European countries ratified the Regulation except Denmark.

[23] These differences are such that the Regulation does not even define the meaning of insolvency proceedings. Each member state is bound by its own insolvency laws and by the definitions contained therein. The Regulation however enlists in annex A, for each country, what insolvency proceedings are according to the various domestic laws of member states.

debtor has conducted its business from a place other than its registered office. While the exercise of this option may require the presentation of probative evidence in each case, it is feasible to establish that although registered, a given office was not primary, or the managerial and administrative decisions of the debtor were regularly taken from another location. For instance, in Re Collins & Aikman III[24], the English court found that the location of the centre of main interests of a German subsidiary does not correspond to its place of incorporation. Rather, considering the evidence as to the managerial and close links between the German subsidiary and its parent in the UK, the Court found this centre to be located in the UK. On a balance of probabilities, which is the test conducted by the English court, the centre of main interests was not the place of incorporation. The English Court confirmed that by following this test, and by allowing more flexibility in administering the estate of closely related group companies, value return to creditors could be enhanced.

It seems more difficult however, to tie such activities to the perception of third parties. Indeed, the preamble of the Regulation indicates that such a centre should, in part, be "*ascertained by third parties*" in order to confer jurisdictional competence to the forum where this centre is located. In this regard, the Regulation appears to operate on two different levels. The protection of third parties would require the application of a standard test[25] to determine what these third parties believed, or had reason to believe,

[24] *See* in Re Collins & Aikman III High Court of Justice London ([2006] EWHC 1343 (Ch)). *See* also In Re Silvalux Sarl (Tribunal de Luxembourg, 15.04.2004 (II No.365/05), where the court considered the mailing address and the social security system applicable to the employees of a French subsidiary to deduct that the subsidiary's centre of main interests was located in the Luxembourg and not in France which is the place of incorporation. On a post financial distress transfer of headquarters, *see* in Re Eurogyp (Tribunal de Commerce de Bruxelles of 12 December 2003). The court has rightfully implemented the Regulation and has found for the main jurisdiction of the Belgium courts despite the transfer of legal siege, which was considered fraudulent and misleading to third party creditors.

[25] *See* Pelletier, European Law, *supra* note 21 (arguing that the decision in Re ISA Daisytek SAS is "a correct application of certain provisions contained in the Regulation allowing a court to use a reality test to determine the localization of the centre of a debtor's main interests"). The issue remains however, whether courts will deduct third parties' perception in light of their status as sophisticated or non-sophisticated creditors. Similarly, in Re Energotech (Tribunal de Grande Instance de Lure 29.03.2006 No.06/01), a standard test was conducted by the court to confer main jurisdiction to the French court system, despite that the company's place of incorporation was in Poland. Among the criteria taken into account by the court so

when they entered into a business relationship with the debtor. When the third party at stake is an individual (with neither professional qualification nor expertise), this test is likely to be less stringent since no special knowledge is required from that individual. The situation may be different when the third party is a corporation that has carefully studied the transaction with the debtor.

This distinction may be useful to now analyse proposals suggesting that an international insolvency regime should only apply to resolve insolvency cases between large multinationals and sophisticated creditors. This system would entail the possibility of deference and asset transfers from one forum to another. That is to say, individuals and non-incorporated entities would remain under the protective umbrella of domestic laws and should seek recovery of their credit from debtor's assets that are located in that same jurisdiction. Rather than explicitly limiting its scope of application in such a manner, the Regulation leaves the appreciation of facts to the court(s) of opening[26], and allows the latter to draw circumstantial conclusions on an ad-hoc basis[27] in order to determine the intentions of the parties. It is likely that these domestic courts will de facto treat individuals and corporations/sophisticated creditors differently, thus recognizing that each is held to a distinct standard of knowledge and expertise.

B. The Model Law

The Model Law uses the concept of the debtor's centre of main interest to determine, in the case of multiple proceedings, which forum is the main forum. This step is essential to foresee the effects the opening and recognition of main proceedings would

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as to assert primary jurisdiction over the foreign entity, attention was given to the forum of meeting of the board of directors, the applicable law to major contracts, the place where the commercial strategy of the subsidiary is decided and the emplacement of the banking and financial institutions to which the subsidiary is indebted.

[26] While the EU convention remains silent on many aspects of its implementation, it would be reasonable to deduce that domestic courts will implement the Regulation consistently with its intended effects. See Wessels, the European Insolvency Framework, supra note 8 at 13 (arguing that where governments fail, judges play a major role in cross-border insolvency cases as "deputy-legislators").

[27] Furthermore, the European Court of Justice (ECJ) and its broad powers of interpretation support this pragmatic approach. Indeed, the ECJ encourages deference from domestic courts whenever there are uncertainties regarding the implementation of a European legislation.

produce in the enacting state. The following parts will respectively explore the implementation of this concept under the Model Law and highlight the effects that ensue from the recognition of foreign main proceedings in the enacting forum.

1. Defining the Centre of Main Interests

As mentioned above, the EU Insolvency Convention was an important source of inspiration to the UNICTRAL Working Group[28]. As a result, the Model Law also recognizes the competent forum to open main insolvency proceedings as the place where the debtor has the "centre of its main interests". The Model Law working group, unable to find a better definition[29], presumed this centre to also be the place of registration, i.e. the place of incorporation.

The concept of the centre of main interests was discussed at length amongst the various representatives of the working group[30]. As each law has a different approach in identifying the home country of the debtor, opting for a flexible definition, such as the centre of main interests, which is presumably the place of registration, was the most effective approach. As it is the case under the Regulation, this approach could prevent fictive registrations in a tax heaven or in jurisdictions where insolvency laws would be more favourable to the debtor and to the protection of its estate.

It is noteworthy to mention that there were other proposals during the negotiation phase so as to include more than one criterion in defining the debtor's home country. Such proposals were bound to fail since the aim of the Model Law is to recognize only one forum entitled to instigate main proceedings against the debtor[31]. With more than one

[28] *See* Berends, Comprehensive Overview, *supra* note 13, at 330.
[29] *Id.*
[30] *Id. See also* Report of the Working Group on Insolvency Law on the Work of the Eighteenth Session, U.N. GAOR, 29th Sess., at 5, U.N. Doc. A/CN.9/419 (1995); Report of the Working Group on Insolvency Law on the Work of the Nineteenth Session, U.N. GAOR, 30th Sess., at 5, U.N. Doc. A/CN.9/422 (1996); Report of the Working Group on Insolvency Law on the Work of Its Twentieth Session, U.N. GAOR, 30th Sess., at 5, U.N. Doc. A/CN.9/433 (1996).
[31] *Id.*

criterion to confer such a jurisdiction over the debtor's estate, the courts of the enacting state of the Model Law could face a situation where more than one foreign forum may present a legitimate claim to be recognized as the main forum.

Given the professional and geographic diversity of the drafters of the Model Law, representatives were well aware that in each forum exist various insolvency and domestic laws - such as trade or commercial law - which may impact the insolvency of corporate entities[32]. This is why the Model Law does not refer to main foreign insolvency proceedings; rather, it simply refers to foreign proceedings, whether compulsory or voluntary[33], in which creditors are collectively involved in view to reorganize or liquidate the debtor's business[34]. In other words, it is not relevant whether the foreign law recognizes the foreign proceedings as insolvency proceedings. The Model Law approach is mindful in this regard because it has opted for an all-inclusive terminology so as to extend its provisions of recognition to instances where the foreign proceedings would not qualify as insolvency proceedings pursuant to the law of the recognizing forum.

Although the test to determine the debtor's home country and the forum entitled to open main proceedings is identical under the Regulation and the Model Law, there is a fundamental difference regarding the scope and objectives of these two instruments.

2. Effects of Recognition

The core aspect of the Model Law is the effect foreign proceedings produce on the domestic level once they are recognized by the enacting state[35]. According to article 20 of the Model Law, the enacting state - through its judiciaries or any other administrative entity that is in charge of adjudicating corporate insolvencies - is bound to attach certain effects to the recognition of foreign main proceedings. These effects

[32] *Id.*
[33] *See* Guide to Enactment, *supra* note 7, at 22.
[34] *Id.*
[35] Article 31 of the Model Law reads "*In the absence of evidence to the contrary, recognition of a foreign main proceeding is...proof that the debtor is insolvent*".

translate into certain types of relief, such as a moratorium against creditors, a stay of the pending proceedings or enforcement against the debtor and a suspension of the right to transfer the debtor's assets from the enacting forum to another[36]. Although the Model Law suggests that these types of relief should be automatically granted to the foreign representative upon recognition, it acknowledges that the intervention of the court is sometimes, if not often, necessary to enable foreign insolvency proceedings to produce these effects on the domestic level[37]. Thus, the Model Law, though by its nature lacking the necessary biding powers, seeks to encourage enacting states' courts to implement the provisions of article 20.

Where a uniform implementation of article 20 would enhance cooperation among forums involved to resolve the insolvency of a multinational debtor, there are a number of exceptions within the same article that give considerable leeway to domestic courts. Indeed, the effects of recognition sought under the Model Law may be modified or terminated pursuant to the provisions of the laws of the enacting state. Such domestic laws, whether related to insolvency or not, may empower domestic courts to considerably limit the intended reach of foreign main proceedings; a situation likely to arise if domestic creditors are unable to collect on their claims[38] as a result of the relief automatically granted to the foreign representative.

As indicated in the previous chapters, the protection of domestic creditors is a key policy matter that often dictates the extent of domestic courts' cooperation with foreign courts and whether foreign proceedings will be permitted to produce domestic effects. Therefore, article 20.4 allows further limitations to the relief granted upon recognition. This article stipulates that the recognition of foreign main proceedings shall have no effect on the right to commence proceedings under the laws of the enacting states. Thus,

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[36] For a complete list of relief available upon recognition of foreign main proceedings, *see* article 20 of the Model Law. Also, it should be noted that the Model Law does not prevent the enacting forum from availing further types of relief to foreign creditors if the law of the enacting forum so permits.

[37] *See* Guide to Enactment, *supra* note 7, at 24.

[38] As seen under article 20, there could be, in theory, instances where the recognition of foreign main proceedings entails the issuance of a stay of execution against the debtor's assets, thereby preventing domestic creditors in the enacting state to collect on their claims.

the actual reach of a moratorium against creditors in the enacting state becomes questionable, should domestic creditors be granted a right to initiate legal process against the debtor, even after recognition of foreign main proceedings.

In addition to the automatic relief mentioned above, the foreign representative may seek further types of relief in the enacting states, such as the entrustment of the administration of the debtor's assets with him or with another person designated by the court. Although article 21 of the Model Law contains a non-exhaustive list of relief available to the foreign representative, the court of the enacting state has discretion over granting specific relief required by the foreign representative, even after recognition of the foreign main proceedings. This is to say, despite the Model Law's inclusion of an arsenal of tools that should ensure a higher degree of cooperation between the enacting forum and the foreign representative, a complete and faithful implementation of the Model Law remains primarily subject to the discretion of domestic courts.

While it is true that the Model Law is not binding and was not intended to compel enacting states to follow a certain course of action, the possible limitations to the effects of recognition constitute a major impediment to improving coordination among courts and empowering the foreign representative. Perhaps the UNCITRAL working group was too eager to see the Model Law adopted by a large number of countries[39], and to achieve this, has included certain provisions that unfortunately hinder the very purpose of the Model Law and leave the discretion of domestic courts intact over cooperation. Compared with the Regulation, the provisions of the Model Law lack decisiveness, regardless of the unbinding nature of the instrument as a whole. While textual differences between the Model Law and the Regulation may be the easiest to discern, other substantial differences between these two instruments' overall approach are more subtle. The subsequent sub-section will highlight how the approach of the Regulation is fundamentally different and more effective from that of the Model Law.

[39] One such presumption may be implied from the limited objective of the Model Law combined with an overly permissive language.

C. The Model Law's Passive Approach

The concept of the debtor's centre of main interests, as discussed above, has resolved a significant problem with respect to the insolvency process of multinational corporations[40]. The Model Law and the Regulation apply this concept though main proceedings under each instrument fulfil different roles.

Indeed, the Regulation takes a pro-active role in main proceedings and directly defines the prerogatives of the main forum. Most importantly, the main forum has power over the debtor's assets, wherever located, and can demand from other foreign courts within the EU to defer and transfer the debtors' assets located within their respective jurisdiction. Although such powers may be curtailed when the debtor possesses an establishment in other forums (*infra)*, they are nonetheless significant, as by definition they were intended to have a universal reach over the debtor's estate[41].

In contrast, the Model Law has adopted a passive view of main proceedings, where the identification of such main proceedings is only relevant for recognition purposes and the resulting effects may be subject to numerous restrictions by either the enacting forum or pursuant to the latter's law. The main forum under the Model Law was not intended to have overall jurisdiction over the debtor's assets, not even when such assets are located in a forum where the debtor has no establishment (*infra*).

In addition, recognition under the Model Law does not refer to the recognition of a foreign insolvency judgment that should produce some effects on the debtor's assets

[40]*See* Chapter Two on the determination of the debtor's home country. In this respect, the Regulation and the Model Law have overcome a substantial amount of indeterminacy to identify the debtor's home country.

[41] *See* Lawrence Westbrook, Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation, 76 AM. BANKR. L.J. 1, 34 (2002) [hereinafter Westbrook, Multinational Enterprises].

located in the enacting state[42]. Rather, recognition simply means that main foreign proceedings are acknowledged and it is at the discretion of the courts of the enacting state to grant relief to the foreign representative, provided that the Model Law was not modified from its original version and was enacted as is. In this regard, it is evident that under the Regulation, a foreign liquidator and more so, a liquidator designated in the course of main proceedings, can rarely be denied the relief sought before foreign courts. This is because the Regulation, unlike the Model Law, is not crippled with substantive exceptions regarding the mandatory extent of cooperation and coordination between courts. Whenever multiple insolvency proceedings are initiated against the same debtor within the EU, they automatically produce certain restraining effects on each other, without being subject to the discretion of the various courts involved or their applicable laws.

Since the Model Law is solely geared towards recognition, or more precisely towards the acknowledgment of foreign proceedings, which may or may not entail the granting of provisional relief to the foreign representative, it contains no explicit provisions on the extent of powers available to the enacting forum when the latter is in fact the main forum. The Model Law actually advises the enacting state to follow a cooperative course of action when a foreign representative presents an application for recognition. It does not however inform the enacting forum how its own demand for recognition will be dealt with before other forums and what effects the opening of proceedings in the enacting state produce elsewhere. These questions cannot be answered with any conviction under the Model Law because each case will have its own set of circumstances, including a more or less cooperative recognizing forum and variably accommodating foreign domestic laws. This stands in contrast with the Regulation, where the prerogatives of the main forum are well defined and the effects of main proceedings in other jurisdictions are known in advance. Needless to say that under the

[42] *See* Chapter Two on the distinction between the recognition of a foreign insolvency judgment on the merits (where the recognizing forum would enforce a foreign court' decision on its territory) and the recognition of foreign insolvency proceedings (where the recognizing forum may or may not allow such foreign proceedings to produce effect on its territory). The Model Law is only concerned with the second type of recognition.

Regulation, predictability is much higher than under the Model Law. Yet the Regulation did not create any substantive insolvency law; it opted for unequivocal language with respect to the relationship between main and secondary proceedings (*infra*).

As a result of the Model Law's passive approach, a number of issues, most importantly the issue of cooperation is largely dealt with subject to the discretion of the court in the enacting state. In fact, one may further reflect on the degree of cooperation among courts in the absence of the Model Law. As mentioned in the previous chapters, cooperation between courts located in different jurisdictions is almost always contingent upon the satisfaction of domestic creditors[43]. This premise has not changed under the Model Law, pursuant to which domestic courts dispose of a number of provisions that not only allow them to modify or terminate the relief granted to the foreign representative, but also to deny such relief in the first place. As it can be fairly argued that the last decade has seen a shift towards more cooperation between courts, rather than conflict in resolving significant cross-border insolvency cases[44], one may question how the Model Law, enacted almost a decade ago, furthers today this cooperation and coordination among several sets of proceedings.

Undoubtedly, the Model Law remains a good initiative as it provides for some guidelines on cooperation, while it assists domestic legislation in coping with the very nature of transnational insolvencies[45]. However, the relatively recent enactment of the Regulation sheds light on the major shortcomings of the Model Law, especially with

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[43] *See* Unt Lore, International Relations and International Insolvency Cooperation: Liberalism, Institutionalism, and Transnational Legal Dialogue, Law and Policy and International Business vol.28, 4-6 (1997) [hereinafter Lore, International Insolvency Cooperation]. *See also* Kurt H. Nadelmann, International Bankruptcy Law: Its Present Status, 5 U. TORONTO L.J. 324, 351 (1944).

[44] *See* Reed, Alan, A New Model Of Jurisdictional Propriety For Anglo-American Foreign Judgment Recognition And Enforcement: Something Old, Something Borrowed, Something New?, 25 LOY. L.A. INT'L. & COMP. L. REV. 243, 243 -247 (2003). On the increasing use of protocols, especially among common law jurisdictions, to overcome difficulties of cooperation in cross-border insolvency cases, see Derrick *Tay*, Insolvencies without Frontiers: The Emergence of the Cross-Border Protocol, Insolvency institute of Canada (1999), available at http://www.globalinsolvency.com/insol/intinsolvencies/ overview.html (last visited August 2005). *See also* cooperation efforts that led to the first coordinated liquidation of a multinational debtor in re Maxwell Communication Corp., 170 B.R. 800 (Bankr. S.D.N.Y. 1994), *aff'd*, 186 B.R. 807 (S.D.N.Y. 1995), *aff'd*, 93 F.3d 1036 (2d Cir. 1996).

[45] *See* Guide to Enactment, *supra* note 7, at 19.

respect to the considerable leverage the Model Law èxtends to domestic courts in their decision to cooperate with a foreign representative.

In parallel, it can be argued that the provisions of the Regulation, which are narrower that those of the Model Law, were the result of closer economic and legal integration among EU member states[46]. While this may be partially true, the Model Law, unlike an international treaty, was not intended to be binding on its signatories. Thus, one may enquire why the UNCITRAL working group did not issue more compelling cooperation rules containing fewer exceptions, and conferring broader powers to the main forum. Either way, the non-binding nature of the Model Law would have enabled each enacting state to waive any provisions deemed too prescriptive or far-reaching. Even if this were the case and the Model Law would have seemed less appealing to countries, a narrower and more compelling approach might have created a more complete and adequate international instrument to resolve cross-border insolvency matters. A flaw of this instrument would be its lacking binding powers, and not its permissive language as is currently the case.

D. Underlying Policy Choices

Projecting the success or the failure of the Model Law in the next decade is a difficult task and it is beyond the scope of this work. However, an awareness of the policies underlying the Model Law and the intent of its drafters may help develop an understanding of how this non-binding instrument may be improved in the future, and whether regional insolvency arrangements[47], such as the EU Regulation, may have any impact on its maturity.

[46] Most importantly, the Regulation, as much as any European legislation, has the necessary binding power to compel member states to abide by its provisions. Despite this biding character however, it took well over forty years to agree on a suitable insolvency framework within the EU Community.

[47] Although this study only covers the Regulation and its potential contributions to the Model Law, other regional insolvency instruments may be the subject of further studies, such as the European Convention on Certain International Aspects of Bankruptcy (1990), the Montevideo treaties on international commercial law (1889 and 1940), the Convention regarding Bankruptcy between Nordic States (1933) and the Convention on Private International Law (Bustamante Code) (1928).

Chapter Three.

In many respects, the Model Law is the result of pragmatic and truly international efforts to address the issues that arise from the insolvency of multinational corporations. Many countries and international organisations[48], either in their capacity of participant or observer, have contributed to the issuance of the Model Law. Insolvency experts, judges and practitioners from all over the globe have provided insightful comments on the Model Law during the various working sessions leading to its final version[49]. Because these global efforts in the area of cross-border insolvency were considered a premiere in the mid-1990s, a substantial amount of pressure was on the participants to create acceptable international guidelines capable of fostering cooperation between courts involved in cross-border insolvency cases[50]. This mounting pressure first arose in the course of the initial discussions regarding the form these international efforts should take and culminated in a choice between a convention and a model law. By opting for the latter, the threshold of expectations and commitments was significantly lowered, thereby placing the Model Law on a fast track for approval[51].

On the substance of the Model Law, the working group has made a clear policy choice based on the treatment of specific issues, within which modest contributions were originally sought[52]. This low profile approach had a number of merits. First, it encouraged a large number of countries to participate in the elaboration of the Model Law[53]. In fact, if the Model Law were intended to be a binding convention among the participants, the negotiation process would have been longer and certainly more

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[48] Recently, the area of insolvency, including its potential cross-border implications, has gained the attention of international organizations such as the World Bank and International Monetary Fund. The contributions of these institutions will be treated in the next chapter. See Bank's *Principles and Guidelines for Effective Insolvency and Creditor Rights System,* available at www.worldbank.org/ifa/rosc_icr.html (last visited July 2005).
[49] *See* Guide to Enactment, *supra* note 7.
[50] *See* Mlevin C. Zwaig, Developments and Trends in United States/Canada Cross-Border Reorganizations, 9 J. BANKR. L. & PRAC. 343, 347-348 (2001).
[51] *Id. See also* Note from the UNCTIRAL Secretariat: Cross-border insolvency, A/CN.9/378/Add.4 (1993), available at www.uncitral.org/pdf/english/yearbooks/yb-1993-e/vol24-p248-253-e.pdf (last visited September 2005). For a preliminary study to assess the desirability of a cross-border insolvency framework, *see* Report of the UNCITRAL Assembly General, U.N. GAOR, 26th Sess., Possible Future Work: Cross-border insolvency, A/CN.9/378/Add.4 (1993).
[52] *Id.*
[53] *Id.*

complex[54]. Second, the modest aim of the UNCITRAL working group made the Model Law more defensible and has allowed such an instrument to create its own anchor in the realm of cross-border insolvency. Today, the Model Law remains an important tool for anyone interested in the subject matter.

Despite its merits and the head start it had when it was issued in 1997, the Model Law may now seem somewhat outdated and incomplete. As trade and investment are increasing in magnitude and complexity, the limited approach and objectives of the Model Law progressively appear to be inadequate[55]. Furthermore, the issuance of the EU Regulation has demonstrated that more effective methods of cooperation are possible, even among countries that have significant differences between their domestic insolvency laws. The Regulation is more complete as it deals with the majority of problems that arise from the insolvency of multinational corporations, without creating substantial insolvency rules. Importantly, the attributes of integration between EU member states should not be overblown. In fact, should this integration be the only reason why the Regulation was enacted, it would not be possible to explain the long process and the several failed attempts that finally led to its issuance·

In light of the above, it could be argued that the Model Law was indented to be a mere stepping stone that would subsequently be subject to further amendments and improvements. Many scholars share such a view and contend that the Model Law may further mature and more effectively and completely address the issues that arise from the insolvency of multinational corporations[56]. To do so, it is necessary that the international

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[54] *See* Berends, Comprehensive Overview, *supra* note 13, at 328.

[55] *See* Westbrook J. Lawrence, A Global Solution to Multinational Defaults, 98 MICH. L. REV. 2276, 2280 (2000) (arguing that while the Model Law may improve cooperation to reorganize multinationals, it is *"frustrating the efforts to engage in manipulation of assets and other fraudulent activity"*) [hereinafter Westbrook, Global Solution]. For a comprehensive critique of the Model Law and any other insolvency system implicating the application of universalistic precepts see Lynn M. LoPucki, The Trojan Horse in UNCITRAL, 33 BANKR. CT. DEC. (CRR) No. 25 at A5 (1999).

[56] *See* Jay Lawrence Westbrook, Universal Priorities, 33 TEX. INT'L L.J. 27 at 28 (1998) [hereinafter Westbrook, Universal Priorities]; Peter J. Murphy, Why Won't The Leaders Lead? The Need for National Governments to Replace Academics and Practitioners in the Effort to Reform the Muddled World of International Insolvency, 34 U. MIAMI INTER-AM. L. REV. 121 (2002) (arguing that the international community should look ahead to increase cooperation through the ratification of a treaty and stresses that

community draws some lessons from the Regulation, which establishes the first regional and binding insolvency arrangement with the explicit remit of increasing predictability and equality among creditors. Perhaps the first lesson from the Regulation is that the main forum should be conferred broader and more assertive powers. This would endow cross-border insolvency proceedings with Universalistic traits, thus reaping the chief advantages offered by this theory. Moreover, it is essential to reduce the permitted exceptions to the effects of recognition under the Model Law. This would tend to ensure uniformity of application and to result in a higher degree of predictability. In other words, the enacting/recognizing forum should no longer be in a position to restrict the reach of foreign main proceedings and to condition the mandatory effects of such proceedings to the satisfaction of its domestic creditors.

It is hoped that the purpose and scope of main proceedings under the Model Law would be amended so that the main foreign representative is empowered to preserve the rights of creditors. Such an improvement however, may require the main forum to assert extra-territorial powers in order to administer debtor's assets located in other jurisdictions. Because this approach may constitute a foreseeable threat to domestic creditors in the enacting/recognizing state, special attention should be given to the choice of law provisions capable of creating a minimum threshold of protection to at least certain categories of domestic creditors. This is precisely the system established by the Regulation and discussed in the next Chapter.

From a regional perspective, the Regulation has effectively resolved the issues that arise from the determination of the debtor's home country. It has met the demand for flexible yet predictable criteria, by choosing the debtor's centre of main interests as

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the Model Law does not address *"the substantive differences in national insolvency laws and procedures"*) [hereinafter Murphy, Why Won't the Leader Lead?]. *See also* Brian Devling, The Continuing Vitality of the Territorial Approach to Cross-Border Insolvency, 70 UMKC L. Rev. 435, 450-51 (2001) (arguing that Chapter 15 of the US Bankruptcy code, which adopts the Model Law, is full of escape hatches that may hinder the objective of achieving cooperation chiefly founded on the precepts of universalism).

presumably the place of registration of its business. Thus, the novelty of the Regulation is less the choice of the approach to follow, but the powers extended to the main forum and its ability to administer the debtor's assets, wherever located. Also, by not imposing a strict application of this methodology, domestic courts are able to settle a handful of cases where the centre of main interests is not located in the place of incorporation. This would considerably reduce deceptive practices where a corporate debtor willingly incorporates in a jurisdiction whose insolvency laws are more favourable[57] and would facilitate the shielding of assets from the reach of foreign creditors[58].

This being said, an advantage the Regulation may have over the Model Law is the experience of the European Community regarding the subject matter. Indeed, by the time of issuance of the Regulation, three texts had already been elaborated, discussed, argued and criticized among member countries. Such a unique experience has facilitated the creation of an almost "flawless" cross-border insolvency regime[59], four decades after the first attempts. This regime includes the accommodating concept of the debtor's centre of main interests, broad and unequivocal main insolvency proceedings, and most note-

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[57] A strict definition of the debtor's centre of main interests as the place of registration would have allowed and encouraged such deceptive practices.

[58] Manfred Balz, The European Union Convention on Insolvency Proceedings, 70 AM. BANKR. L.J. 485,507 (1996) [hereinafter Balz, The European Union Convention] (arguing that "by focusing on insolvency related issues where no community-wide single conflicts approach can be found, the Convention produces legal certainty", he further adds that the process set forth by the convention would reduce the incentives for Forum Shopping). Nonetheless, this opinion is not shared among scholars. See Nielsen, Cross-border Insolvency Concordat, *supra* note 12, at 552 (arguing that "the EU Convention may encourage forum shopping by a debtor to select a contracting state to be the plenary proceeding, if the debtor considers that the laws of that State are favourable to debtors"). This uncertainty leads to the observation of an early case that arose from the insolvency of Enron. As a result of an order issued by an English court recognizing its primary competence to adjudicate the insolvency of the debtor (an Enron subsidiary), a French court refused the opening of main insolvency proceedings requested by that debtor which was operating in Spain, but effectively headquartered in England. As one can see, the effectiveness of the Regulation to prevent forum shopping will greatly depend on domestic courts. The latter will serve as guardians of the Regulation and should help ensure its proper implementation so as to prevent forum shopping. See Pelletier, European Law, supra note 21. *See also* E. Bruce Leonard, The International Year in Review, 22-JAN AM. BANKR. INST. J. 22, 22 (2004).

[59] "Although the EU Insolvency Regulation bears some uncertainties and leaves some issues unresolved, its result fills an embarrassing 40-year-old blind spot in the broader framework of EU civil and insolvency law, and for that reason only, it should be welcomed". *See* Wessels, Principles of European Insolvency Law, *supra* note 11, at 31.

worthy, limited secondary (or ancillary[60]) proceedings where the debtor has an establishment.

III. Domestic Proceedings

Given that a purely universalistic insolvency regime was not feasible in the EU, not even between countries committed to a high level of integration, the Regulation allows the opening of secondary proceedings before any forum where the debtor has an establishment. The process of opening such secondary proceedings and their purpose and benefits will be examined in the sub-section A of this Part III. As much as the Model Law has borrowed the concept of the debtor's centre of main interests from the EU insolvency convention, it has also resorted to use the concept of establishment as elaborated under the EU insolvency system. Sub-section B will attempt to demonstrate that despite using the same concepts as the Regulation, the Model Law fails to achieve the same objectives set forth by the Regulation, especially regarding the protection of domestic creditors. Finally, sub-section C will examined whether a restriction on the scope of non-main proceedings under the Model Law could help achieve greater protection of domestic creditors, thereby fostering cooperation among the various courts involved in the insolvency process of the same multinational debtor.

A. Secondary Proceedings under the Regulation

Before examining the conditions imposed by the Regulation for the opening of secondary proceedings and their scope, one should first consider how the European system is inherently different from previous proposals that suggest either the application of Universalism or Cooperative Territoriality on a global level.

1. Retrieving the Benefits of Territoriality

Despite a Universal approach clearly spelled out in the Preamble[61], the Regulation establishes an overall insolvency process that encompasses strong elements of

[60] *See* Westbrook, Global Solution, *supra* note 55, at 2328. Ancillary proceedings describe limited insolvency proceedings, which aim at aiding the main proceedings. These limited proceedings are also referred to as "secondary proceedings".

Territoriality. While the Regulation empowers a specific court to open the main proceedings, thus conferring to that forum exclusive and general competence over the debtor's assets, it also allows the opening of secondary proceedings in other jurisdictions against the same debtor. In actuality, it could be argued that the Regulation captures the essence of Universalism by allowing only one court to administer the debtor's assets, wherever located. Indeed, the Regulation is simply a medium whereby the objectives of Universalism find a regional implementation. However, whereas pure Universalism advocates the opening of one set of proceedings in a single forum and forbids the opening of secondary proceedings in other forums[62], the Regulation allows the opening of secondary proceedings alongside main proceedings and therefore does not faithfully adhere to a purely universalistic model. Its approach to insolvency within the EU cannot be reconciled with Cooperative Territoriality, where no main proceedings take place. Indeed, under the latter approach, insolvency proceedings may be initiated against the debtor on a strictly territorial basis[63]. The term "cooperative" refers to the discretion of courts to cooperate on an ad-hoc basis by sharing information and transferring assets when there is a surplus[64], a situation that rarely occurs because the claims of domestic creditors are seldom fully satisfied. Clearly, the European model does not follow either system.

The explanation to such a hybrid approach is simple. Building a purely universalistic regime within the EU was not feasible due to substantial differences

[61] *See* Regulation at art. 12.

[62]Under Pure Universalism, jurisdictions where the debtor has assets are compelled to cooperate, provide assistance and defer to the forum where main proceedings are held. This translates into asset transfers from one forum to the other. As seen in Chapter Two, such transfers would be harmful to certain categories of creditors. Pure Universalism also entails the election of a representative in the foreign proceedings and most importantly, the issuance of a moratorium against all creditors in other forums. *See* Jay M. Goffman & Evan A. Michael, A Comparative Examination of Insolvency Laws of Industrialized Countries, 050503 ABI-CLE 11 (2003) [hereinafter Goffman, A Comparative Examination].

[63] *See* Robert K. Rasmussen, A New Approach to Transnational Insolvencies, 19 MICH. J. INT'L L. 1 (1997).

[64] In this respect, the Regulation goes beyond the courtesy provided for under the rules of "International Comity". Indeed, pursuant to article 35 of the Regulation, the court of opening of secondary proceedings is compelled to transfer local assets when local creditors are satisfied. This approach was neither adopted on the international nor regional level. The Model Law for instance does not demand the transfer of assets even after the satisfaction of domestic creditors.

between the various domestic insolvency laws[65]. In turn, it was necessary to provide for a margin of security to local creditors who may find their preferential rights affected under the main proceedings held before another forum.

As previously discussed, "Pure Universalism" has often been criticized as negatively affecting the rights of small domestic creditors who do not necessarily have the means to effectively protect themselves against the default of their debtor[66]. The opening of limited secondary proceedings, as permitted under the Regulation, offers domestic creditors an appealing alternative to avoid lengthy and complex main proceedings, where their priority claims might be affected. Thus, the opening of such secondary proceedings would at least enable domestic creditors to hold to the debtor's assets as security until the main proceedings, held before another forum, comes to an end. Used as a preservation tool, secondary proceedings would deter the debtor from transferring assets to more favourable jurisdictions within the EU, or in the worst-case scenario, outside the European community and beyond the reach of European courts[67]. These explanations give strong justification to the opening of secondary proceedings. It is therefore understood why the Regulation has permitted the opening of such proceedings, either before or after the opening of main proceedings.

2. The Presence of an Establishment

According to article 2 of the Regulation, secondary proceedings may be opened in forums where the debtor possesses an establishment[68]. The notion of establishment may be construed broadly because the Regulation does not give further guidance as to what constitutes an establishment, and whether such an establishment must enjoy a legal personality. Conversely, the issue becomes relevant where the debtor has effectively

[65] *See* Regulation at art. 11.
[66] *See* discussions in Chapter Two on the critical position of non-adjusting creditors under Universalism.
[67] It should be noted that a mere transfer of assets outside the community does not prevent the application of the Regulation. Assets located outside the European Union may be governed by the Regulation so long as the debtor's centre of main interest is located in a member country of the EU. Although the Regulation thereby receives a broad scope of application, European courts may be unable to retrieve assets located outside the community, even if these assets were fraudulently transferred overseas.
[68] *See also* article 12 of the Preamble.

registered several of its offices. Drawing the line in these cases may be difficult given the lack of guidance in the Regulation. For the most part, the word establishment - as commonly referred to - can be a branch, a representative office or simply a building carrying the debtor's name and engaging in limited non-transitory commercial activities[69].

As long as the possibility to cross-file a claim is available to creditors, the opening of secondary proceedings in a secondary forum will only be an attractive option in cases where the debtor has valuable assets in that forum. These secondary proceedings are limited in scope to the assets located in that jurisdiction and pursuant to article 3 of the Regulation; they can only be winding up proceedings. In other words, secondary proceedings cannot administer the entirety of the debtor's estate and far less so, attempt a reorganization of the debtor's business[70]. Although domestic creditors' rights seem vested to seize the debtor's assets located in their jurisdiction subject to the presence of an establishment, there are two important limitations to this principle.

The first stems from the ability of the liquidator in the main proceedings to order preservation measures against the debtor's assets located in another jurisdiction, where the debtor may have an establishment. These preservation measures supersede domestic creditor's rights to carry on with the winding up proceedings against the debtor's estate. The second limitation pertains to the timing of the opening of secondary proceedings. Indeed, article 4 of the Regulation provides only for one situation where the opening of

[69] On a recent application of the Regulation as to the definition of an establishment, *see* In Re Conception (Belgian Court of 18 March 2003). The court in Belgium had to decide on a case where a UK based debtor (Conception Entreprises Limited, registered in Dover/Kent) had an establishment in Belgium. The Belgian court opened limited territorial proceedings recognizing that a branch had been opened and registered in Belgium and that the branch had a representative in Belgium. On the notion of establishment, *see* also Tellia v. Hillcourt [2002] EWHC 2377(Ch). Nevertheless the Belgian court had to admit that the branch office in Belgium was a mere mailbox. *See* also Fletcher, the European Union Convention, *supra* note 17, at 137.

[70] For instance, in Re UK Rover Group High Court of Justice, Chancery Division, 11 May 2005 (Rover Group companies), the court highlighted that the aim of secondary proceedings is to assist main proceedings in the administration of the debtor's estate and accordingly, domestic proceedings should liquidate the debtor's estate only if no reorganization plan can be reached. As such, the English court has conferred main jurisdiction over the insolvency of the Rover Group to the English court system.

secondary proceedings can take place before the instigation of main proceedings. This is where the law in force at the debtor's centre of main interests does not allow the opening of insolvency proceedings against that debtor[71]. In such a case, only domestic creditors who reside in the same jurisdiction where the debtor has an establishment could exercise this right. In principle, non-resident creditors cannot bring action against the debtor unless their claims arise from the operation of the establishment located in the secondary forum.

Despite complex procedural rules, the Regulation has shrewdly allowed the opening of secondary proceedings. In practice, this right may rarely be exercised due to the absence of an establishment that belongs to the debtor, lack of valuable assets or simply as a result of the preservation measures exercised by the liquidator in the main proceedings. Yet the possibility of limited secondary proceedings was believed to be an important element to the issuance and adoption of the Regulation. Without such a right, a number of states would have been reluctant to ratify the Regulation, fearing a complete inability to protect their domestic creditors[72]. This is particularly true when one considers the reasons behind the failure of the 1982 text elaborated between the EEC member states. The 1982 insolvency proposal prescribed the holding of main proceedings that had a universal reach, even beyond the boundaries of the community. Domestic creditors under the 1982 Draft had no right to commence secondary proceedings and national courts in the EU were compelled to cooperate with and defer to the court conducting main proceedings[73]. Not surprisingly, this proposal was faced with strong opposition by

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[71] This provision indicates an important digression from a purely universalistic regime. Allowing the opening of secondary proceedings at that particular time also reveals that prudential measures are necessary for the entire system to function properly, given the substantive differences between domestic insolvency laws.

[72] E. Bruce Leonard, Melvin C. Zwaig, Developments and Trends in United States/Canada Cross-Border, 9 J. BANKR. L. & PRAC. 343, 345 -346 (2000) (arguing that generally countries are reluctant to cooperate in cross-border insolvency cases so as to protect their local creditors. The author further adds that the existence of a primary/secondary scheme of proceedings may considerably reduce the risk of forfeiture to local creditors.).

[73] *See* Richard A. Gitlin & Evan D. Flaschen, The International Void in The Law of Multinational Bankruptcies, 42 BUS. LAW 307, 312 (1987) [hereinafter Gitlin, the International Void] (arguing that the 1980 Draft proposes that original bankruptcy jurisdiction be exercised only by the courts of the state where the debtor's centre of administration' is located). See Fletcher, The European Union Convention, supra note

several countries, thus leading to its abandonment. In actuality, it will always be difficult - if not impossible - to satisfy small domestic creditors' claims to a full extent when it comes to the insolvency of large multinationals. However, availing a protective option to these creditors would, in many cases, overcome the reluctance of governments to abide by a binding cross-border insolvency arrangement. Under the Regulation, secondary proceedings might seldom be initiated, yet the psychological effects they produce were necessary to reach a consensus built upon an original combination of Territoriality and Universalism.

B. Non-main Proceedings under the Model Law

Similarly, the Model Law recognizes the opening of domestic insolvency proceedings - known as foreign non-main proceedings - before the forum where the debtor possesses an establishment. The definition of establishment is very similar to that used under the Regulation, if not identical[74].

Although the notion of establishment under the Model Law was borrowed from the EU convention[75], there are some fundamental differences between the Regulation and the Model Law in this regard. First, as it is the case for main proceedings, non-main proceedings are only relevant for their recognition by the enacting forum. As a result, the Model Law does not define the scope of competence of non-main courts; far less compelling the recognizing (enacting) state to give effect to such non-main proceedings upon their recognition. While the Model Law simply encourages the enacting forum to recognize non-main proceedings and to grant the non-main representative the relief sought, the enacting forum may still enjoy a considerable amount of discretion when deciding whether or not it would follow a cooperative course of action.

17, at 124 (arguing that "the EU Convention has avoided the twin errors that gave rise to the fatal flaws and inconsistencies for which the earlier versions of the Convention were so notorious, namely of aspiring to unattainable levels of doctrinal purity while simultaneously seeking to appease basic, national instincts among its own participants").

[74] On the definition of establishment, *see* Model Law at art. 2 (f).

[75] *See* Berends, Comprehensive Overview, *supra* note 13, at 324.

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Secondly, the scope of non-main proceedings under the Model Law can address any type of action initiated against the debtor, whether it is an action to liquidate or to reorganize the debtor's business. As discussed, the Regulation provides only for limited secondary proceedings, intended to be territorial in scope, and 'restricted to winding-up proceedings. Needless to say, in this regard, the Regulation achieves a more unitarian approach to the overall insolvency process of the debtor, while it increases the chances for its possible reorganization[76]. Indeed, because main proceedings under the Regulation are endowed with primacy over secondary proceedings *(infra)*, secondary courts are bound to abide by the findings of the main court. Therefore, when the debtor possesses an establishment and assets in secondary jurisdictions, and the main court finds that these assets are important to achieve the reorganization of the debtor; secondary courts must cooperate and could be required to transfer these domestically located assets if and when the need arises. In contrast, under the Model Law, main proceedings do not supersede, either materially or territorially, the scope of non-main proceedings, and the non-main forum has no obligation to wait for and comply with the decision of the main forum. Consequently, reorganization can be a difficult process insofar as the debtor's assets located in the non-main forum are essential to the reorganization process of that debtor.

Finally, the very terminology "non-main proceedings" used by the UNCITRAL working group testifies to the independence of such proceedings vis-à-vis main proceedings. In other words, the opening of main-proceedings is not necessary for creditors to initiate non-main proceedings. As seen under the Regulation, the opening of secondary proceedings before the opening of main proceedings is restricted to very specific instances. This ensures a higher degree of coordination between the courts involved to resolve the insolvency of the same multinational debtor and limits the possibility of multiple proceedings against the same debtor.

[76] *See* Westbrook, Global Solution, *supra* note 55.

While these differences greatly affect the effectiveness of the Model Law to establish a uniform and predictable regime to increase coordination and cooperation among courts, there are other issues that render the Model Law lacking relative to the Regulation in terms of predictability and equality. The first problem pertains to the location of the debtor's assets and how under the Model Law, any given forum where the debtor possesses only assets, is not prohibited from initiating insolvency proceedings against that debtor. Another remarkable divergence between the Regulation and the Model Law stems from the type and most importantly, the objectives of the relief available to the non-main foreign representative

1. Presence of Assets

Whereas the Model Law encourages the enacting forum to recognize and give effect to the opening of foreign non-main proceedings, it is silent regarding the effect the opening of "asset-based"[77] proceedings should produce in the enacting forum.

In actuality, during the discussions in the working sessions leading to the Model Law, heated opposition arose between the proponents of a broad definition and purpose to the notion of establishment, which should include the emplacement of assets, and those who advocated a more restrictive definition inspired by the EU convention[78]. It has been argued that a strict adherence to the EU convention and to the specific purpose of the notion of establishment[79] would be unfeasible on a global level. Indeed, under the EU insolvency regime, only the presence of an establishment allows the opening of secondary insolvency proceedings against the debtor. In other words, the presence of assets cannot confer a proper basis of jurisdiction to the forum where such assets are located. While this EU approach is more cost effective and avoids the multiplicity of proceedings against the same debtor, it was argued during the course of elaboration of the

[77] Asset based proceedings are those instigated in a forum where the debtor possesses neither the centre of its main interest nor an establishment. Such proceedings are initiated on the basis of the presence of assets in the forum of opening. Under the Model Law, these proceedings do not qualify as main or non-main proceedings.

[78] *See* Fletcher, the European Union Convention, *supra* note 17, at 137.

[79] This is a place where the debtor conducts its business by using labour and capital.

Model Law that following the same approach would entail a significant curtailment of states' sovereignty because jurisdictions, where the debtor possesses only assets, would be prevented from opening insolvency proceedings against that debtor.

In order to overcome this problem under the Model Law, and because the approach of the Model Law is geared towards recognition rather than determining the criteria that would allow a given court to open insolvency proceedings against the debtor; the UNCITRAL working group reached a compromise and spelled out the effects resulting from the presence of an establishment and those deriving from the mere presence of assets in the opening forum. It was decided that only the presence of an establishment would enable the foreign proceedings to be conferred the status of foreign non-main proceedings and hence, the non-main representative may demand recognition and relief before the enacting forum. In contrast, it has been stressed by the Model Law guide to enactment that the mere presence of assets in any given jurisdiction would not prevent courts from opening full-fledged insolvency proceedings against the debtor[80]. Such proceedings however, will not be conferred the status of foreign non-main proceedings, and as a result, the foreign representative cannot apply for their recognition before the enacting forum.

Although this compromise may have seemed necessary in order to avoid longer and inconclusive discussions on this matter, it emphasises an important shortfall of the overall approach contained in the Model Law. By solely focusing on the issue of recognition, the Model Law, unlike the Regulation, fails to provide for assertive rules with respect to the conditions for the opening of insolvency proceedings against a multinational debtor. In turn, the mere presence of assets in a given jurisdiction under the Model Law constitutes an acceptable criterion to open insolvency proceedings against the debtor. This is a basic application of the "grab rule", which has often been accused of increasing inequality among creditors of the same class. In addition, such asset-based

[80] These proceedings will be limited to the assets of the debtor located in the state of opening. *See* Guide to Enactment, *supra* note 7, at para. 73 & 128.

proceedings would not be recognized under the Model Law, which creates no rules to ensure cooperation among courts when such proceedings are initiated against the debtor. Therefore, it is difficult to comprehend how the Model Law ensures cooperation among courts in these instances.

Because it can be fairly argued that the EU assertive approach was unfeasible under the Model Law, perhaps the Model Law should have allowed full recognition to the opening of insolvency proceedings based on the mere presence of assets. After all, the objective of the Model Law was to foster cooperation among courts and not to create certain criteria that would allow courts to open insolvency proceedings against the debtor. Under the Model Law as it stands today, a forum where the debtor possesses only assets may find it advantageous to not submit to the findings of, or cooperate with main and non-main proceedings, especially when these assets have a significant value. This would entitle such a forum to liquidate the debtor's assets on a purely territorial basis and distribute the proceeds to domestic creditors.

2. Provisional Relief

As seen under the Regulation, domestic creditors in secondary proceedings may resort to specific relief in order to preserve their rights vis-à-vis the main liquidator and against creditors located in other jurisdictions. This ensures that domestic creditors will be treated equally in the course of main proceedings, and that the main liquidator is obliged to accommodate the demands of domestic creditors in secondary proceedings[81].

Although the issue of provisional relief and the conditions of its granting to the foreign representative is central under the Model Law, there is a substantial amount of ambiguity as to the nature of the relief that can be granted to the non-main representative and the limits that may apply to such a relief. First, the Model Law does not specify whether the provisional relief available is of a collective or individual nature[82]. Collective

[81] *See* Regulation at art. 18.2. *See also* Murphy, Why Won't the Leader Lead?, *supra* note 56, at 139.
[82] *See* Berends, Comprehensive Overview, *supra* note 13, at 358.

relief, such as a moratorium against all creditors, can only be granted upon the recognition of foreign proceedings and could act as a deterrent to other creditors from pursuing their claims against the debtor[83]. By contrast, provisional individual relief would only attach to specific assets, thereby ensuring that foreign creditors preserve their rights without "freezing" the continuance of proceedings before the enacting forum[84]. Whereas the Regulation has provided for specific individual relief to the secondary liquidator, the UNCITRAL working group has left the type of relief available to be decided by each forum pursuant to the latter's laws and procedures. This, in turn, does not endow recognition with uniform effect and non-main representatives may seldom know in advance what consequences the recognition of non-main proceedings could produce in the enacting forum.

Secondly, as much as the automatic relief available to domestic creditors under the Model Law can be subject to modification or termination (supra), provisional relief does not create any vested rights for foreign representatives. Whereas the relief under the Regulation represents an essential tool that is hardly challengeable, ensuring that domestic creditors are not disadvantaged under the main proceedings, the Model Law does not provide for any definite reach resulting from the provisional relief that could be granted to the foreign non-main representative. Indeed, article 19 of the Model Law stipulates a series of measures the enacting forum may undertake, pending the recognition of foreign proceedings, in order "*to protect the assets of the debtor or the interests of creditors*"[85]. While such measures could, in many cases, prevent fraud and the displacement of assets from one jurisdiction to another, article 22 of the Model Law gives the enacting forum the authority to either subject the grant of the provisional relief to any additional condition its deems appropriate (article 22(2)) or to terminate the provisional relief in its sole discretion (article 22(3))[86].

[83] *Id.*
[84] The Regulation affords this type of relief to the secondary liquidator who, among other prerogatives, may demand the transfer of assets that were fraudulently removed from the secondary forum.
[85] *See* Model Law at art. 19.
[86] Additionally, pursuant to article 22 (1) of the Model Law, the modification or termination of the relief granted must be satisfactory to the court of opening with respect to the right of "*creditors and other*

In light of the above, it is understood that the UNCITRAL working group aimed at endowing the foreign non-main proceedings with a variety of tools to ensure the protection of domestic creditors. However, the Model Law fails to provide for any certainty and compulsive reach for such provisional measures, whose original purpose was to increase protection to creditors and foster cooperation among the various courts involved in the proceedings of the debtor's insolvency. By contrast, despite the fact that the Regulation enables the foreign liquidator to apply for a specific type of relief as a measure of preservation, the reach of the latter may hardly be disputed, amended and far less be terminated under the sole discretion of the main forum. Thus, instead of leaving this issue to be governed by each forum and subject to the discretion of the recognizing court, the Model Law could have achieved more uniformity and certainty by restricting the type of relief available to the non-main foreign representative, while ensuring that the conditions to grant such relief are homogenous and not dependent on the discretion of each forum.

C. Protecting Domestic Creditors

Perhaps one of the most significant contributions of the Regulation is the protection afforded to domestic creditors in secondary proceedings. Such a high level of protection however, is not surprising in light of the previous tentative conventions on insolvency proceedings among EU member states[87]. Indeed, European countries learned from their various experiences that the success of any EU arrangement on cross-border insolvency would always be contingent on the satisfaction of each forum on the treatment of its domestic creditors. This equality of treatment was ensured under the Regulation

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interested persons". Since the interests of domestic creditors traditionally conflict with the interests of foreign creditors, the court of opening would systematically amend or terminate the provisional relief granted to the foreign representative if such a modification or termination would serve better the interests of its domestic creditors. By contrast, the Regulation does not allow the court of main proceedings to terminate a relief granted to the foreign liquidator unless there are compelling public policy grounds to do so.

[87] *See* Gitlin, the International Void, *supra* note 73, at 314.

through unequivocal language and the few exceptions with respect to the power of the secondary liquidator and the preservation measures the latter can undertake for the benefit of domestic creditors. In other words, while the Regulation establishes an insolvency regime conditioned on strong elements of territoriality and embodied in the form of secondary proceedings, it does not create "secondary creditors" as far as the priority claims of such creditors is not affected by the opening of main proceedings[88]. By the same token, the protection of domestic creditors, achieved through a consistent choice of forum and special choice of law provisions, was conducive to a political compromise pursuant to which the forum of opening of main proceedings could assert extra-territorial powers over the debtor's assets located in other jurisdictions where the debtor has no establishment.

Although the protection of domestic creditors has long been an impediment to the creation of a global cross-border insolvency system, the provisions of the Model Law seem to marginalize this issue. Of course the non-main representative under the Model Law disposes of unrestricted powers[89] in comparison with a secondary liquidator under the Regulation and may apply for recognition and for relief before the enacting forum. However, the acts of the non-main representative under the Model Law are associated with lesser certainty than those of the secondary liquidator under the Regulation. Even when the Model Law is adopted as is and is not modified from its original version; the acts of the non-main representative remain subject to the scrutiny and discretion of the recognizing forum. This results in lower protection of domestic creditors under the Model Law, lower level of predictability and most importantly, lesser cooperation between courts.

[88] This is true so long as the secondary court would apply its own domestic law along with its home priority ranking to liquidate the debtor's assets domestically located and to distribute the proceeds resulting therefrom.

[89] These powers are unrestricted to the extent that they are not defined. Unlike the Regulation, there are no provisions under the Model Law that stipulate what kind of actions the non-main representative may or may not undertake, whether in the course of main or non-main proceedings.

This is why the Model Law reaches neither a political compromise that ensures that main and non-main proceedings have their respective scopes without overlapping, nor does it provide for an acceptable margin of security to domestic creditors. Additionally, because of the limited objectives of the Model Law and its sole dedication to recognition matters, forums where the debtor has only assets are not prevented from opening insolvency proceedings against the debtor. When such proceedings are banned from recognition, it is understood how creditors might be subject to a significantly different treatment from one forum to the other.

Although the debate between Pure Universality and Pure Territoriality is moot, the EU experience has shown that an effective combination of these theories can offer higher predictability and equality among creditors, irrespective of their location. In this respect and as argued by Westbrook, the Regulation may seem "*breathtakingly Universal*"[90] when there are no secondary proceedings initiated against the debtor. When secondary proceedings are opened however, the Regulation manages to extract the benefits of each theory to the advantage of creditors, whether sophisticated or not. By contrast, the Model Law does not exalt any of the advantages of either theory, whether or not non-main proceedings are initiated against the debtor. Therefore, it is believed that certain adjustments to the scope of non-main proceedings under the Model Law would be desirable. One such improvement that could be learned from the Regulation is that through the empowerment of the non-main representative, non-main proceedings could be tailored to satisfy domestic creditors' needs. In fact, such an empowerment can only take place if the Model Law endows the non-main representative with specific "preservation" tools and incontestable prerogatives, which could be used before the main-forum without challenge. Achieving this nonetheless may require that the Model Law shifts its basic approach, from one geared towards recognition to one aiming to establish a direct relationship between main and secondary proceedings[91].

[90] *See* Westbrook, Universal Priorities, *supra* note 56, at 38.
[91] So far the Model Law has established an indirect relationship channelled through the enacting state, which has fulfilled the role of a buffer between main and non-main proceedings.

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IV. Primacy of Main Proceedings

One of the recurrent themes of the Regulation is the primacy of main proceedings over secondary proceedings. Therefore, the first part of the following section will identify how such a primacy was achieved and what benefits may result therefrom. The second part will study the level of primacy between main and non-main proceedings established under the Model Law. Based on international experience in cross-border insolvency matters, it will be examined whether the Model Law may be conducive to an unconditional and universal degree of primacy, thereby increasing predictability and cooperation among courts.

A. The EU Context

One of the lessons to be learned from the European insolvency regime and from international experience is that the initiation of multiple proceedings against the same debtor is not sufficient to create a viable and coordinated system to resolve the insolvency of large multinationals[92]. Indeed, in addition to allowing the opening of several sets of proceedings, the EU Regulation establishes a number of ground rules to govern the relationship between these proceedings. In order to achieve the advantages conferred by Universalism, and to overcome the traditional territorial approach, the Regulation has given broader scope, reach and hierarchic superiority to main proceedings. This spirit is reflected in a series of actions only the court of main proceedings can take[93] and in the limitations imposed on the court of secondary proceedings[94].

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[92] Current practices in cross-border insolvency have proved ineffective although the "grab rule" encourages the opening of multiple proceedings against the same debtor. In other words, the opening of concurrent proceedings is not by itself a solution to the transnational insolvency dilemma. See for instance the Model Law at art. 28. The Model law explicitly allows the opening of multiple proceedings against the same debtor so long as countries comply with guidelines for cooperation. The modalities of concurrent proceedings under the Model Law are studied below.

[93] The court of opening of main proceedings is endowed with broader powers than courts of secondary proceedings. These powers are either expressed materially (different types of actions that could be exercised in the main proceedings) or territorially (these actions encompass the entirety of the debtor's assets located inside or outside the forum of opening)

[94] Conversely, limitations on secondary proceedings entail territorial insolvency proceedings, which can only liquidate the debtor's assets located in that jurisdiction. In the alternative, secondary proceedings may entail preservation measures on local assets subject to the broader powers of the court in main proceedings.

Initially, the objectives of the Regulation were to limit the settlement of insolvency cases to one forum that has the authority to open main proceedings. Because such a system is not feasible on the community level, and far less so on a global level[95], the authors of the Regulation had to contemplate the opening of secondary proceedings, which would have a limited scope. In actuality, secondary proceedings may be thought of as a "political" compromise necessary to reach a regional insolvency arrangement. This rationale is implicitly expressed throughout the Regulation by the presence of a considerable number of provisions limiting the prerogatives of the courts in secondary proceedings.

For instance, the preamble of the Regulation restricts the opening of secondary proceedings to what is "absolutely necessary"[96] when such proceedings are initiated prior to the opening of main proceedings. As a result, the primacy of main proceedings has endowed the Regulation with a rather Universal character. Two subsequent sub-sub-sections will analyse this primacy. The first will envisage the role of the liquidator under each set of proceedings. The second will explore the limits imposed on secondary proceedings and other forums regarding their right to refuse recognition on the grounds of public policy. Although the issues pertaining to recognition and enforcement will be studied separately, it is appropriate to tackle the Regulation's restrictive definition of the concept of "public policy" in the context of judicial powers.

1. Role of the Liquidator

Traditionally, the liquidator must act in the best interests of the creditors. In the domestic context, this requires a thorough understanding of the needs and entitlements of the creditors, employees, holders and other parties, and how best to achieve the realization of the debtor's assets to match those entitlements. To achieve these objectives, the liquidator guards against the premature dismemberment of the debtor's business and

[95] *See* Chapter Two on the political impracticability of Pure Universalism.
[96] *See* article 17 of the Preamble.

endeavours to preserve the assets within the reach of the court that appointed him. When the debtor is a multinational corporation with assets dispersed across the globe, it is crucial that the liquidator has adequate powers and means to preserve these assets[97].

It is not surprising that the first article of the Regulation explicitly mentions the presence of the liquidator. It even makes it one of two necessary conditions for the Regulation to apply. For instance, Annex B of the Regulation enlists, by country, all the possible denominations of the liquidator under the various insolvency laws. Because of the numerous provisions that deal with the role of the liquidator (*infra*), it could be fairly argued that the authors of the Regulation have dedicated much attention to the liquidator's tasks and powers.

Indeed, liquidators play an important role in insolvency proceedings, especially when cross-border implications arise. The duties to provide information and to liaise among several courts make the tasks of the liquidator burdensome and difficult[98]. In the EU context, the powers of the liquidator seem to mirror those of the court where the former was appointed. The fact that the main liquidator is conferred broader powers than those conferred to his counterpart in secondary proceedings retrieves the theme of primacy of main proceedings over secondary proceedings. It is also a way to ascertain the recurrent Universal character of the Regulation. Such an unequal attribution of powers ensures that there is a single set of proceedings that shall have overall jurisdiction over the debtor's assets and that there is only one person that should be able to dispose of the debtor's estate, wherever located.

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[97] On the different tasks of the liquidator on the domestic level, *see* Francine L. Semaya & Cozen O'Connor, Insurance Insolvencies: Has the Current Cycle Peaked?, 854 PLI/COMM 111, 132 -134 (2003); Roger Enock & Geoff Nicholas London: The Company Market and Insolvency: Schemes of Arrangement; Section 304; The Policyholders Protection Board, 735 PLI/COMM 71, 95 (1996); Leslie H. Miles, Jr. *et al.*, Choosing a Liquidator and Negotiating the Fees, 16-SEP AM. BANKR. INST. J. 26, 26 (1997). The liquidator's responsibilities are however extended and become more complex in cross-border insolvency cases. *See, for instance*, Arnold M. Quittner, Maxwell Communications and Cross-Border Insolvency Issues, 752 PLI/COMM 647, 658 -660 (1997).

[98] For instance, on the duty of the liquidator to notify the various creditors located in different jurisdictions, *See in Re* R.Jung GmbH Cour d'appel d'Orléans 25 February 2006.

Aside from the general duty to cooperate and to provide information when requested, article 18 of the Regulation defines the role of the liquidator, either in main or secondary proceedings. In the first case, and pursuant to article 18-1, the liquidator enjoys "*all the powers conferred on him by the law of the state of the opening of proceedings in other member state*". Despite the special attention given to the liquidator and its role, the Regulation does not enunciate the prerogatives the main liquidator may dispose of to complete his task. Instead, the Regulation purports to the law governing the main proceedings so as to determine what the functions of the liquidator are[99], and how his duties and limitations should be determined[100]. This simply shows that the court of main proceedings may, through the liquidator it appoints, exercise extra-territorial powers to administer the debtor's assets located in other jurisdictions. In many respects, the Regulation has left enough room for the main forum to define the boundaries of its own judicial powers. While some commentators have criticized such an extra-territorial reach, the broad powers of the main forum resulting from the Regulation's flexible approach have rendered the Regulation more appealing and effective in many ways[101].

In turn, the primacy of main proceedings over secondary proceedings seems sufficient to prevent, or at least limit future conflicts between liquidators respectively designated in each set of proceedings. Also, it should be noted that the role of the liquidator in the main proceedings is not limitless. The same article 18 of the Regulation

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[99] *See* Bob Wessels, European Union Regulation on Insolvency Proceedings, 20-NOV.AM. BANKR. INST. J. 24, 31 (2001) (arguing that under the EU Regulation, "a liquidator may *automatically* exercise all powers conferred on him by the member state's *lex concursus*"). This provision, like many others, was inherited from the 1995 EU Convention on Insolvency Proceedings. See Fletcher, The European Union Convention; supra note 17 at 134 (asserting that "article 4(2)(e) of the EU Convention affirms the basic principle that it is for the *lex concursus* to determine the extent of the liquidator's powers in relation to current contracts")

[100] *Id.* This approach may seem surprising, especially when these provisions are designed to handle such a complex process involving multiple courts and proceedings. Indeed, a greater need for precision is often expected when it comes to cross-border issues.

[101] "Flexibility in the rules appears to be indispensable in international bankruptcy. The situations which arise are so varied that any one rigid rule cannot solve all of them satisfactorily...neither the theory of territoriality nor the theory of ubiquity can cope adequately with the divergent situations." *See* Professor Kurt H. Nadelmann, Solomons v. Ross and International Bankruptcy Law, 9 MOD. L.R. 154, 167-68 (1946)

confines these powers when prior preventive measures were duly undertaken[102] before other forums. Additional restrictions to the liquidator's prerogatives derive from article 18-3, where in the course of his duties, the liquidator is not entitled to use "*coercive measures or the right to rule on legal proceedings or disputes*". Nonetheless, in general terms and under main proceedings, the liquidator has the power to remove the debtor's assets from one jurisdiction to another and similarly initiate any action in order to preserve creditor's rights.

Such extensive powers stand in stark contrast with the restricted prerogatives of the liquidator in secondary proceedings. Pursuant to article 18-2 of the Regulation, the secondary liquidator has the right to avert the assets that have been removed from one jurisdiction to another. This liquidator has the privilege to do so either out of, or before the courts of any other member state. Apart from the recognition of his status and access to EU courts, the liquidator plays a restricted, yet vital, role in secondary proceedings. However, a mere obligation to alert and inform does not include any entitlement to remove assets, unlike his counterpart's prerogatives in the main proceedings. The same article grants the secondary liquidator the possibility to "*bring an action to set aside*" with no further details as regards the requirements of such an action. Clearly, the Regulation has extensively curtailed the role of the liquidator in secondary proceedings. This reveals the limited impact intended to result from the opening of secondary proceedings. It also emphasizes that the main liquidator, along with the main court, will have an unchallenged upper hand in adjudicating the insolvency of the corporate debtor throughout the EU.

The relationship between liquidators in main and secondary proceedings embodies the very spirit of the Regulation. This primacy is an important aspect that may promote closer cooperation in cross-border insolvencies. It would however, be incorrect to consider the EU regime as a purely Universalistic model; the possibility for secondary

[102] Article 18.1 prevents the liquidator from using the prerogatives conferred to him under the *lex concursus* "as long as no other insolvency proceedings have been opened there nor any preservation measure to the contrary has been taken there further to a request for the opening of insolvency proceedings in that State."

proceedings attests to the contrary. Yet the intended limited effect of secondary proceedings reflected in their scope and supplemented by the restricted, no less definite, powers of the secondary liquidator, renders the Regulation more identifiable to Universalism, and thus more viable. The powers accorded to the court of main proceedings and to main liquidator hardly seem challengeable, not even on public policy grounds.

2. Limited "Public Policy" Concept

Automatic recognition of foreign judgments is a landmark of the European Union. It first appeared in the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters[103] and has also been a long-standing tradition expressed in several legislative texts that are binding to all member states in the community[104]. With minor variations between the instruments that are built upon such a method for recognition, the general principle is that all judicial decisions rendered by the courts of one member state are automatically and unconditionally recognized within the territories of all other member sates[105]. This practice has so far helped achieve the objectives set in the treaty to create a common market with a certain degree of trust upon which participants can rely. However, domestic courts can refuse the recognition of foreign judgments when the exequatur of these decisions is incompatible with the public policy of the recognizing forum[106].

[103] *See* Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, Sept. 27, 1968, amended by art. 5, 1990 O.J. (C 189) 1, reprinted in 29 I.L.M. 1413, 1419 (1990). [hereinafter the Brussels Convention]. Article 26 of this convention reads: "A judgment given in a Contracting State shall be recognized in the other Contracting States *without any special procedure being required.*"
[104] *See* Convention on the Law Applicable to Contractual Obligations, June 19, 1980, 1980 O.J. (L 266) 1, art. 15, reprinted in 19 I.L.M. 1492 [hereinafter Rome Convention].
[105] *See* the Brussels Convention, *supra* note 103.
[106] *See* the Brussels Convention, *supra* note 103, article 27-1: "A judgment shall not be recognized... if such recognition is contrary to public policy in the State in which recognition is sought".

Chapter Three.

Although the concept of public policy is somewhat elusive and has never been defined[107], it is the role of the recognizing court to assess whether a given foreign judgment constitutes a breach of this concept. Generally, violations of the principles or objectives pursued by the recognizing country's legislation are often construed to be against the public policy of that forum, hence recognition will not be granted. As regards the implementation of automatic recognition of foreign judgements, some jurisdictions in the EU have used the public policy argument rather extensively. In France for instance, it was common practice that courts would find a violation of public policy or order when foreign courts decided a case in a different manner than French courts would[108]. However, when courts follow such a "chauvinistic" approach, not only do they run the risk of seeing their own decisions unrecognised by other forums[109], they also breach their duties under the Treaty and the Brussels convention[110]. For many years, this weight of reciprocity combined with community obligations have functioned as deterrents to this practice and have in fact reduced the abusive use of the public policy exception.

Despite a reasonable use of this defence among EU member states, the Regulation found the necessity to restrictively define public policy so as to increase cooperation among EU courts in insolvency matters. According to article 26[111] of the Regulation, public policy is limited to the cases where *"fundamental rights or the constitutional rights...of individuals"* are at stake. That is to say, in the majority of cases, courts will not be able to raise the exception of public policy against the recognition of insolvency proceedings and/or decisions rendered by the court of opening of main proceedings. Indeed, it seems difficult to stretch the terms "fundamental" and "constitutional rights" to

[107] Each jurisdiction has its own definition of public policy. Thus there is no uniform public policy concept, not even between member states to the EU.
[108] Under the French legal system, there are two public policy concepts. The first is known as *"ordre publique national"* and relates to purely domestic considerations, and which is hardly waived by French courts. The second is known as *"ordre publique international"* which is more flexible as it applies when international aspects arise from the case at stake, such as an international contract or a tort occurring in a foreign jurisdiction and nevertheless producing some effects in France.
[109] *See* Chapter Two on reciprocity and recognition of foreign judgments.
[110] *See* the Brussels Convention, *supra* note 103, article 29: "Under no circumstances may a foreign judgment be reviewed as to its substance".
[111] *See* Regulation at art. 26.

include the loss of a preferential right on the insolvency proceeds, or even an injunction to transfer assets from one jurisdiction to another, so long as foreign creditors have a right to lodge their claims before the court of main proceedings.

The drafters of the Regulation were aware of the sensitive character of insolvency proceedings and how courts may be willing to broadly resort to "public policy" defences to protect their domestic creditors. Indeed, without such a narrow definition, domestic courts would have often resorted to the use of public policy arguments to refuse recognition of insolvency judgments that run against the interests of their domestic creditors. Article 26 completes the objectives of the Regulation to endow the court of opening of main proceedings with broad and universal powers. The automatic recognition of insolvency judgments, along with the limited grounds for the recognizing state to refuse recognition achieves these objectives.

If the primacy of main proceedings could be effectively achieved within the EU, perhaps a similar hierarchic relationship between main and non-main proceedings could be more fully implemented under a revamped Model Law.

B. Channelling Primacy through the Model Law

Given the UNCITRAL working group was inspired by the EU convention, the theme of primacy has been spelled out in the Model Law. However, the primacy of main proceedings over non-main proceedings is limited to recognition matters, and the enacting forum is exempt from complying with such a primacy, even when the debtor possesses only assets in the territory of that enacting State. The first part of this Section B will study the provisions of the Model Law that seek to establish a certain primacy of main proceedings over non-main proceedings when concurrent and multiple proceedings are initiated against the debtor. The second part will demonstrate that there is a real potential to improve the provisions of the Model Law, thereby creating an unambiguous hierarchic rapport between the various courts involved in the insolvency of a multinational corporation. It will be argued that courts around the world are familiar with

the notion of primacy and that there is already a "de facto" primacy, based on the location of the debtor's assets in a given forum.

1. Concurrent and Multiple Proceedings

While the Regulation creates a direct relationship between main and secondary forums and favours the primacy of main proceedings over secondary proceedings, the Model Law only establishes a limited relationship between the various forums involved in the resolution of a multinational's insolvency. In fact, the closest the Model Law has come to establishing a direct rapport between several sets of proceedings is through chapter V dealing with concurrent proceedings. Furthermore, the Model Law does not attempt to set up a full hierarchy between main and secondary proceedings.

According to article 28 of the Model Law, once the enacting forum has recognized foreign main proceedings, domestic proceedings may be initiated in the enacting forum only if the debtor possesses assets in that forum. Such domestic proceedings are - pursuant to the same article - limited to the assets located in the enacting forum. Surprisingly, the Model Law does not use the concept of establishment in the case of concurrent proceedings. This means that domestic proceedings (in the enacting forum) cannot be recognized as non-main proceedings or even recognized at all by other enacting states[112]. As aforementioned, asset-based proceedings may, under the Model Law, be initiated against the debtor, though they cannot produce any effect in other jurisdiction because they cannot be recognized.

Although this may be viewed as an attempt to establish a certain primacy of main and non-main proceedings over asset-based proceedings, such an approach is not in line with the very spirit of the Model Law. Indeed, if the objective of the Model Law was to increase cooperation and predictability, and since chapter V includes certain rules related

[112] The Guide to Enactment provides that this approach "*would typically not be the most efficient way to protect the creditors, including local creditors*".

to the opening of proceedings against the debtor[113], it should have provided that asset-based proceedings cannot be initiated before the enacting forum, especially when the latter has already recognized foreign proceedings as main foreign proceedings. Since the concept of establishment was used in the Model Law for the purpose of recognition, article 28 should have extended the application of this concept, thereby imposing certain conditions on the enacting forum to open insolvency proceedings against the debtor. Such an inconsistent approach was highlighted in the Model Law guide to enactment, which provides that *"the enacting state would act in line with the philosophy of the Model Law if it enacts the article (article 28) by replacing the words "only if the debtor has assets in this State...with the words "only if the debtor has an establishment in this State""*.

In addition to the Model Law's inconsistent approach in article 28, article 29 reiterates a strong hold of territoriality and advocates the "pre-eminence" of domestic proceedings over foreign proceedings, whether main or non-main. First, article 29 (a)(i) provides that once the proceedings are initiated before the enacting forum, any provisional relief based on the protection of foreign creditors (article 19), along with any relief to the foreign non-main representative (article 21), must be consistent with such proceedings, irrespective of whether or not the enacting forum is in actuality the debtor's centre of main interest. Hence, if the rights of foreign creditors were in jeopardy, the main or non-main representative would be denied relief based on urgency considerations, such as preservation measures, so long as this relief may prevent domestic creditors in the enacting forum from liquidating the debtor's estate. Clearly, these provisions cannot improve coordination between the courts, and far less so achieve equality among creditors.

Furthermore, article 29 (a)(ii) states that the provisions of article 20 shall not apply once proceedings are opened in the enacting forum and foreign main proceedings

[113] Although the Model Law has an overall approach geared towards recognition, chapter V comes into play when foreign proceedings have already been initiated and recognized (or on the verge of recognition) by the enacting forum. Therefore, chapter V provides for certain rules related to the possibility of opening insolvency proceedings against the debtor in light of the foreign proceedings already initiated before other forums.

are pending for recognition before that forum. Somehow, article 29 (a)(ii) makes sense because article 20 may entail an automatic moratorium against creditors, which would have resulted in the discontinuance of the proceedings in the enacting forum. This being said, the waiver afforded to the enacting forum as regards the application of article 20 as a whole, indicates a major alienation and weakening of main proceedings. Indeed, the debtor centre of main interest seems to lose its meaning and purpose every time concurrent proceedings are simultaneously initiated before a foreign court and before the enacting forum. Additionally, such a waiver to the application of article 20 places main and non-main proceedings on equal footing, if not giving a certain pre-eminence to foreign non-main proceedings so long as they are consistent with the proceedings in the enacting forum (*supra*, article 29 (a)(i)).

In term, the effect of main and secondary proceedings and the relief that may be granted to foreign representatives will be determined within the confines of article 29 (a)(i) and will be conditioned on the consistency of the provisional relief demanded with the proceedings in the enacting forum. The Model Law guide to enactment itself provides that the aim of article 29 was not to establish "*a rigid hierarchy*" between the proceedings because it would have prevented the courts from cooperating with each other. This argument will be discussed in the following part.

Despite the rather territorial and inconsistent articles 28 and 29, the idea of primacy of main proceedings over non-main proceedings was envisaged under the Model Law. In fact, the UNCITRAL working group has indeed attempted to remedy the territorial orientation of the Model Law and salvage its territorial approach through article 30, which advocates a limited primacy of main proceedings over non-main proceedings. Article 30 stipulates, among other provisions, that upon recognition of foreign main proceedings by the enacting forum, the relief granted or to be granted by the enacting forum to foreign non-main representatives must be consistent with foreign main proceedings. Certain prerogatives, such as the right to modify or even terminate any relief granted under article 19 and 21 are left to the enacting forum to ensure that non-main

proceedings are consistent with main proceedings. Thus, the Model Law indirectly establishes the primacy of main proceedings only when there are no proceedings initiated before the enacting forum. When proceedings are opened before the enacting forum, article 28 and 29 ought to apply.

It is somewhat unclear why the UNCITRAL working group decided to provide for the limited application of primacy of main proceedings, to which the enacting forum would not be subject. In fact, where proceedings are opened before the enacting forum, the Model Law as a whole may seem extraordinarily territorial because not only would the enacting forum be entitled to open proceedings on the basis of the presence of assets, but such a forum would also have very limited obligations vis-à-vis foreign courts and representatives, whether main or non-main. One plausible reason behind the exemption of the enacting forum from the provisions of article 30 is that the UNCITRAL working group wanted to issue an instrument that would attract states to adopt it. Had the Model Law provided that main proceedings prevail over non-main proceedings opened in the enacting forum, or that the enacting forum had no right to initiate proceedings against the debtor based solely on the presence of the debtor's assets on its territory, the Model Law would have been less appealing to states. This eagerness to please may in actuality have skewed the very objectives of the Model Law and prevented it from becoming a more effective international instrument.

Although the Model Law has borrowed a number of important concepts from the Regulation, such as the "debtor's centre of main interests" or the debtor's "establishment", it has employed these concepts in a different and less effective manner. As seen, the Regulation has used these very concepts to create a hierarchic ranking between main and secondary proceedings, the Model Law has reverted back to the precepts of a longstanding and criticized purely Territorial approach. This stance is surprising when one considers that a "de facto" hierarchic ranking and primacy among several sets of proceedings on the global level occurs frequently in cross-border insolvency cases.

2. Prospects of Advocating Primacy

The primacy of main proceedings in the EU context created a rather Unitarian approach to cross-border insolvency cases within the community. Comparing this scheme to the prospects of advocating primacy of main proceedings over non-main proceedings under the Model Law may seem rather unrealistic in many respects.

Unlike most countries, EU member states previously abided by regional arrangements that contained provisions on the choice of law, forum and automatic recognition of judgments[114]. Although the Regulation marks a clear distinction from previous instruments, EU member states were "ready" to move to the next stage in regards to judicial cooperation[115]. The acceptance of a regulation that prods the main forum to assert extra-territorial powers in the area of insolvency testifies to this fact[116]. In turn, it could be argued that most countries in the world do not have the expertise necessary to engage in such a process, which requires a certain level of knowledge, familiarity with cross-border issues and judicial integration. As much as situations of *lis pendens* are often difficult to resolve on a global level[117], it would be equally difficult to expect that a forum would give priority to another to settle the insolvency of a multinational debtor that has an establishment and/or assets in the territory of the first.

Furthermore, the Regulation gives certain autonomy to the courts in EU member states to implement its provisions. Although the Regulation provides guidelines for interpretation and construction, the EU insolvency regime could not be created without

[114] On the EU experience on cross-border insolvency matters, see Westbrook, Multinational Enterprises, *supra* note 41, at 8 (arguing that the issuance of the UNCITRAL model law was a great achievement, although unexpected by the international community. He further adds that such an achievement was possible because of the participation of EU delegates, who previously ingrained a certain expertise in cross-border insolvency matters in the course of creating the EU Regulation)
[115] *Id. See also* supra notes 103 & 104.
[116] More so, when secondary forums accept a curtailment in their right to initiate full-fledged insolvency proceedings against a multinational debtor that has an establishment on their territory or when secondary forums accept the primacy of main proceedings over their own proceedings.
[117] *See* Black's Law Dictionary 932 (West 6th ed. 1990) ("Lis pendens"); Gersten, The doctrine of lis pendens: The need for balance, FLA. B.J. 83 (1995); Levy, Lis pendens and procedural due process: A closer look after Connecticut v. Doehr, 51 MD. L.REV. 1054, (1992).

the existence of a supreme court (ECJ) to supervise the implementation process and ensure the uniform application of insolvency principles. The absence of a similar authority on the global level could render the adoption of a global instrument containing such progressive precepts, such as an amended or improved Model Law, rather difficult.

Another impediment to the primacy of main insolvency proceedings on the global level is the risk of using public policy defences to refuse recognition of foreign insolvency judgments[118]. Despite the success of a limited definition of this concept in the EU context for recognition purposes, there is nothing to guarantee uniform interpretation of and compliance with the concept of public policy, should an international instrument stipulate similar provisions[119]. Under the Model Law for instance, the UNCITRAL working group has only reiterated the public policy exception to recognition and cooperation, without providing for any restrictions. During the negotiation process of the Model Law, article 6 was discussed at length and it has been agreed that the UNCITRAL working group cannot define this concept since each jurisdiction has its own definition. In the alternative, the Model Law has only attempted to restrict the interpretation and implementation of this notion by stipulating in article 6 that the enacting forum may refuse to recognize foreign proceedings if and when such proceedings "*would be manifestly contrary to the public policy*" of the enacting state.

Despite these critiques, it could be argued that a de facto primacy of insolvency proceedings often occurs in cross border insolvency cases. The most common situation is where a multinational debtor possesses valuable assets in one jurisdiction, even without the presence of a registered office or establishments in that forum. Because the

[118] *See also* Chapter Two on the dangers of exporting public policy form one forum to another.

[119] A primary concern would be founded on the notable differences in implementation between developing and developed countries, where the former will more often invoke public policy exceptions to refuse the recognition of foreign insolvency judgments. *See* John K. Londot, Handling Priority Rules Conflicts in International Bankruptcy: Assessing the International Bar Association's Concordat, 13 BANKR. DEV. J. 163, 176 -177 (1996). Public Policy defences are likely to be used more often in developing countries so as to protect domestic creditors from unfavourable foreign insolvency judgments. This argument should be understood in light of the potential disparity between developed and developing countries to be the forum of opening of main proceedings (*see* Chapter Two on the disadvantages resulting from a Pure Universal system vis- á- vis creditors in developing countries).

administration of those assets is important to the overall insolvency proceedings against that debtor, the forum where such assets are located would find itself in a privileged position vis-à-vis other forums, where the debtor has minor or no assets at all. Indeed, when the debtor's assets located locally are insufficient to satisfy the claims of domestic creditors in any given forum, a natural advantage arises to the benefit of the forum where the debtor's most significant and valuable assets are located. Because forums deprived of this advantage cannot administer the debtor's assets that are located overseas[120], these forums are left no option but to hope that the forum where the "enriched jurisdiction"[121] will cooperate and possibly transfer any surplus from the proceeds of the debtor's liquidation. Although there is no international treaty to regulate the relationship between the various forums involved when such a situation arises, the presence of assets will automatically confer to the forum where they are located certain primacy and broader powers over the debtor's estate. For instance, decisions to reorganize or to liquidate will depend on the privileged forum's willingness to cooperate and to transfer assets when required[122]. When these situations take place, the attitude of courts will vary from one jurisdiction to another. Some courts would be recalcitrant to cooperate; others will try to reach a compromise between all stakeholders in the proceedings. That is to say, the primacy of a given set of proceedings on the global level is not a new situation. Albeit, disorganized and unforeseeable[123] in comparison with the EU Regulation, courts around the globe have had opportunities to administer a multinational's large estate on a

[120] This is a straightforward consequence of state sovereignty, which has so far prevented the assertion by any given forum of extra-territorial judicial powers. To illustrate, *see* In re Sefel Geophysical Ltd., 62 Alta.L.R.2d 193, 70 C.Bankr. (N.S.) 97 (Q.B.1988) (where the Canadian court limited the stay on the insolvency proceedings to assets located in Canada. To stay the proceedings as regards assets located overseas, creditors need to present their claim before the court where such assets are located.)

[121] This expression is borrowed from Professor Westbrook and refers to the forum where the debtor's valuable assets are located at the time insolvency proceedings are initiated against that debtor. See Westbrook, Universal Priorities, *supra* note 56, at 41.

[122] This assumption stems naturally from the predominant state of territoriality. Since courts are never compelled to transfer assets (see chapter II on international comity), the location of important assets in a given jurisdiction would prioritize the latter's decision to cooperate or not. *See* Fletcher, The European Union Convention, *supra* note 3, at 123 (arguing that "the insolvency laws of the world's constituent states lay claim to worldwide effectiveness over the debtor's assets, wherever they may be found (although such pretensions cannot be translated into concrete effect without the concurrence of the rules of private international law of the countries where the assets happen to be located").

[123] This method is unforeseeable because the primacy of a given set of proceedings will depend on the location of the assets at the time of opening.

worldwide basis. It is doubtful that these courts will lack expertise if they ascertained primacy in insolvency proceedings, only this time in an organized and pre-determined fashion.

A step closer to confer a global primacy to a given set of insolvency proceedings against a multinational debtor is the use of protocols between courts to settle the insolvency of large multinationals. These protocols are legal arrangements between forums to decide how assets in different countries will be dealt with[124]. Commonly, protocols determine how bankruptcy courts in those different jurisdictions will coordinate their actions. This helps restructure businesses on an international scale[125] and thus preserves the corporate asset value for all investors, employees or other stakeholders. It could also enable a more effective liquidation of the debtor's estate, hence achieving a higher degree of equality between creditors of equal standing. Although protocols in cross border insolvency cases foster cooperation between courts, one should not overlook the negotiation process that determines each court's rights, duties and prerogatives[126]. This is not an equity-based process; rather there is often one forum that has the upper hand in the insolvency proceedings at stake. More likely than not, this will be the forum that has the debtor's most valuable assets under its control, compared to other forums[127].

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[124] "Protocols provide a case-specific structure to govern how parties to an international insolvency communicate, take actions, and apply the procedural and substantive elements of law". *See* Steven G. Golick, What, How, Where, and When to File: Considerations and Implications in Cross-Border Insolvency Proceedings in Canada, 12 JBKRLP 5 ART. 2 (2003)

[125] *See* Chapter One on the reorganization of multinationals.

[126] *Id.* (arguing that although Canada and the United States agreed on the ALI guidelines to facilitate cooperation and protocols in cross-border insolvency cases, these Guidelines "are not meant to be static, but are meant to be adapted and modified to fit the circumstances of individual cases") These arguments support that in each case, there is a "bargaining" process which leads to the creation of a protocol among courts.

[127] *See* Shinichiro Abe, Recent Developments of Insolvency Laws and Cross-Border Practices in The United States and Japan, 10 AM. BANKR. INST. L. REV. 47, 81(2002) (arguing that in negotiating a protocol on a given case, the court of ancillary proceedings may "decide to surrender the assets conditionally... it must negotiate an agreement with the court of the home country" so as to ensure that its domestic creditors are satisfied.) The absence of a protocol on the contrary would entail a total discretion of the forum where such assets are located to cooperate. If no agreement were reached among courts, these assets would be exclusively distributed among domestic creditors, thus perpetuating the overriding state of territoriality. *See also* William L. Norton, Jr., Part 19. Related Laws and Issues, Chapter 152. International Insolvencies, VII. Cross-Border Insolvency Concordat, NRTN-BLP § 152:66 (1994)

The communication process between the courts, though channelled through the parties[128], certainly makes the proceedings more civil and organized. Yet the assertion of jurisdiction and the prerogatives resulting thereof are based on the same traditional criterion: the emplacement of the debtor's assets.

In contrast to the European model, the superiority of one forum over others is a frequent occurrence in cross-border insolvency cases. If courts had been technically and legally able to handle the administration of a multinational's estate under the present and somewhat disorganized system, there is no reason to believe that they will not be able to carry the same tasks pursuant to an international arrangement embodied in a possible amendment to the Model Law. Based on such analysis, it may be realistic to believe that the primacy of insolvency proceedings may be formally established through the Model Law. Doing this would require abolishing the exemption of the enacting forum from the rule of primacy[129] and ensuring that non-main proceedings opened before the enacting forum are consistent with the relief granted to the foreign main representative. While it should be expected that such provisions would, in the majority of cases, be waived by enacting states, this approach provides for a pragmatic indication as to which extent countries would refute the principle of primacy and oppose restrictions on their prerogatives when the debtor holds its centre of main interests in another jurisdiction. On the bright side however, it will determine how far or close the international community is from establishing a global insolvency system that retrieves the basic advantages of Universality, without implementing a purely Universal approach.

V. Conclusion

Despite the striking similarities that exist between the Regulation and the Model Law on the concepts used to determine an acceptable basis of jurisdiction, the provisions

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[128] *Id.*

[129] The current version of the Model Law opts for a flexible criterion, which includes the mere presence of assets, to attribute jurisdiction to the enacting forum. As mentioned above, this has given many countries the incentives to adopt the Model Law. See articles 28 and 29 of the Model Law.

of the Model Law seem lacking than those of the Regulation. Through its unequivocal language and regardless of its binding character, the Regulation has significantly increased predictability and equality among creditors located in different jurisdictions, something the Model Law has fallen short in achieving.

One of the more probable reasons why the UNCITRAL working group did not follow the approach of the EU Convention to a greater extent was the mounting pressure to accommodate the different insolvency principles and policies in the majority of countries. Since it was unsure how the international community would react to the issuance of the Model Law, the working group made a conscious choice not to issue far reaching insolvency provisions and limited its objectives to the confines of uncertain cooperation and sporadic recognition of foreign insolvency proceedings.

Today however, such parameters have considerably changed. A number of countries, including the United States, have implemented the Model Law[130] (at least partially) thereby giving a certain weight to the UNCITRAL initiative. Although it is hoped that more countries will adopt the Model Law in the near future, the pressures that previously arose from its potential failure and rejection have notably decreased. On the other hand, the Regulation, which was the main source of inspiration to the UNCITRAL working group, has demonstrated that the same concepts may be put to better and more effective use to address the insolvency of multinational corporations. The provisions governing the choice of forum under the Regulation are just one aspect of this more effective approach. This being said, the choice of forum provisions under the Regulation could not have achieved this degree of predictability and protection to domestic creditors unless they are associated with insightful and complementary choice of law provisions.

[130] *See* Jay Lawrence Westbrook, Chapter 15 at Last, 79 AM. BANKR. L.J. 713, 720-721(2005).

Chapter Four.
A Further Lesson from the EU Regulation: Applicable Law - The Reach of the *Lex Concursus* and its Limits

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I. Introduction

To increase the level of coordination and cooperation among the various courts involved in cross-border insolvency cases, unambiguous rules for the opening and recognition of proceedings in and by each forum are insufficient. So long as the applicable law to each set of proceedings determines the ranking of domestic and foreign creditors, the prerogatives of the foreign representative and the procedures to be followed; choice of law provisions are essential to enhance predictability[1].

The UNCITRAL Model Law constitutes the first truly international effort to address the various issues that arise from the insolvency of multinational corporations, specifically those relating to the recognition of foreign proceedings. However, the Model

[1] The choice of law is doubly important in cross-border insolvency cases. First, the applicable law will govern all procedural aspects of the proceedings (the forms to submit, the admissibility of evidence and the timeframe within which these various proceedings should be completed). Because of the broad guidelines of the Regulation, this law will also be the sole reference to determine the prerogatives and powers of the various participants in the proceedings (liquidator, creditor, debtor and the court). Secondly, the applicable law will bear considerable consequences on creditors' rights. It will determine the ranking of creditors (privileged or not) and the order according to which they ought to be paid from the debtor's assets.

Law does not contain explicit choice of law provisions and falls short of the characteristics a comprehensive cross-border insolvency arrangement should have in order to offer an utmost predictability and protection to foreign creditors. In contrast, the EU Regulation has designed functional conflict of law rules according to which, the forum of opening may accommodate the needs of foreign creditors to a greater extent. Notably, the EU insolvency system has acknowledged that each country has important needs to protect certain categories of creditors deemed too fragile to compete either in domestic or in cross-border insolvency cases[2].

This Chapter will examine choice of law provisions as spelled out in the Regulation and will attempt to identify the contributions of the EU insolvency system in this regard. This is an important step in assessing the suitability of creating developed choice of law provisions under a revamped and enhanced Model Law approach. To do so, Part II of this Chapter will analyse the general principle under both the Model Law and the Regulation, which provides that the court of opening shall apply its own law to the proceedings. As will be highlighted, the application by the "forum of opening" of its domestic law[3] (the lex concursus) presents various advantages.

Although the Regulation and the Model Law provide for the application of the *lex concursus*, the Regulation has set its distinctive mark by stipulating a series of useful exceptions to the application of this general principle. Some of these exceptions will be the subject of Part III of this Chapter, which will demonstrate how the application of a law other than the *lex concursus* can ensure the certainty of domestic transactions while significantly improving the protection of foreign creditors, especially to certain categories thereof. In turn, it will be examined whether the Model Law can, through adequate choice of law provisions, enable certain categories of foreign creditors to maintain their home priority of claims in the proceedings initiated before the enacting forum. It will be argued

[2] Such categories are those traditionally and commonly protected by the legislator in most jurisdictions. To protect the interests of employees for instance, the Regulation provides for special choice of law provisions (infra).

[3] This law is also known as the "lex fori concursus", and refers to the law of the court of opening [hereinafter the *lex concursus*].

that this approach can further cooperation among courts that are often reluctant to cooperate unless their domestic creditors are fully protected, or at least equally treated in the course of foreign proceedings.

Because a "universal" order of priority is difficult to create either on the EU or global level, Part IV of this Chapter will attempt to explain how choice of law provisions in the Regulation can achieve an appealing alternative to a system of "cross-priority"[4] among the various creditors. Such an alternative regime may seem particularly relevant when one considers that despite the non-discrimination principle and the "hotchpot rule"[5] spelled out in the Model Law, the latter fails to produce a system even comparable to a "cross-priority" regime, and far less so to ensure a minimal level of equal treatment between domestic and foreign creditors. Instead, the Model Law has limited its objective of improving cooperation to the confines of cross-filing and subject to the discretion of each enacting forum to accept foreign claims and to treat domestic and foreign creditors equally.

II. <u>Conflict of Law Rules</u>

Before tackling the scope of application of the lex concursus and understanding how this principle is implemented under the Model Law and the Regulation, one should highlight the important role conflict of law rules play in cross-border insolvency cases.

In fact, experience in creating a cross-border insolvency instrument, whether regional or international, has shown that choice of law provisions were too often neglected at the cost of an adequate insolvency framework that would preserve the rights of both domestic and foreign creditors[6]. One possible explanation to the marginalization

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[4] *Cross-priority* is "*the availability of local priorities to foreign creditors whose claims would qualify for priority treatment if they were local creditors*". See Westbrook J., Universal Priorities, 33 TEX. INT'L L.J. 27 (1998) [hereinafter Westbrook, Universal Priorities].

[5] *See* Model Law at art. 32.

[6] *See generally* Hannah L. Buxbaum, Rethinking International Insolvency: The Neglected Role of Choice-of-Law Rules and Theory, 36 STAN. J. INT'L L. 23 (2000) [hereinafter Hannah, Rethinking International Insolvency].

of choice of law provisions stems from the very theories of "Territoriality" and "Universality" (discussed in previous Chapters) around which the debate of creating a cross-border insolvency system has long revolved[7]. Indeed, the primary focus of this debate has been centred on the identification of the forum entitled to instigate insolvency proceedings against a multinational debtor. Hence, there has always been an assumption under either theory that the adjudicating forum will simply apply its domestic law to the proceedings, with no room left to accommodate the provisions of any other foreign law, even when the application of the *lex concursus* would result in an unfair outcome to foreign creditors. Under the pristine model of "Universalism", for instance, such a law would be applied to the administration of the debtor's assets located in other jurisdictions and would, as a result, determine the ranking of foreign creditors[8].

Although tentative instruments to resolve cross-border insolvency cases have long ignored the role of "balanced"[9] choice of law provisions, practical experience in the realm of cross-border insolvency has shown that the decision of a domestic court to cooperate and to defer to foreign proceedings often implicates a "de facto" choice of law process[10]. The most frequent example arises when a foreign representative files a claim before a domestic court in order to attach the debtor's assets or to stay the proceedings before that court in favour of foreign proceedings[11]. By deciding to stay its domestic proceedings or to transfer assets to foreign jurisdictions, the domestic court accepts that a law other than its own can determine the rights of its domestic creditors and the priority of their claims. Such an implicit process entails that the domestic court first assesses the

[7] *Id.* at 25-26.

[8] Such a far-off vision however would be unrealistic to achieve on a global level. As seen in the second Chapter, the pristine model of Universalism stands little of a chance of being implemented globally. This being said, in order to ensure that cross-border insolvency proceedings are fair, irrespective of the location of the debtor's assets, states would have to reach a compromise where they accept that foreign insolvency laws may produce certain effects on the domestic level, especially with regard to certain special categories of claimants (*infra*).

[9] Conflict of law rules should strike the balance between protecting national interests and promoting equality of treatment between domestic and foreign creditors.

[10] *See* Hannah, Rethinking International Insolvency, *supra* note 4, at 32.

[11] *Id.*

content of the foreign law, its provisions with respect to priority claims and how this law might affect the rights of its domestic creditors.

Therefore, the decision to stay or to defer would be taken by a domestic court only if this court finds in favour of the foreign law, and that the application of the latter would not negatively harm the interests of the deferring court's domestic creditors. This overall process stresses that cooperation among courts is largely contingent on the content of the law applicable to the insolvency of a multinational debtor and not merely on the forum in charge of adjudicating the insolvency at stake. Thus, it seems surprising to contemplate a cross-border insolvency system aimed at increasing cooperation without providing for choice of law provisions therein. Indeed, the lack of choice of law provisions does not encourage the adjudicating forum to consider the application of a law other than its own, nor to defer to foreign proceedings so as to accommodate the legitimate expectations of foreign creditors.

Unfortunately, the Model Law does not deviate from the long-standing practice that neglects choice of law provisions and opts instead for the application of only one law without exception, the *lex concursus*. Furthermore, as a result of the Model Law's primarily territorial and passive approach centred on recognition matters, the scope of application of the *lex concursus* under the Model Law is more limited than under the Regulation. The subsequent parts will highlight the modalities of the application of the *lex concursus* under both instruments and will demonstrate how the broad application of the *lex concursus* under the Regulation achieves an important symmetry between domestic insolvency laws and the market within which these laws ought to apply[12].

A. The Lex Fori Concursus

After deciding on what grounds main and secondary proceedings can be opened to adjudicate the insolvency of the debtor, the Regulation establishes conflict of law rules

[12] On the market-symmetry argument, *see* Westbrook J. Lawrence, A Global Solution to Multinational Defaults, 98 MICH. L. REV. 2276, 2280 (2000) [hereinafter Westbrook, Global Solution]

to decide which law should apply to these proceedings. The Regulation commands that the applicable law is the one of the forum where the insolvency proceedings were opened. That is to say, the debtor's centre of main interest not only determines the main forum that will have overall jurisdiction over the debtor's estate, but it will also determine the law that will govern main proceedings and the assets located in jurisdictions where the debtor has no establishment. The same rationale follows for secondary proceedings where the law of the "forum of opening" applies to the winding-up of the debtor's assets located in that secondary jurisdiction[13].

While these rules are not as elaborate as traditional conflict of law rules, they present the advantage of certainty[14]. Once insolvency proceedings have been initiated before one forum, there will be little doubt as to what law this forum must apply. Within the EU, the simplicity of this rule is more appreciable when one comes to assess complex situations under the simultaneous application of the Rome[15] and Brussels[16] conventions; where the forum that adjudicates a given case may be compelled to apply the laws of another EU member state or in some cases, the laws of a third country. The first sub-section of this Section A, therefore, will explain the modalities of application of the *lex concursus* under the Regulation.

In parallel, the Model Law also provides for the application of the *lex concursus,* though it does not provide for a "choice of law" *per se.* In fact, while the Model Law empowers the enacting forum to apply its own law to govern the proceedings, it limits the effects of the *lex concursus* to the territory of the enacting forum. Therefore, the second sub-section of this Section A will demonstrate how the application of the *lex concursus*

[13] *See* Regulation at art. 4.
[14] *See* Jay Lawrence Westbrook, Choice of Avoidance Law in Global Insolvencies, 17 BROOK. J. INT'L L. 499, 517 -518 (1991) [hereinafter Westbrook, Avoidance Law]. *See also* Manfred Balz, The European Union Convention on Insolvency Proceedings, 70 AM. BANKR. L.J. 485,507 (1996) [hereinafter Balz, The European Union Convention].
[15] *See* Convention on the Law Applicable to Contractual Obligations, June 19, 1980, 1980 O.J. (L 266) 1, art. 15, reprinted in 19 I.L.M. 1492 [hereinafter Rome Convention].
[16] *See* Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, Sept. 27, 1968, amended by art. 5, 1990 O.J. (C 189) 1, reprinted in 29 I.L.M. 1413, 1419 (1990) [hereinafter Brussels Convention].

under the Model Law remains primarily territorial in scope, and fails to achieve the results a "minimally global" insolvency system should produce.

1. Modalities of Application under the EU Regulation

Pursuant to article 4.1 of the Regulation, the "court of opening" of the proceedings applies its own domestic insolvency laws to administer the debtor's estate. Unless otherwise stipulated in the Regulation, this law will apply with all its ensuing effects and legal principles it contains[17]. In this respect, the Regulation does not distinguish between main and secondary proceedings for which the same principle applies; that is, the application of the *lex concursus* to govern all aspects of the proceedings.

Aside from increasing predictability for creditors[18], the Regulation presents an advantage that is often overlooked. When the *lex concursus* finds such a pre-determined and certain scope of application, the court of opening should be able to implement the provisions of its own domestic insolvency law more aptly[19]. Unlike traditional conflict of law rules where courts are sometimes bound to apply the laws of a foreign jurisdiction, the EU Regulation establishes a system where there is little room for error in interpretation as to the meaning of the applicable law and all its effects. This also translates into less recourse to the European Court of Justice[20], thereby saving a considerable amount of time and resources, to the benefit of creditors.

[17] All substantive provisions of the *lex concursus* should apply to the proceedings, either main or secondary. In this respect, the Regulation excludes any "renvoi" whereby the court of opening would apply the law of another state. *See* Miguel Virgos & Etienne Schmit, Report on the Convention of Insolvency Proceedings, EU Council Doc. 6500/96, DRS 8 para. 87 (CFC) (May 3, 1996) [hereinafter Explanatory Report].

[18] *See* Westbrook, Avoidance Law, *supra* note 14, at 518-519.

[19] *See* Ulrich Drobnig, Secured Credit in International Insolvency Proceedings, 33 TEX. INT'L L.J. 53, 67 (1998) [hereinafter Ulrich, Secured Credit] (arguing that the administrator of an insolvency will be more familiar with its own insolvency law, rather than complying with the laws of another state).

[20] *See generally* Blankenburg Erhard and Harm Schepel, Mobilizing the European Court of Justice, in The European court of justice, ed. Weiler J.J. and G. De Burca, Oxford University Press (2001); Rasmussen Hjalte, *European Court of Justice*, Gadjura, (1998), at 128; *see also* Mads Andenas (ed), article 177 References to the European Court – Policy and Practice, Butterworths, 1994.

Article 4.2 of the Regulation contains a non-exhaustive list of 13 matters where the application of the *lex concursus* is the rule. Although most of these provisions are self-explanatory, it would be appropriate to comment on a few of them.

Subject to the exceptions set forth in the Regulation, article 4.2(i) reaffirms that even to these exceptions; the principle that remains is the application of the *lex concursus.* Thus, the application of a law other than the *lex concursus* takes place only in specific instances and subject to certain conditions (*infra*). Most importantly, the same article confirms that the law of the place of opening will determine the creditors ranking of claims regarding the proceeds that result from the liquidation of the debtor's assets located in the forum of opening. When the forum of opening is in fact the main forum, the *lex concursus* will also determine creditors' priority claims with respect to the debtor's assets located in jurisdictions where secondary proceedings cannot be opened. Despite growing concerns in the EU and on a global level regarding creditors' rights and the priority of their claims, the general rule in the EU regime is to set aside foreign priority schemes and to apply the order of priority provided for under the *lex concursus.*

Other well-founded provisions are contained in article 4.2(m) of the Regulation, which introduces the notion of "*legal acts detrimental to all creditors*". These provisions are commonly found under domestic insolvency laws and allow national courts - at the request of the liquidator or creditors - to nullify the debtor's acts which were executed prior to, or after the opening of proceedings, and which may substantially affect the value of the debtor's estate[21]. While creditors and liquidators often resort to this method in domestic disputes in order to prevent the fraudulent dissemination[22] of the debtor's estate,

[21] *See* Thomas E. Plank, The Constitutional Limits of Bankruptcy, 63 TENN. L. REV. 487, 545 (1996); *see also* James H.M. Sprayregen et. al., International Issues: Are You Ready for the New European Union Regulations?, 041802 ABI-CLE 287 (2002); Gary W. Marsh, The Many Faces Of Directors' Fiduciary Duties, 22-SEP AM. BANKR. INST. J. 14, 54 (2003); *See* Wolfgang Lueke, The New European Law on International Insolvencies: A German Perspective, 17 BANKR. DEV. J. 369, 394 (2001) [hereinafter Lueke, German Perspective].
[22] *See* Martin Vlieland-Boddy v. Clive Vlieland-Boddy [2004] EWHC 2752 (Ch)).

the Regulation establishes a new and effective mechanism to implement this concept on a community-wide basis.

Indeed, in domestic insolvency cases, the detrimental character of the debtor's acts[23] is appreciated in light of the applicable law to the suspect transaction. For instance, when the act consists of a real property transfer from the debtor to a third party, the applicable law will be that of the place where the property is located[24] (*lex situs*). By contrast, the Regulation has modified this rule by applying the *lex concursus* to all acts of the debtor in order to assess whether or not such acts are detrimental to creditors. This approach is conducive to a more centralized procedure, whereby the acts of the debtor can be consistently and uniformly supervised. Thus, a court of the main proceedings may, by applying its own law, nullify the acts of disposition of the debtor's assets located in a foreign jurisdiction so long as no secondary proceedings were opened in that jurisdiction. This extends an unprecedented reach to the *lex concursus* and considerable authority to the main forum.

Because the acquirer of such assets or rights may be a bona fide third party[25], who has no knowledge of the current or imminent insolvency proceedings against the transferor (the debtor); the Regulation, under limited circumstances, allows the application of a law other than the *lex concursus*. Article 13 enables the beneficiary of these acts to raise its defense based upon the law of another contracting state. More precisely, this third party will be able to preserve the rights created by these acts if it proves that (1) "*the said act is subject to the law of a member state other than that of the state of opening of proceedings*" and (2) "*that law does not allow any means of*

[23] These acts are usually contracts whereby the debtor transfers part of his assets to a third party. It is a way to preserve those assets and place them out of the reach of collective proceedings. *See* Christoph G. Paulus, The New German Insolvency Code, 33 TEX. INT'L L.J. 141, 155 (1998) (arguing that courts dispose of a broad range of powers to nullify any acts entered in by the debtor, which may affect the value of the latter's assets)

[24] For enforcement purposes, the law of the land is commonly applied to determine proprietary and non-proprietary rights (such as a right to lease, or an encumbrance) relating to a real estate.

[25] *See* Ian F. Fletcher, The European Union Convention on Insolvency Proceedings: Choice-of-Law Provisions, 33 TEX. INT'L L.J. 119, 119 -120 (1998) [hereinafter Fletcher, the European Union Convention].

challenging that act in the relevant case". This article provides for the inapplicability of the *lex concursus* when the defense is based upon the content of the law of another member state.

In turn, avoidance powers are governed by the *lex concursus* as far as the detrimental character of a transaction is invoked by creditors or by the liquidator for the preservation of rights. Conversely, the law of another contracting state will govern the validity of the same transaction when the beneficiary (a bona fide third party) proves the transaction's unimpeachable character under that law. The cumulative application[26] of two different laws helps to achieve important objectives. It facilitates the task of the liquidator who henceforth will only refer to one law, that of the state of opening of proceedings. This provides him with more autonomy and certainty to lead his tasks to a successful end. In parallel, the exception to the application of the *lex concursus* provides for a degree of protection to third parties who have relied on the validity of the transaction they entered into[27]. Avoidance powers are just an example among many of how conflict of law rules, when adapted to the nature of cross-border insolvency cases, may achieve a higher degree of coherence and predictability.

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[26] *Id.* However, such a cumulative use of the *lex concursus* along with the law of another member state is not new for some European courts; see Bundesgerichtshof (BGH), Judgment of 21 November 1996, case IX ZR 148/95, BGHZ, Entscheidungen des Bundesgerichtshofs in Zivilsachen, 134, 116, 121 [U.S. citation: 134 BGHZ 116, at 121 (1996)] (where the court confirmed a cumulative use of the *lex concursus* and the law of another member state so as to govern avoidance powers). On a recent implementation of the Regulation on the law governing avoidance powers, *see* In Re BBB (Netherlands Supreme Court 24 October 1997, NIPR 1998, 114; NJ 1999, 319) (The court had to decide on the question of applicable law with regard to transaction avoidance between a German debtor and a Dutch claimant. The Dutch Supreme Court considered that according to Dutch private international law, the law, which was applicable to liquidation, was the lex concursus. Nevertheless the principle of ascertainability and legal certainty demands to take into account that a Dutch contracting party of the foreign insolvent debtor will not be prepared for the application of non-Dutch rules in a case where the legal act (of payment) is not subject to that foreign claim (as the contract implied a choice for Dutch law)).

[27] *See* Lueke, A German Perspective, *supra* note 21 (arguing that avoidance powers would less likely be exercised because of the cumulative application of the *lex concursus* and the law that "normally" governs the transaction at stake. The author further adds that such a system is more "protective of the legitimate interests of the person who benefited from the detrimental act"). On the modalities of application of the "paulian action" allowing creditors and/or the liquidator to seize the debtor's assets in possession with a third party acquirer, *see* Robert M. Zinman et. al., Fraudulent Transfers According To Alden, Gross And Borowitz: A Tale Of Two Circuits, 39 BUS. LAW. 977, 987-988 (1984).

The general applicability of the *lex concursus* to all aspects of the debtor's insolvency is suited to the broad powers of main proceedings. It would have been unrealistic to grant the forum of opening of main proceedings extensive authority with little means to exercise it. A balance between authority and legal instruments is therefore necessary to a successful cross-border insolvency arrangement. The EU Regulation uses the *lex concursus* to achieve this objective; by the same token, it enables domestic courts to implement their own insolvency laws in order to adjudicate multinational's default.

2. Implied and Limited Application under the Model Law

Throughout its provisions, the Model Law consistently refers to the application of the *lex concursus*[28]. This is primarily due to the legislative format of the Model Law, which was intended to be transposed, preferably without major amendments, onto the laws of each enacting forum. As a result, the enacting forum always applies its domestic law to the proceedings; no matter how unfair and impractical the application of this law proves to be to foreign creditors.

Additionally, in contrast to the Regulation where the reach of the *lex concursus* mirrors the powers of the adjudicating forum, the Model Law is silent as to the reach of the *lex concursus*, irrespective of whether the enacting forum is the main or non-main forum. Indeed, even when the enacting forum is the main forum, the latter cannot exercise extra-territorial powers by applying its own law in other jurisdictions. Thus, the *lex concursus* is only applied territorially and for the limited purpose of recognizing foreign proceedings and where possible, for granting the foreign representative specific relief.

As seen in the previous Chapter, the Model Law does not prevent any forum from initiating proceedings against the debtor, even when the debtor has no establishment in

[28] As such, the Model Law does not refer to the *lex concursus per se*; rather, it refers to the relevant law of the enacting state, and requires the legislator in each enacting forum to insert in the Model Law format, the title of the domestic law that governs insolvency proceedings.

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that forum[29]. This is why initially there was no reason to enable the enacting forum under any circumstances to apply its domestic law to administer the debtor's assets located in other jurisdictions. For instance, the mere presence of assets in a given forum would, pursuant to the Model Law, confer to the courts of that forum an acceptable basis of jurisdiction. Although chapter V of the Model Law seems to establish a limited primacy of main proceedings over non-main proceedings, it does not entail that the *lex concursus* of the main forum would in any event produce effects in other jurisdictions.

As one can see, there is a recurrent territorial theme under the Model Law. Article 10 for instance, reiterates the "*limited jurisdiction*" principle underlying the Model Law and pursuant to which, the enacting forum cannot extend the effects of domestic proceedings to either foreign creditors or foreign assets[30]. In this regard, it could be argued that the drafters of the Model Law never intended to confer excessive extra-territorial powers to any forum, and therefore, did not endow the *lex concursus* of the main forum with far reaching effects even after an enacting forum recognizes foreign main proceedings. While there is a certain consistency to limit both the powers of the main forum along with its applicable law to that forum's territory, the Model Law falls short in creating a single set of proceedings which would be able to administer the debtor's assets in jurisdiction where the debtor has no establishment. In sum, unlike the Regulation, the Model Law does not use the concepts and purpose of "main proceedings" and "main forum" to the fullest extent, thereby making the distinction between main and non-main proceedings questionable at best.

There is little doubt that a number of participants to the UNCITRAL working group would have objected to an extra-territorial reach of the main forum's *lex concursus*. Doing so would have required that when the debtor's centre of main interests

[29] *See* Andre Berends, The UNCITRAL Model Law on Cross-border Insolvency: A Comprehensive Overview, 6 TUL. J. INT'L & COMP. L. 309, 333 (1998) [hereinafter Berends, Comprehensive Overview].
[30] This limited jurisdiction applies even when the foreign representative has filed a claim before the enacting forum for the recognition of foreign proceedings.

is located in another jurisdiction, the enacting forum must refer to the law of such a jurisdiction (known as main forum only after recognition by the enacting State) to decide the manner whereby the debtor's domestic assets can attach and importantly, to determine creditors' ranking of claims according to the provisions of that foreign law. Although these concerns may be understood (since one of the key issues in cross-border insolvency cases is the protection of domestic creditors and the priority of their claim), an intriguing fact is that neither the UNCITRAL Guide to enactment nor any other official report issued in connection with the Model Law envisaged an extra-territorial application of the *lex concursus*, or even the application of a law other than the *lex concursus* to decide the order of priority of special categories of creditors (*infra*). It is believed that a mere introduction of the idea would have been a major step forward in terms of developing an agenda that would fully address the issues that arise from multinational's insolvency. It is likely the participants would not have supported this approach, and consequentially the main forum could not exercise its powers and implement its domestic law extra-territorially. This being said, debating this issue within such an international venue could have demonstrated how likely participating countries may (or may not) accept applying a foreign insolvency law or to give full effect to insolvency proceedings initiated against the same multinational debtor before foreign jurisdictions.

In parallel, the territorial implementation of the *lex concursus* under the Model Law affects the method of supervising and preventing detrimental acts to creditors. As seen under the Regulation, avoidance powers can be governed by two different laws, thereby achieving more predictability to creditors and liquidators and more certainty to a bona fide third party (acquirer of rights)[31]. Similarly, the Model Law foresaw the necessity in allowing foreign creditors to challenge the acts of disposition of the debtor's assets before the enacting forum and to prevent their fraudulent dissemination. However, according to article 23 of the Model Law, the detrimental and fraudulent nature of such acts is solely appreciated in light of the domestic law of the enacting forum[32]. In other

[31] *See supra* note 27.
[32] *See* the Model Law at art. 23.

words, a third party *bona fide* acquirer has no means but to refer to the *lex concursus* of the enacting forum in order to prevail in his claim as to the validity of the transaction he entered into with the debtor[33]. This could create legal uncertainty with respect to concluded transactions since any transaction that allegedly took place with a malicious intent and during the suspect period[34], may initially be governed by the laws of another state, and may furthermore be valid under such a law. Hence, the sole application of the *lex concursus* may seem unfair since the third party acquirer may have been unable to determine which law would apply to the transaction and even if he did, he could have had no knowledge of the fraudulent character of the transaction under that foreign law.

It could be fairly argued that the material rigidity[35] and limited application of the *lex concursus* under the Model Law makes the latter rather inadequate and inflexible to govern a broad range of issues that arises from the insolvency of multinational corporations. One such issue is the necessity to apply the law of another state in order to determine the validity of a transaction executed under that law. Furthermore, where the Regulation enables the main forum to apply its domestic law extra-territorially, subject to certain conditions[36], it achieves an important symmetry between insolvency law and the European market, an objective the drafters of the Model Law did not even contemplate.

B. <u>Market Symmetrical Insolvency Law</u>

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[33] *Id.*

[34] In a number of insolvency laws, there is a period within which the acts of disposition of the debtor's assets are void, regardless of the debtor's fraudulent intent. This period is most commonly known as the "suspect period". See for instance, Luiz Bernardo Gomide *et al.*, Commercial Financing And Insolvency Law In Brazil, 2 Sw. J.L. & Trade Am. 123, 138 -139 (1995); Sandy Shandro, Italian Law Reform, 24-OCT(What if OCT) Am. Bankr. Inst. J. 18, 18 (2005).

[35] Such a rigidity primarily results from the strict application of the *lex concursus* to all aspects of the debtor' insolvency and that, the Model Law does not provide for instances where the enacting forum would be able to apply a law other than its own, even when the circumstances would justify a deviation from the *lex concursus*.

[36] The main forum can exercise extra-territorial powers and apply its law in other forums when the debtor has no establishment in such forums, and as a result, no secondary proceedings could be opened therein. By creating a "judicial vacuum" in certain areas, the Regulation gave the main forum a justified purpose to administer the debtor's assets located in other jurisdictions.

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The comparison between the scope of application of the *lex concursus* under the European insolvency regime and the Model Law brings forth one of the most interesting arguments made by Westbrook. In defending the theory of Universalism, he stresses, "*Bankruptcy is one of those laws that cannot perform its function unless it is symmetrical to the market in which it operates*"[37]. Presenting another defense of Universalism is not the purpose of this thesis, thus it is preferable to understand the interplay between a given market and insolvency laws, regardless of the regime pursuant to which such laws are modelled.

Westbrook's argument, also known as the "market-symmetry" argument, states that commercial activities and insolvency laws should, in essence, cover the same scope, whether geographically or materially. Any dissymmetry between their scopes could lead to inconsistencies, where any given business will either be too restricted by all-embracing insolvency laws, or contrarily, commercial activities will be vastly un-regulated due to the limited and territorial approach of insolvency proceedings[38].

In this regard, the Regulation presents a recent and interesting example of market-symmetry application. Indeed, the Regulation does not create a "purely universal" insolvency regime, yet it promulgated a number of insolvency principles to cover the European internal market as defined by its geographical boundaries. In parallel, the Regulation established certain rules - although not substantive[39] - to cover the broad range of transactions that one can engage in within that market. From secured transactions to contracts of employment, there is always a set of rules that is more likely

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[37] Virtually all theorists share this view and it is reflected in the nearly unanimous practice of nations, including the United States. "*Although political predictions are difficult, it is evident that globalization is producing enormous pressures for legal convergence and those pressures are most likely to prevail as to laws that require market-symmetry to be successful*". *See* Westbrook, Global Solution, *supra* note 4, at 2288.

[38] *See* Jay M. Goffman and Evan A. Michael, Cross Border Insolvencies: A Comparative Examination of Insolvency Laws of Industrialized Countries, 12 JBKRLP 5 ART. 1 (2003); *See also* Lueke, A German Perspective, supra note 2, at 373 -373; Liza Perkins, A Defense of Pure Universalism in Cross-Border, Corporate Insolvencies, 32 N.Y.U. J. INT'L L. & POL. 787, 803 -806(2000).

[39] As demonstrated in the previous Chapter, the Regulation simply provides for a choice of law/forum, whereby it achieves a higher level of equality among the various stakeholders.

than not to settle the various claims that arise when a multinational debtor faces financial distress within the European Communities.

On this basis, it can be inferred that the market symmetry argument is not just relevant when applied to Pure Universalism. With the Regulation[40], such symmetry was necessary to facilitate and regulate commercial activities within the internal market, along with an insolvency regime built on modified Universalism. The fact that the *lex concursus* of the main forum may be applied extra-territorially, so as to embrace the operations of the multinational debtor within the EU, brings forth the question of whether a similar approach could at least be contemplated on the global level through the Model Law.

In actuality, the Model Law has come a long way in creating a limited symmetry between the law of the enacting forum and the overall insolvency process of the financially distressed multinational. As explained in the previous Chapter, although the Model Law does not prevent any forum from initiating domestic proceedings against the multinational debtor on the basis of the presence of assets, it does not require the enacting forum to recognize such proceedings. As a result, foreign proceedings that stand a chance of being recognized by the enacting forum are those that would qualify as either main or non-main proceedings, as per the criteria set out in the Model Law.

This being said, the mere fact that "asset-based" proceedings could be opened in the first place - thereby encouraging fragmented and uncoordinated insolvency processes against the same entity in multiple forums - refutes any justification for the main /enacting forum to extend the application of its law in order to administer the debtor's assets located in jurisdictions where "recognizable" proceedings cannot be opened.

[40] Although the primary focus of this work is on the EU regime, other regional insolvency arrangements are being currently debated. *See* the American Law Institute's Transnational Insolvency Project, which is being proposed as a potential regional bankruptcy regime for member countries of the North American Free Trade Agreement (NAFTA), available at http://www.ali.org/ (last visited March 2006).

Perhaps, the Model Law should introduce certain limitations on the opening of proceedings in the enacting forum when the debtor possesses only assets therein.

However, since doing so could be considered an important attenuation to the sovereignty of the enacting forum[41], such limitations cannot consist of an absolute denial of the right to open proceedings against the debtor. Instead, the opening of "asset-based" proceedings in the enacting forum could be limited to situations where domestic creditors would suffer irreparable harm as a result of the application of the law of the main forum. In other words, the enacting forum would conditionally refrain from opening proceedings so long as the adjudicating foreign main forum fairly and equitably deals with the claims of the enacting forum's domestic creditors. This would be conducive to more cooperation and court-to-court communications leading to further *ad hoc* agreements and insolvency protocols among the forums involved in a given cross-border insolvency case.

Importantly, this method would significantly reduce the number of proceedings against the same entity, while giving the opportunity to the main forum to apply its law extra-territorially, thereby achieving more market symmetry. While such a proposal may be founded on a far-off vision to globally harmonize domestic insolvency laws, an adequate market-symmetry implementation of insolvency proceedings is necessary to cope with the very nature of multinational corporations and their cross-border commercial activities. In this regard, it would not be absurd to believe that the "de facto" international market, with its current pace of development and liberalization, could prompt nations to head to this direction. Indeed, a considerable driving force behind this phenomenon is the expansion of international trade[42], propelled by an ever-increasing number of multinational corporations. Many corporations no longer compete solely on a domestic level, and national borders have considerably lost their meaning when confronted with international commerce.

[41] *See* Berends, Comprehensive Overview, *supra* note 29, at 333.
[42] *See* Michael P. Malloy, Note, Shifting Paradigms: Institutional Roles in a Changing World, 62 FORDHAM L. REV. 1911 (1994).

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In parallel to this phenomenon, globalisation has also had a profound impact on the legal sphere by 'internationalising' the domestic legal systems of countries. Therefore, a justified and extra-territorial implementation of the insolvency law of a given forum - deemed necessary to address the financial distress of a multinational corporation, along with the various transactions this entity may have engaged in throughout its life and across the borders of sovereign states - may not seem as surprising as it was a decade ago. Additional incentives to create such a system may be derived from Professor Westbrook's argument. Mainly, the Model Law's purely Territorial application of domestic insolvency proceedings is no longer adequate to oversee the insolvency process of a large multinational. That is to say, the current state of Territoriality is unconstructive in developing an international market and the continuous application of the "grab rule" will prove even more ineffective as multinationals' activities increase in scope and complexity across the boundaries of sovereign states[43].

It is believed that the market symmetry argument could well enhance the Model Law by making the latter come closer to following a more Universal approach (although not necessarily pure Universalism)[44]. Otherwise, trade and investment may ultimately stagnate due to the inadequacy of the international legal infrastructure to regulate global activities. In the same way European institutions had to address this issue on the European level and ensure the proper functioning of the internal market, there should be genuine international efforts that provide for the same legal adequacy on a global level,

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[43] *Id.*

[44] This does not mean that there should be a single set of proceedings governed by the insolvency laws of a single country. Rather, the creation of a system – similar to the European regime –could enable a single forum to have overall jurisdiction while allowing domestic courts to protect their local creditors. Although this view suggests a strong approval of the market-symmetry argument, it may somehow differ from the purely universalistic approach advocated by professor Westbrook. "Virtually *all theorists have agreed that bankruptcy requires a single proceeding in which all of the debtor's assets and claims are administered under a single set of rules - in traditional terms, in rem.* To achieve that result, it is necessary that the bankruptcy law cover the entire market in which the debtor company operates, and bind all of its participants. It is therefore unsurprising that virtually every country has established a national bankruptcy regime co-extensive with its national market". *See* Lawrence Westbrook, Multinational Enterprises In General Default: Chapter 15, The ALI Principles, and The EU Insolvency Regulation, 76 AM. BANKR. L.J. 1, 34 (2002) [hereinafter Westbrook, Multinational Enterprises].

preferably through an international instrument that has already gained popularity, such as the Model Law.

In sum, insolvency laws should be symmetric to the market they govern. This paradigm is not restricted to the European Union no more than it is with respect to "pure Universalism". The incentives to build a cross-border insolvency system should, to a greater extent, stem from achieving this market-symmetry objective, as the absence of which may impede the proper functioning of the international market. Such global efforts should also take into account the role of international institutions and instruments capable of channelling and enforcing global insolvency standards[45].

III. Exceptions to the *Lex Concursus*

Contrary to the principle of applying the *lex concursus* to all aspects of the proceedings, the Regulation has established a series of exceptions where the applicable law is not the *lex concursus*. These exceptions apply to specific categories of claims, and the applicable law is that of another member state[46]. This law may be the "lex situs", the "lex causae" or the "lex contractus". The first part will study some of these exceptions, their application, and how conflicts that rise between the *lex concursus* and other applicable laws are overcome under the Regulation. In the same way the Regulation allows the opening of secondary proceedings to make the overall insolvency system acceptable to all member states, it has also anticipated situations where the *lex concursus* could be detrimental to special categories of creditors. Hence, it is important to understand how far the Regulation has come in accommodating public policy concerns of each state and waiving the application of the *lex concursus* when the protection of special categories of foreign creditors so requires.

[45] *See* Chapter Five.
[46] Such as claimants of set-off rights, employees, third party rights *in rem*, *etc.* In such instances, the Regulation provides that the law of the place where these claims arise should apply.

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As the Regulation achieved a workable system to settle these issues, the second part will determine the extent to which the Model Law, as it currently stands, protects foreign creditors. Importantly, it will be examined whether the Model Law could, through choice of law provisions, further protection to special categories of claimants. The analysis in this part will be based on the premise that despite dissimilarities between EU countries' privileged categories of creditors, the Regulation could achieve a comprehensive system of priority claims, although not a "universal" order of priority.

A. The EU Approach

1. "Special" Categories of Creditors

Aside from the general application of the *lex concursus*, the Regulation stipulates a series of special conflict of law rules[47] to ensure the smooth functioning of the EU insolvency system. Among these various exceptions, special attention will be given to the provisions that apply to third parties rights *in rem*, set-off claims and employment contracts.

a. Third Parties' Rights *in Rem*

The Regulation gives a broad definition to rights *in rem*. These can be assets that are "*tangible or intangible, moveable or immoveable*"[48]. Additional details are provided under article 5.2, which enumerates certain prerogatives with respect to these *in rem* rights that remain unaltered by the opening of insolvency proceedings against the debtor.

Indeed, in order to protect third parties and creditors who have entered in a secured transaction with a multinational debtor, article 5 of the Regulation establishes an exception to the application of the *lex concursus*. For instance, when proprietary rights are used as collateral in structured finance transactions, the beneficiary should have direct recourse to this security in order to cover any risk of default. Therefore, the most

[47] *See* Regulation at art. 4.
[48] *See* Regulation at art. 5-1.

important concern when insolvency proceedings are initiated against the debtor is creditor's access to this collateral at the appropriate time in the course of the proceedings.

Hence, the location of the collateral and the applicable law to its enforcement is of paramount importance to creditors and third parties who have been granted a security interest in a specific asset from the debtor[49]. Moreover, in cross-border insolvency cases, third parties may be impeded from enforcing their security because the collateral is located in another state and governed by the laws and procedures of that forum. As a result, the application of the *lex concursus* to all aspects of the proceedings would render access to and enforcement of such a security interest more difficult to foreign creditors than it would have been under the laws of the state, which initially applied at the creation of this security[50]. To remedy this situation, thereby increasing the predictability for foreign secured creditors, the Regulation provides for the application of the law that - absent insolvency proceedings - should govern the security at stake.

Although the Regulation shifts from the application of the *lex concursus*, it does not provide for full-fledged conflict of law rules to determine which law should apply to *in rem* rights. Because the determination of this law may depend on many factors, such as the contract creating the credit/debt relationship between the parties[51], or the location of the security at the time the beneficiary wishes to enforce its right[52], it is more consistent

[49] Nick Segal, The Choice of Law Provisions in The European Union Convention on Insolvency Proceedings, 17 BANKR. DEV. J. 369, 393 -394 (1997) [hereinafter Segal, Choice of Law]; *see also* Ulrik Rammeskow Bang-Pedersen, Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests, 73 AM. BANKR. L.J. 385, 433 (1999)[hereinafter Rammeskow, Predictability and Protection] (arguing that under the EU convention, the applicable substantive law that governs creditors' security interests in the debtor's assets is usually the *lex rei sitae* at the relevant time")
[50] Ralph Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases In Chapter 11 Reorganizations, 1997 U. ILL. L. REV. 959, 1037 (1997) (arguing that the concept of exclusive jurisdiction applies to an *in rem* or *quasi in rem* action to the extent that possession or control of property is necessary for effective relief)
[51] *See* Ulrich, Secured Credit, *supra* note 19, at 67 (arguing that the inapplicability of the lex concursus to secured claims is more protective of secured creditors. The author adds that the application of the lex contractus or lex situs would satisfy the expectations of secured creditors). *See also* Roy Goode, Security in Cross-Border Transactions, 33 TEX. INT'L L.J. 47, 51 (1998).
[52] *Id.*

to delegate the of choice of the applicable law to the domestic court before which evidence as to the existence of such *in rem* rights is submitted[53].

For instance, the general rule for real security is the application of the law of the state where such a security is located, also known as the *lex situs*. This applies to situations where secured creditors wish to exercise direct recourse to pre-determined assets upon the occurrence of an event of default from their debtor. To this end, article 2(g) of the Regulation provides some guidance as to the location of these assets. In the case of tangible property, it is the "*state within the territory of which the property is situated*". For property or ownership rights that are registered in a public register, it is the state where such register is kept. Lastly, with respect to claims - which is understood as the right of the debtor against a defaulting third party- the Regulation cites the basis of jurisdiction under article 3-1, where the applicable law is that of the state where the third party has the centre of its main interests.

In light of these various provisions, the Regulation has not established substantial rules to settle the claims of secured creditors within the EU Community. Its provisions are less innovative and daring than those pertaining to the choice of forum and the general competence of main proceedings. In actuality, the authors of the Regulation chose to limit the effects of the Regulation with respect to secured creditors and to exclude the latter from the scope of application of the *lex concursus*. This not only placed secured creditors beyond the reach of insolvency proceedings per se[54], but it has also increased the predictability for anyone acquiring an *in rem* security interest from a multinational debtor.

[53] The *lex situs* or *lex contractus* appear to be the most appropriate law to govern real security in the European context, and perhaps, by analogy, on a global level. A deviation from the principle of the *lex concursus* is therefore justified, if not desirable.

[54] Jose M. Garrido, Some Reflections on the EU Bankruptcy Convention and Its Implications for Secured and Preferential Creditors, 7 INSOL INT'L INSOLVENCY REV. 79 (1998). The contributions of the Regulation in this regard can only be welcomed because one of the most intricate questions that arise in cross-border insolvency cases is how to reconcile the interests of secured creditors that are located in different jurisdictions, while respecting the different rules governing the enforcement of their rights.

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The reason why the drafters of the Regulation adopted a different approach vis-à-vis secured creditors is quite simple. Due to notable divergences between the laws of the European states with respect to collaterals and secured transactions, it was impractical and unrealistic to design a uniform European regime[55]. Indeed, these various domestic laws prescribe different procedural rules, not to mention the public policy implications they bear. It is more convenient, although not progressive, to refer these rights to the law that initially enabled their creation.

Had the Regulation imposed a strict application of the *lex concursus* to these situations, two major consequences would have resulted. First, even if the secured right was recognized before the court of opening, the security in question may eventually be inaccessible because of a general moratorium against all creditors for the purpose of reorganization[56]. Hence, secured creditors would be unable to enforce their right[57]. Secondly, the inability of secured creditors to collect on their claims would defy the very essence of security in commercial transactions. In turn, creditors would perceive the futility of collateral security and compensate risk taking by other means (price increases, interest rates *etc.*). As mentioned in the first chapter, this practice would be detrimental to any free market environment and would prevent the development thereof. On the European Community level, this could have slowed the creation of a common market and hindered the implementation of fundamental principles stipulated in the EC Treaty[58].

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[55]*See* Jay Lawrence Westbrook & Jacob S. Ziegel, The American Law Institute NAFTA Insolvency Project, 23 BROOKLYN J. INT'L L. 7, 12 (1997) (arguing that important technical issues, such as the differences between the regimes that apply to secured claims, constitute a strong impediment to the creation of an insolvency system among several countries)

[56] *See* Ian G. Williams, Time for a Change: Will the U.K. Embrace the "Rescue Culture"?, 20-MAR AM. BANKR. INST. J. 18, 18 -37 (arguing that the issuance of a moratorium practically prevents secured creditors from exercising their rights on the security)

[57] *See for instance* the EU Convention Art. 4(2)(i) and see the Explanatory Report, *supra* note 17, at 174 (stating that the EU Convention does not contain substantive rules on reduction due to security interests/setoff rights, but leaves it to the law of state where the proceedings are opened). Therefore, it is apparent why the Regulation avoided the prescription of general rules to govern in rem rights, especially when they are used as collateral in secured transactions. This is an area of cross-border insolvency that is too contentious to be substantially regulated.

[58]These principles encompass the right to freely engage in commercial undertakings within the community. *See* Treaty Establishing the European Economic Community, MAR. 25, 1957, 298 U.N.T.S. 11, 1973 GR. BRIT. T.S. NO. 1 (Cmd. 5179-II). This treaty, also known as the Treaty of Rome, entered into force on January 1, 1958 and is still in force, though much amended, as part of the complex series of treaties, which

b. Set-off Claims

A second exception the Regulation establishes is the applicable law to set-off claims[59]. When such a situation arises, article 6 of the Regulation provides that the applicable law is the law that governs the debtor's claim. The availability of this action will thus be determined according to that law, regardless of the *lex concursus*' provisions[60] in this regard.

At first glance, the Regulation appears to contain conflicting provisions regarding the applicable law to set-off claims. Indeed, article 2(d) of the Regulation elects the *lex concursus* to determine the availability and conditions of these claims when insolvency proceedings are initiated against the debtor. As previously mentioned, the *lex concursus* enjoys a broad scope of application in the European insolvency regime. This applicability extends to all aspects of the insolvency proceedings, including set-off claims. It is therefore important to understand the interplay between article 2(d) and article 6 of the Regulation, and how the court of opening can ensure the uniform application of these seemingly contradictory provisions[61].

currently link 15 European states as members of the EU. *See* Treaty Establishing the European Community, Feb. 7, 1992, O.J. (C 224) 1 (1992), (1992) 1 C.M.L.R. 573 (1992).

[59] In the context of insolvency, a set-off is a claim by the debtor that the creditor owes him money that should be subtracted from the amount the debtor owes to the creditor. For the purposes of the Regulation, either the debtor or the creditor in the proceedings can present these claims. The doctrine of set-off provides "[t]he equitable right to cancel or offset mutual debts" to parties with lending relationships. *See* Black's Law Dictionary 1372 (6th ed. 1990). "*Setoff is a time-honored creditor's remedy whereby mutual debts may be netted-out*". *See* Jack F. Williams, Application of the Cash Collateral Paradigm to the Preservation of the Right to Setoff in Bankruptcy, 7 BANKR. DEV. J. 27, 63 (1990).

[60] Eventually, there will be cases where the *lex concursus* is the applicable law to determine the effects of insolvency proceedings vis-à-vis set-off claims.

[61]In a recurrent way, the Regulation brings forth the broad mandate of the *lex concursus* to govern all aspects of the proceedings. On the other hand, the exceptions to this principle are carefully drafted so as to limit the application of another law when it is only necessary. The creation of these various exceptions derives from the need to protect creditors from some negative aspects that main proceedings and *lex concursus* may entail. Therefore, it is expected that courts will extensively recourse to the ECJ with interpretation claims in order to effectively implement the Regulation. It is customary though that new legislations in the European Community are subject – in the first years of their implementation – to a number of interpretative decisions from the ECJ.

In practice, to reconcile the provisions contained in article 2(d) and article 6, courts will first apply the *lex concursus* in order to determine the admissibility of set-off claims in the course of the proceedings. This law will also dictate the requirements for these claims to be granted. If the *lex concursus* does not allow either party to raise its claim, or if the conditions for such claims are not fulfilled from the evidence presented before the court of opening, the parties may seek recourse to article 6 of the Regulation. To do so, they will have to prove that the relief they are seeking "*is permitted by the law applicable to the insolvent debtor's claim*"[62].

This dual approach is certainly similar to the provisions regarding the applicable law to third parties' rights *in rem*[63] (*supra*). For the second time, the Regulation operates on two levels to provide for a substantive degree of flexibility, should the application of the *lex concursus* be detrimental to some of the stakeholders involved. In this regard, it is difficult to determine whether the Regulation is pro-debtor or pro-creditor. Unlike most domestic insolvency laws, the Regulation does not seem to take side on the issue, instead it provides alternatives, albeit restricted alternatives, to both parties in order to bring their claims. Original conflict of law rules help to achieve this objective while satisfying domestic concerns with respect to sensitive issues (rights *in rem*, contracts of employment, *etc*).

This approach would also ensure that non-adjusting creditors do not suffer irremediable consequences from the opening of main and "universal" proceedings against the debtor. This approach could, from a global perspective, mitigate the disadvantages suffered by certain categories of creditors under a universal insolvency regime. While adjusting creditors will be able to measure and protect themselves against risk taking, non-adjusting creditors would be protected under the law that normally applies to their

[62] *See* Anne Nielsen & Mike Sigal, The Cross-Border Insolvency Concordat: Principles to Facilitate the Resolution of International Insolvencies, 70 AM. BANKR. L.J. 533, 554 -555 (1996) (arguing that the applicable law under the EU convention to setoffs can either be the *lex concursus* or the law that governs the claim of the debtor). *See also* Fletcher, The European Union Convention, *supra* note 25, at 139.
[63] *See* Lueke, A German Perspective, *supra* note 21, at 391 (arguing that the regime applicable to set-off claims is similar to the one applicable to third parties rights in rem).

credit[64], should the *lex concursus* fail to provide such protection in the first place. The fall back on the application of a law other than the *lex concursus* is a novel element in the Regulation that could inspire the creation of a similar regime regarding domestic creditors' rights on the global level.

More specifically, the law that governs the admissibility of set-off claims is important when such claims arise in the course of the proceedings. The principle of equality among creditors of equal standing - also known as the *pari passu* principle - may be hindered if the court of opening systemically allows settlements of debts based on the subtraction of sums due between the multinational debtor and its creditors. The latter would enjoy a *de facto* privilege over other creditors[65] who - according to the law governing the priority of their claims - should be paid first from the liquidation proceeds. Yet, the Regulation does not create material rules to limit this practice, nor does it seek harmonization between domestic insolvency laws in the European community.

In order to limit the breaches of the *pari passu* principle, the Regulation anticipates the possibility of applying a law other than the *lex concursus.* So long as the law that normally applies to the debt (the law of the debtor's claim) was taken into account when the creditor and the debtor entered into an agreement, both parties can rely on the possibility of set-off claims. When the *lex concursus* denies them the right to bring this action, this may affect their legitimate expectations at the time of execution of the transaction. Although this reasoning is slightly far fetched, the Regulation consistently minimizes its effects and restricts the application of the *lex concursus* when the parties could benefit from different solutions under the law that normally applies to their transaction.

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[64] *See* Bob Wessels, Principles of European Insolvency Law, 22-SEP AM. BANKR. INST. J. 28, 29 (2003) [hereinafter Wessels, Principles of European Insolvency Law] (arguing that there is a protective effect of the EU insolvency proceedings through the issuance of important provisions such as the reversal of juridical acts, set-off, *etc).*

[65] Lawrence Kalevitch, Setoff And Bankruptcy, 41 CLEV. ST. L. REV. 599, 600 -602 (1993) (arguing that setoff claims have the "effect of conferring a priority on holders of setoff rights"). *More generally see* Samuel R. Maizel, Setoff and Recoupment in Bankruptcy, 820 PLI/COMM 279, 281(2001)

Since domestic insolvency laws treat set-off claims differently, with varying degrees of admissibility, it is important for creditors to realize what the applicable law to their claims will be, and whether this law would allow them to bring their action for mutual settlement. Lastly, it is noteworthy to mention that the most significant discrepancies as to the treatment of set-off claims exist between the common and civil law approaches[66].

c. Contracts of Employment

Although the Regulation establishes other exceptions to the application of the *lex concursus*[67], this category was deliberately chosen because the Regulation follows a different and unequivocal approach in determining the applicable law to contracts of employment. Article 10 of the Regulation stipulates "*the effects of insolvency proceedings on employment contracts and relationships shall be governed solely by the law of the Member State applicable to the contract of employment*". This somewhat short article bears a number of public policy concerns. Before understanding the justification for this exception, one must first study the peculiarity of the Regulation with respect to contracts of employment.

In this particular case, the Regulation does not create a system where two different domestic laws are equally applicable to resolve the same issue. To determine the effects of insolvency proceedings on contracts of employment, the court of opening shall "strictly" apply the law that ordinarily governs the contract at stake. It is only under specific circumstances that the *lex concursus* applies to determine these effects (*infra*).

[66] "*In the United Kingdom, set-off is treated as a mandatory process which must be applied, as a matter of public policy, in both individual and corporate insolvencies in which the necessary requirement of mutuality is present. In most civil law systems, on the other hand, the prevailing view is that set-off constitutes a violation of the principle of pari passu distribution, and that as a matter of public policy it must be confined to the most carefully limited circumstances, as where the cross-liabilities arise out of one and the same contract or obligation.*" *See* Fletcher Ian, Insolvency in Private International Law: National and International Approaches, Oxford University Press, 1999, 273.
[67] *See* Regulation at art. 4.

The restrictive language of article 10 highlights domestic concerns around the protection of employees when they are creditors in insolvency proceedings. Perhaps more vulnerable than other creditors, these employees may not be able to collect their wages due to the insolvency of their employer (debtor). The risk of unemployment, added to the potential difficulty of collecting overdue wages (and possibly compensatory sums), have generally prompted legislators in a number of countries to protect employees from the lengthy and somewhat uncertain outcome of cross-border insolvency proceedings. To achieve this, most jurisdictions endow employees' claims with a high priority of payment from the insolvency proceeds. If the *lex concursus* were to apply to these claims and determine employees' rights, the objectives of domestic law would be considerably unrealised. Indeed, while most jurisdictions favour employees in the context of insolvency proceedings, the law that normally governs contracts of employment may be more protective and grant higher priority claims to employees than does the *lex concursus*. It is therefore understood why the Regulation confines the effects of insolvency proceedings to the law that governs employment contracts, and not to the law of the state of opening.

This exception, however, is in line with previous legislative instruments pertaining to either the choice of law or the choice of forum between EU member states in civil and commercial matters. Both the Rome[68] and Brussels[69] conventions contain special provisions on the settlement of disputes arising from contracts of employment. Although these contracts are executory in nature and should be subject to the same principle that governs other similar contracts, the European council has, in order to protect employees, prioritised the objectives of domestic legislation over those of harmonizing domestic laws in EU member states.

Since the *lex concursus* does not apply to these employment contracts, the court of opening would have to determine the applicable law to settle such employment claims.

[68] *See* Rome Convention, *supra* note 15.
[69] *See* Brussels Convention, supra note 16.

To do so, the court of opening will refer to conflict of law rules that are dictated[70] by the Rome Convention[71]. When the provisions of this convention point to the application of the law of one member state of the EU, that law will solely govern the claims that arise from employment contracts, and will determine the effects of insolvency proceedings vis-à-vis employees' rights. Conversely, and unlike the Regulation where only the law of an EU member state applies, the Rome convention may point to the law of a third country that is not part of the European Union. In this case, the Explanatory Report elects the *lex concursus* to determine the effects of insolvency proceedings vis-à-vis contracts of employment.

The reason underlying this choice is simple. In the same way each member state protects its domestic employees (who are part of a "vulnerable social group") from the magnitude of a multinational insolvency, the European council sought to protect employees from the application of foreign non-European laws and the unfamiliar provisions contained therein. Indeed, these laws may provide for completely different dispositions with respect to employees' priority claims in the context of insolvency proceedings. Therefore, the *lex concursus* - which by definition is the law of a contracting state - serves as the last resort to protect European employees.

It is noteworthy to mention that despite substantial differences between domestic insolvency laws in the EU, certain issues are treated similarly among member states. Public policy in each forum pursues the same objectives regarding certain issues, such as the protection of employees, taxation authorities' right, the claim of those who initiated

[70] In asserting so, it is important to note that the Regulation says little about employment contracts, and it does so with respect to a number of exceptions that prescribe the application of a law other than the *lex concursus*. Most importantly, the Regulation does not explicitly refer to the Rome convention. However, these assertions are drawn from the Explanatory Report upon which, much of the interpretative work is based. The report was originally drafted to accompany the 1995 European convention on insolvency proceedings. Since the Regulation retrieves most of the provisions contained in that convention, courts are likely to seek guidance from this report so as to uniformly implement the Regulation.
[71] *See* Rome Convention, *supra* note 15, at art. 6.

insolvency proceedings against the debtor, etc. This explains why it is always preferable to apply the *lex concursus* rather than apply the law of a third non-EU country[72].

2. A Necessary Compromise

In many respects, it can be argued that the Regulation, through choice of law provisions, achieves an essential compromise between the universality of insolvency proceedings and the need to protect local interests. The special choice of law provisions studied above reveals the two principal approaches followed by the Regulation to achieve such a compromise.

Firstly, as seen with respect to third parties' rights *in rem* and set-off claims, the Regulation provides for the application of the *lex concursus* along with the possibility to deviate from this rule when such an application will affect the certainty of concluded transactions or prove detrimental to certain creditors. Secondly, as regards especially sensitive categories of claimants, such as employees, the Regulation completely and unconditionally discards the application of the *lex concursus*. As a result, the opening of proceedings in a given forum against the multinational debtor produces no effect on the applicable law to employees' claims in other forums. Indeed, this approach leaves employees' domestic priority of distribution unaffected by the insolvency of their multinational employer.

Perhaps an important lesson to be learned from the Regulation is that one need not create substantive insolvency laws containing specific rules on the priority of distribution, in order to afford greater protection to foreign creditors. The EU experience has shown that simple choice of law provisions, taking into account several special categories of

[72] This could also point to the possibility of creating universal priority claims that favour the most commonly protected categories of creditors by domestic insolvency laws in, and outside the European Union (*infra).*

claimants, may significantly improve predictability and the equality of treatment between foreign creditors and those residents in the forum of opening.

Despite the Regulation's original approach with respect to choice of law provisions, it has been argued that the various exceptions to the application of the *lex concursus* considerably reduce the broad and "universal" character of main proceedings within the EU[73]. While this critique may be well founded, and that the Regulation would, without such exceptions, be strictly universal in scope, one must acknowledge the merits of these exceptions rather than their shortcomings. Indeed, the Regulation is the first instrument that pragmatically deals with broad and sensitive set of issues, such as priority claims, while departing from the long and unproductive theoretical debate between "Universality" and "Territoriality"[74]. Thus, resorting to these exceptions was the only plausible way to achieve any advancement with respect to cross-border insolvency proceedings, which is an area marked by an unproductive debate for over 40 years within the European Union.

In other words, without the very exceptions to the application of the *lex concursus*, the Regulation could not have been ratified, because to this day, significant differences exist among domestic insolvency laws of EU member states[75]. In the same manner the Regulation has mitigated the opening of one set of "universal" main proceedings against the multinational debtor by enabling domestic secondary proceedings to be initiated, it has foreseen the necessity to provide for the application of a law other than the *lex concursus* to ensure that each forum would be able to cooperate without infringing upon the rights of its domestic creditors.

B. The Model Law: Modest Protection to Foreign Creditors

[73] *See* Segal, Choice of Law, *supra* note 49, at 73.
[74] *See* Fletcher, the European Union Convention, *supra* note 25, at 139.
[75] *See* Preamble of the Regulation at art. 11.

Chapter Four.

Following the analysis of special conflict of law rules under the Regulation, this part will explore how the Model Law has come to establish a number rules aimed at improving the treatment of foreign creditors. The subsequent parts will respectively treat the non-discrimination principle under the Model Law, the provisions relating to the distribution of proceeds in concurrent proceedings, and at last, will expose the three basic models that may be found under the various domestic insolvency laws for the treatment of foreign creditors.

1. Non-Discrimination Rule

Although the drafters of the Model Law did not attempt to create a system whereby foreign creditors can maintain their domestic priority of claims, it would be improper to consider that the Model Law did not provide for any kind of protection to foreign creditors. In fact, the Model Law introduces some standards to ensure that foreign creditors are not discriminated against in the proceedings held before the enacting forum. Article 13 of the Model Law stipulates a "non-discrimination" principle pursuant to which foreign and domestic creditors are to be treated equally, at least in theory[76]. This implies that the enacting forum is obliged to treat in the same manner domestic and foreign creditors, which according to the *lex concursus*[77], belong to the same class of creditors irrespective of their domicile.

Because this approach is rather ambitious and contradicts the long-standing impulse of each forum to favour its domestic creditors, the same article provides for the first exception to the non-discrimination principle by setting a minimum threshold for the treatment of foreign creditors. Article 13 stipulates that, in all events, foreign creditors shall not be ranked lower than "general non-preference claims". While such a threshold

[76] Article 13 contains both the principle of non-discrimination and the exception thereto. While the first paragraph of article 13 states "*foreign creditors have the same rights regarding the commencement of, and participation in, a proceeding*" under the law of the enacting forum, the second paragraph provides for significant exceptions that would in fact favor domestic creditors over foreign creditors.

[77] The application of the *lex concursus* to such a matter means that the enacting forum shall not "import" foreign classification of creditors. Instead, it would apply its own law to determine whether a given foreign creditor fulfils the conditions to be considered and treated as a given class of domestic creditors, regardless of how such a creditor may be treated under its domestic law.

for the treatment of foreign creditors may seem less progressive than the general above mentioned principle of "non-discrimination", it appears more realistic and adapted to common provisions found under a number of domestic insolvency laws, which generally confer a lower ranking to foreign creditors. The establishment of such a threshold in the Model Law reflects the concerns of each forum to prioritise its domestic creditors and to place greater risks of non-payment solely on foreign creditors.

Although the lowering of the ranking of foreign creditors to that of "general non-preference claims" may constitute a significant curtailment of foreign creditors' rights, the Model Law allows the further inequality of treatment between domestic and foreign creditors. The third exception under the Model Law, which is in fact "an exception to the exception"[78], provides that foreign creditors may be ranked lower than general non-secured creditors, if the nature of their claim places them in the same category as domestic creditors who, in virtue of the *lex concursus*, are ranked lower than such general non-secured creditors. Since the ranking of priority claims may greatly differ from one jurisdiction to another, it is needless to say that such an exception may significantly affect the legitimate expectations of foreign creditors who could have benefited from a much higher ranking pursuant to the law that, absent insolvency proceedings, would normally govern their transaction with the multinational debtor.

Aside from the rather permissive exceptions detailed above, the "non-discrimination" principle as spelled out in the Model Law may be subject to further discussions. In the best-case scenario, the *lex concursus* may provide for no special ranking to foreign creditors and the latter's claims will be treated equally with domestic claims of the same category. However, because a number of domestic insolvency laws place foreign creditors in a low priority ranking, and since the Model Law does not establish any substantial priority rule, and far less so identifies special categories of foreign claims to which a law other than the *lex concursus* applies, the prospects of achieving this equal treatment under the Model Law seem rather bleak.

[78] *See* Berends, Comprehensive Overview, *supra* note 29, at 345.

In light of the exceptions that are stipulated in article 13, which substantially affect the reach of the non-discrimination principle, it may be argued that foreign creditors have little incentive to participate in foreign proceedings and should instead concentrate their efforts and resources on domestic proceedings, if any. That is to say, the possibility to file a claim before a foreign jurisdiction considerably loses its significance if there is no strict adherence to the non-discrimination principle, so as to ensure equal treatment between domestic and foreign creditors. Unfortunately, the Model Law gives too much leeway to the enacting forum to favour its domestic creditors; a purely territorial and continued practice to which the Model Law does not put an end. In this regard, the Model Law is lacking behind the Regulation, which not only ensures equal treatment between domestic and foreign creditors, but also in certain cases, allow foreign creditors to benefit from their "home treatment"[79] (*infra*).

2. Payment in Concurrent Proceedings

Other than the attempt to achieve equality between domestic and foreign creditors, the drafters of the Model Law included a further provision in order to ensure that equality is also achieved among creditors of the same class. Article 32 of the Model Law stipulates a "rule of payment in concurrent proceedings", according to which a creditor who has received partial payment of his claim in other proceedings against the same debtor cannot lodge his claim before the enacting forum, unless creditors of the same class have also received partial payment of their claim in the same proportion.

While this rule on payment, also known as the "hotchpot rule", is found in the Regulation under article 20, there are important differences between the Model Law and the Regulation in this regard. The first stems from the Model Law's silence with respect to the method of calculation that should be used in order to determine the paid and unpaid portion of each claim. Whereas the Explanatory Report provides for a pre-determined

[79] This means that certain categories of creditors, such as employees, would always benefit from their home priority ranking throughout the European Union, regardless of the forum before which the proceedings were opened.

method of calculation[80], so as to render the EU insolvency system more predictable and to ensure its uniform implementation from one forum to the other, the Model Law guide to enactment fails to provide for any such guidelines. As a result, under the Model Law, each enacting forum is entitled to apply its own method of calculation to determine – which portion of the creditors' claim has been satisfied when partial payment has taken place in the course of other proceedings and if creditors, who obtained partial payment in concurrent proceedings, will be entitled to lodge their claims before the enacting forum.

The second and more important distinction between the Model Law and the Regulation with respect to the application of the hotchpot rule arises from the applicable law to identify the different classes of creditors. As previously mentioned and more elaborated below, under the Regulation each forum automatically recognizes foreign classification of creditors. For instance, when the courts and laws of the country of opening recognize a creditor's claim as an employee claim, other forums within the European Union would be bound by such a classification, even though it was made pursuant to the provisions of a foreign law. This method is conducive to more equality, not only between creditors of the same class, but also between domestic and foreign creditors (*infra*).

By contrast, the Model Law entitles the enacting forum to "re-classify" each creditor who has obtained partial payment in other proceedings and who is subsequently seeking to obtain payment of the unpaid portion of his claim before the enacting forum. For example, an employee in state B may have received partial payment of his claim before the courts of that state, which affords a high priority ranking to employees' claims. When such an employee seeks to claim the outstanding amount of his claim before the court in state A (which is an enacting state), employee B stands the risk of neither being considered, nor treated as an employee according to the laws of state A. Hence, should the laws of the latter place the claim of the employee from country B at a low ranking,

[80] *See* Explanatory Report, *supra* note 17, at 175.

such as general non-preference claims[81], it may be that the employee from state B has already received a greater portion of his claim than other general non-preference claims. Thus, the employee from state B would, under the Model Law, be prevented from lodging his claim before the enacting forum.

In term, the implementation of the hotchpot rule under the Model Law entails the "re-classification" of creditors according to the provisions of the *lex concursus.* Although the rule on partial payment in concurrent proceedings aims at achieving equality among creditors of the same class, its concrete application would spawn further inequalities between domestic and foreign creditors. Indeed, creditors who have obtained partial payment of their claim in foreign concurrent proceedings are often, if not always, foreign creditors. As such, the re-classification of these creditors offers further means to the enacting forum to prevent foreign creditors from accessing and participating in the proceedings opened before it. Thus, foreign creditors will not be able to lodge their claims before the enacting forum and would not benefit from the liquidation proceeds of the debtor's assets located in the enacting forum.

The lack of a uniform method of calculation, along with the possibility to re-classify creditors who obtained partial payment in concurrent proceedings would increase the possibility of the enacting forum to discriminate against foreign creditors and would reduce the incentive of such creditors to lodge their claims in multiple forums[82]. This constitutes an important shortcoming of the Model Law insofar as it legitimises the territorial application of the liquidation proceeds, and impedes further cooperation among forums in the long run. This being said, this problem may be remedied through the inclusion of moderate choice of law provisions in the Model Law.

3. Models for the Treatment of Foreign Creditors

[81] *See* Model Law at art. 13.

[82] As seen under the Regulation, for the "hotchpot" rule to reach its intended objectives, special attention was given to the method of calculating the partially paid portion of each claim, and most importantly, to the acceptance of foreign classification of creditors.

Chapter Four.

In light of the different provisions of both the Regulation and the Model Law as studied above, it appears that achieving equal treatment between domestic and foreign creditors may call for several models. As it will be demonstrated, these models vary considerably from a tolerant insolvency system accepting foreign classification of creditors, to one that would result in the sole application of the *lex concursus* and the systematic re-classification and alienation of foreign creditors. The following sections will expose the characteristics of each model in order to determine how far the Model Law is behind the Regulation in terms of equality of treatment between domestic and foreign creditors.

a. Lower Priority Ranking

The first and perhaps most territorial among other models for the treatment of foreign creditors consists of conferring to foreign creditors, irrespective of the nature of their claim, a low priority ranking while conferring senior priority rankings only to domestic creditors. Such a system ensures that domestic creditors would always be the first to benefit from the liquidation of the debtor's assets located in the forum of opening. Although the Model Law does not directly advocate such an inequality of treatment between domestic and foreign creditors, its provisions remain too permissive[83]. Indeed, when the law of the enacting forum confers a low priority ranking to foreign creditors, the Model Law does not condemn such a disparity of treatment so long as certain conditions are met[84]. As previously stated, this system considerably affects the incentives of foreign creditors to lodge their claims in multiple forums.

In light of the objectives of the Model Law, it is difficult to comprehend how the marginalization of foreign creditors would improve cooperation among the forums involved in a cross-border insolvency case. Undoubtedly, this system will prove more detrimental in the long run, as foreign creditors will recurrently fail to obtain satisfaction of their claims before the enacting forum.

[83] *See* Model Law at art. 13 and the exceptions to the non-discrimination principle (*supra*).
[84] *Id.*

Furthermore, this system could well be misleading with respect to the objectives of the Model Law in fostering more cooperation, coordination and unity in managing cross-border insolvency cases. Placing foreign creditors at the bottom of the priority scale does not mean that foreign creditors are unable to lodge their claims before the enacting forum. Thus, this system cannot be considered as purely territorial in nature, insofar as foreign creditors have the right to lodge their claims before the forum of opening. At the same time, the unequal treatment between domestic and foreign creditors produces the same results in practice as if the enacting forum were applying a territorial "grab rule" and distributing the liquidation proceeds only to domestic creditors.

It should be mentioned however, that the drafters of the Model Law did not intend to encourage this approach. It is only by way of an exception to the "non-discrimination" principle that this method of dealing with foreign creditors' priority claims would be acceptable. The reason why the drafters of the Model Law did not foresee a strict non-discrimination principle free of any exceptions is unknown. This being said, a possible explanation to these exceptions is that a number of domestic insolvency laws allow the participation of foreign creditors in domestic proceedings, so long as the participation of these foreign creditors does not constitute any threat to the interests of domestic creditors[85]. This means that foreign creditors implicitly relinquish any priority of claim the law of their home country may have bestowed upon them in order to participate in foreign proceedings.

b. National Treatment

A second model for the treatment of foreign creditors calls for a simple application of the "non discrimination" principle as advocated under the Model Law, this time, however, without any exceptions. This means that foreign creditors are to be treated equally with domestic creditors of the same class. While such a system prevents the

[85] *See* Westbrook, Universal Priorities, *supra* note 4, at 30-31.

enacting forum from conferring a low priority ranking to foreign creditors, even when the *lex concursus* contains such provisions, there are two variants of this model.

The first requires that the determination of the class of foreign creditors[86] takes place pursuant to the criteria set by the *lex concursus*. For instance, a foreign creditor who is an employee of the multinational debtor could, upon the fulfilment of the criteria set by the law of the court of opening to qualify as an employee, be treated as a domestic employee of that forum. Unlike the previous model studied above, the re-classification of foreign creditors here takes place on an individual basis, rather than placing the mass of foreign creditors at a low priority ranking. Although this approach is bound to produce more equality between domestic and foreign creditors, it remains greatly subject to the provisions of the *lex concursus* and the different categories of creditors this law recognizes[87].

The second variant of this model entails no re-classification. The forum of opening simply accepts foreign classification of creditors as they are, and treats the latter as its own domestic creditors of the same class[88]. As it will be more fully discussed in the subsequent parts of this chapter, this system is built on the cross-priority of claims where the forum of opening does not re-assess the status of each foreign creditor pursuant to the provisions of the *lex concursus*. The recognition of foreign categories of claimants takes

[86] This classification is different from the first model studied insofar as the forum of opening would not assign a general ranking to foreign creditors irrespective of each individual claim. Rather, such a classification seeks to determine whether or not a given foreign creditor could be considered as a priority claimant pursuant to the criteria set by the *lex concursus*. In term, this approach waives any general ranking of foreign creditors that may be provided for under the *lex concursus*.

[87] But for the permissive exceptions in the Model Law (article 13) with respect to the non-discrimination principle, it could be fairly argued that the re-classification process reflects the initial intent of the Model Law's drafters. Although such a systematic reclassification pursuant to the provisions of the *lex concursus* may considerably affect the rights of foreign creditors, this practice may be regarded as an improvement compared to the current status of affairs where most domestic insolvency laws either confer an overall low priority ranking to foreign creditors (the first model of treatment), or in the worst case, forbid foreign creditors from lodging their claims in domestic proceedings (unavailability of cross-filing). Another risk may stem from the implementation of the *lex concursus* to determine the ranking of foreign creditors; that is when the forum of opening does not recognize certain categories of creditors, who enjoy preferential treatment by their home court.

[88] *See* Westbrook, Universal Priorities, *supra* note 4, at 30-31.

place quasi-automatically and the recognizing forum is compelled to treat domestic and foreign creditors of the same class equally. Such a system, which will be more thoroughly studied in the subsequent parts, is more commonly referred to as a "cross-priority" system.

c. Home Treatment and Special Choice of Law Provisions

The last model for the treatment of foreign creditors is by far the most progressive and ambitious amongst the models discussed above. This time, not only does the forum of opening automatically recognize foreign categories of creditors and treat such foreign creditors equally with domestic creditors of the same class, but also ensures that certain categories of creditors and/or claims receive the same treatment and ranking their home court would normally confer to them.

Despite the advantages that derive from this model, no international instrument has contemplated the creation of an insolvency regime that combines both cross-priority to the mass of foreign creditors (*i.e.*, a strict non-discrimination principle) and home treatment to certain categories thereof. The Regulation for instance, preserves the priority ranking of those special categories of claimants, which are typically protected by the legislator in their home country, without spelling out a non-discrimination principle vis-à-vis other categories of foreign creditors.

Despite the absence of the non-discrimination principle in the Regulation (*i.e.* ,cross-priority system), the latter has gained the support of EU member states by ensuring the home treatment to these special categories of claimants and made certain that each forum is more lenient towards cooperating with the forum of opening[89]. As seen, the various exceptions to the application of the *lex concursus* provided for under the

[89] This is true especially when one considers that these special categories of claimants usually emanate from sensitive public policy concerns in each state. Through conflict of law provisions, the Regulation has come closer to overcome the problems that arise from importing foreign social policies into the state of opening.

Regulation, through adequate conflict of law rules, could achieve in part a home treatment model[90].

In light of the different models the forum of opening may follow in determining the priority ranking of foreign creditors, it becomes more evident how the Model Law is far behind the Regulation as regards the equality of treatment between domestic and foreign creditors. Whereas efforts within the European Communities have, after 40 years of debate, yielded a system partially based on the home treatment of certain categories of foreign creditors throughout the EU, the UNCITRAL commission could not even ensure that even a partial national treatment model is unequivocally and without exceptions provided for under the Model Law.

While such a shortcoming is a hurdle in achieving equal treatment between foreign and domestic creditors under the Model Law, it is important to consider that even within the European Community and despite the strong commitment of each EU member state to the process of legal and judicial integration, reaching a consensus on the categories of foreign claimants that enjoy special treatment has been a long and uncertain process[91]. Indeed, the insolvency law of each member state of the EU contains diverse categories of creditors and different orders of priority ranking, which were difficult to reconcile on a community wide basis. By analogy, the determination of such categories on a global level may yield no concrete result in the short run[92], yet it is believed that following an EU pattern of choice of law provisions is a route that should not be

[90] This system achieves only partial home treatment because not all categories of claimants benefit from such a treatment; rather certain pre-determined categories of foreign creditors do enjoy this privilege.
[91] Therefore, it could be argued that the process of determining the most commonly privileged categories of claimants on a global level would prove even more difficult and uncertain than it was within the European Union. However, as it will be argued in the subsequent chapter of this thesis, the international community may today possess further incentives and additional tools in order to reach a more effective cross-border insolvency framework.
[92] Had the UNCITRAL working group attempted, a decade ago, to pursue a similar venture and identify those categories of claimants that are most commonly privileged in and by each forum, its efforts may have been bound to fail. It is believed however that today, the international legal infrastructure along with stronger incentives to address the difficulties that arise from cross-border insolvency cases, could contribute to the improvement of the Model Law. This argument will be more fully treated in Chapter Five.

discarded by the UNCITRAL commission, so as to remedy one significant shortcoming of the Model Law.

IV. Cross-Filing and Cross-Priority

A number of observations stem from the Regulation's method of handling the exceptions to the application of the *lex concursus*. The first pertains to the possibility of "cross-filing" within the European Union. This means that creditors - through the domestic liquidator - enjoy the right to lodge their claims wherever insolvency proceedings are initiated against their debtor. By doing so, they avail the determination of their rights and the priority of there claims to the application of the *lex concursus*[93]. It is therefore important to understand how the European cross-filing system works and how domestic courts treat foreign creditors with respect to priority claim issues. The study of this model in Section A below may suggest some improvements to the Model Law as regards the mechanics of cross-filing. A second observation relates to the concept of cross-priority as defined by Professor Westbrook. More precisely, the second section will analyse how the European insolvency regime effectively addresses the issue of conflicting priority claims and achieves equality among creditors, despite the absence of cross-priority provisions in the Regulation[94]. Lastly, after asserting the importance of conflict of law rules in determining the ranking of creditors, the third section will shed more light on the issue of "universal priorities". More specifically, whether the similarities between priority claims in the various domestic insolvency laws combined with a Universal cross-filing system would enable the creation of global system of priority claims that may be advocated by a revamped Model Law.

A. Access to the Foreign Representative and Cross-Filing

The possibility to cross-file a claim would considerably lose its purpose if the foreign representative were prevented from accessing the court before which proceedings

[93] Aside from the exceptions earlier exposed, the law of the state of opening will also determine the ranking of creditors, procedural and material rules that shall govern the administration of the debtor's estate.

[94] While the European insolvency regime allows cross-filing, it does not provide for cross-priority (i.e. national treatment to foreign creditors). Despite a strong universalistic character, the Regulation does not provide for local treatment to foreign priority claims. As Westbrook notes: "Universalism-territorialism and cross-priority vel non are independent variables".

are initiated. Thus, the issues of cross-filing and access to the foreign representative are closely related, if not interdependent. The subsequent parts will each study the availability of cross-filing and the ease of access to the foreign representative under both the Regulation and the Model Law.

1. Unconditional Access under the Regulation

The possibility for creditors to file their claims in forums other than their own is not a new practice in the realm of cross-border insolvency. The Model Law for instance, attempts to foster cooperation between courts located in different jurisdictions where a foreign representative *"is entitled to apply directly to a court"*[95] located in the enacting state. Another example is the former section 304 of the U.S. Bankruptcy code, which allows foreign representatives, after fulfilling some threshold requirements[96], to lodge the claims of foreign creditors before American courts. Other examples of cross-filing are also found in other jurisdictions[97].

This being said, the majority of countries do not recognize such a right, or in the best case, strict conditions are imposed on cross-filing, rendering this right practically impossible to exercise[98]. This practice reflects the strong hold of territoriality in handling

[95] *See* Model Law at art. 9. *See also* Chapter Two on the access of foreign representatives and creditors to courts.

[96] Former section 304 of the American Bankruptcy Code would allow the foreign representative to file a claim if the latter establishes that (1) a foreign proceeding has been commenced in the appropriate jurisdiction; (2) the petitioner has been duly appointed in the foreign proceeding; (3) the foreign debtor qualifies as a debtor under foreign law; (4) the foreign representative is authorized under foreign law to commence proceedings in the United States regarding the foreign debtor's property or the administration of the foreign debtor's estate and, if need be, the foreign substantive law has extra-territorial effect; (5) the foreign debtor has complied with at least one of the § 109(a) criteria; and (6) if need be, the debtor has assets in the relevant district (Note on Status of 304)

[97] *See* Goffman, A Comparative Examination, *supra* note 27. For a discussion on the recent changes in the German law of insolvency and cross-filing provisions, *see* Klaus Kamlah, The New German Insolvency Act: Insolvenzordnung 70 AM. BANKR. L.J. 417 (1996); for a discussion on the French Insolvency law, see Richard L. Koral & Marie-Christine Sordino, The New Bankruptcy Reorganization Law in France: Ten Years Later, 70 AM. BANKR. L.J. 437 (1996). See also Fujimoto Mie, Japan's New Law on Recognition of and Assistance in Foreign Insolvency Proceedings, ABI Journal, July/August 2001 at 14.

[98] On some of the logistical and material difficulties encountered by the foreign representative/creditors to lodge their claims or to obtain ancillary relief before US courts, *see* In re Papeleras Reunidas, S.A., 92 B.R. 584, 590 (Bankr. E.D.N.Y. 1988) (the Spanish representative was not entitled to ancillary relief because Spanish law/proceedings do not recognize certain US creditors' contingent claims). *Similarly,* In re

cross-border insolvency cases. The "grab rule" entails a purely domestic application of insolvency laws, where local assets are exclusively confined to satisfy the claims of local creditors. It is only after local claims are fully satisfied - which rarely occurs - that the court of opening may consider the transfer of the remaining proceeds to other forums. Thus, there is no room in the proceedings for the intervention of a foreign liquidator, far less so for the satisfaction of foreign claims.

Within the European Community, and more so beyond its boundaries, cross-filing is an attractive option to creditors in two situations. The first is when the multinational debtor possesses little or no assets in a given forum. Without the possibility to cross-file their claims, and pursuant to the rule of forgiveness[99], creditors located in that forum will be compelled to accept lower settlement sums than the value of their claim. Aside from affecting creditors' rights on a domestic level, this situation is likely to increase the inequality among creditors on a global level. This is particularly troubling when the insolvent debtor possesses valuable assets in other forums where domestic creditors might recover a higher portion of their claim.

Irrespective of a system founded on cross-priority, where foreign claims benefit from a national treatment (*infra*), ease of access to domestic courts would enable foreign creditors to receive, at the very least, a higher portion of their claim compared to what they would recover solely before their home court. Hence, cross-filing should be discussed in connection with the issue of access and the conditions imposed by each forum to allow a foreign representative to file the claims of foreign creditors.

Hourani, 180 B.R. 59 (Bankr. S.D.N.Y. 1995) (relief was denied because Jordanian liquidation proceedings provide for no "*adequate assurance of fairness*").

[99] *See* Edward J. Balleisen, Navigating Failure: Bankruptcy and Commercial Society In Antebellum America 28 (N. Carolina Press 2001), 522 (indicating that debt forgiveness is essential function of bankruptcy law); Nathalie Martin, Common-Law Bankruptcy Systems: Similarities and Differences, 11 AM. BANKR. INST. L. REV. 367, 410, (2003).

A second situation occurs when insolvency laws in the home forum does not allow the opening of insolvency proceedings against the multinational debtor[100]. Home creditors in this case would naturally turn to other jurisdictions where the debtor may possess valuable assets. If the forum where such assets are located ban the access to the foreign representative, then home creditors may, in practice, be prevented from cross-filing spawning further inequalities between those creditors who have the right to participate in the proceedings and those that are unable to cross-file their claims. The latter, with no immediate recourse against their debtor, will also be unable to apply for preservation measures before the forum of opening. In this respect, reference should be made to the European regime, which contains specific provisions allowing the opening of secondary proceedings before main proceedings are initiated and availing preservation measures to the mass of creditors, irrespective of their domicile.

In connection with the issue of cross-filing, it is understood how the access of the foreign representative, whether to participate in or to initiate foreign proceedings, is important. Such prerogatives enable foreign creditors to file their claims in multiple forums, and where the need for prompt action arises, allow foreign creditors to request preservation measures in the forum of opening. This is precisely why the Regulation spells out the rule according to which a foreign liquidator always has the right to participate in the proceedings held before the forum of opening, regardless of whether or not the law of that forum initially allows such an intervention[101]. Thus, the right of the foreign liquidator to participate in the proceedings held before the forum of opening is unconditional[102] and unsubordinated to the content of the law in the state of opening[103].

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[100] This situation may occur even when the debtor is on the verge of insolvency and might not be able to honor its obligations vis-à-vis its creditors. *See* "balance sheet" insolvency.

[101] On the possibility to cross-file a claim under the Regulation, despite that such a filing may be in breach with the provisions of the Lex Concursus, *see* in Re Cedarlease Ltd. High Court of Ireland, 8 March 2005 (2005 No.23 COS). The powers of the liquidator under the Regulation are determined pursuant to the law of the forum that appointed him and not according to the law of the forum where the liquidator seeks to intervene. *See* Regulation at art. 18. In this regard, it may be argued that the Regulation overrides any restrictive domestic provisions, which objective is to ban foreign liquidators from participating in domestic proceedings.

[102] It should be noted however that, the powers of the foreign liquidator would have to comply with the provisions of the *lex concursus*.

2. The Model Law: Achieving Uniform Access

Given the above mentioned arguments highlighting the usefulness of cross-filing in any given insolvency regime, it could be argued that the Model Law fails to provide the certainty to ensure that the foreign representative has an unconditional right to commence proceedings before the enacting forum.

Article 11 of the Model Law stipulates that the foreign representative possesses such a right *"if the conditions for commencing such a proceeding are otherwise met"* under the law of the state of opening. Unlike the Regulation, the Model Law does not reserve the right to commence proceedings only to the foreign main representative. This right is afforded to both main and non-main representatives, who may request the commencement of proceedings if doing so would facilitate the administration of the debtor's estate. Thus, the Model Law could, in theory, entail greater potential for the opening of proceedings in multiple forums, which would result in more cross-filling possibilities to foreign creditors[104]. This being said, a notable difference exists between the Model Law and the Regulation in this regard.

Although article 11 seems to grant an irrefutable right to both the main and non-main representative to commence proceedings, such a right remains subject to the national law in the enacting forum where the foreign representative wishes to commence such proceedings. Indeed, as noted in the Model Law's guide to enactment, many national laws deny the foreign representative the right to commence proceedings before

[103] Despite an unconditional right to participate in the proceedings, the Regulation provides that only the foreign main liquidator has the right to open secondary proceedings in other jurisdictions.
[104] As state above, the Regulation confers the prerogative of opening insolvency proceedings only to the main liquidator so as to limit the number of proceedings initiated against the same debtor, thereby endowing the EU insolvency regime with Universalistic traits. This approach was possible because member states to the EU accepted certain limitations to their judicial sovereignty, which is something difficult to achieve among countries less committed to achieve legal and judicial integration.

their courts[105]. When the law in the enacting forum contains such restrictive provisions, article 11 of the Model Law neither changes, nor overrides these provisions. As a result, the access of the foreign representative to the courts of the enacting forum is uncertain and the possibility for foreign creditors to cross-file their claims could be limited to situations where proceedings have already been initiated in the enacting forum[106].

Thus, the inability of the Model Law to override the provisions of the law in the state of opening may constitute an obstacle to foreign creditors to cross-file their claims. This could be especially harmful when the debtor has little assets in the home state of such creditors, or when domestic proceedings in that home state cannot yet be initiated against the debtor. Perhaps a desirable, though progressive amendment to the Model Law should be made to article 11 so as to endow the right of the foreign representative to commence proceedings in the enacting forum with more certainty, regardless of any contrary provisions that may exist in the latter's law. More realistically, the drafters of the Model Law could have attempted to provide for a non-discriminatory rule according to which, the foreign representative shall be subject to the same conditions as domestic creditors for the commencement of proceedings. As long as domestic creditors may commence the proceedings against the debtor, the foreign representative would enjoy that same right, subject to the same conditions.

By such a method, the access of foreign representatives to the courts of the enacting forum would be more certain and uniformly implemented amongst enacting forums, thereby increasing predictability and encouraging foreign creditors to take the lead in initiating proceedings against their debtor before multiple forums. Even if this approach produces fragmented territorial proceedings against the same debtor, it has the

[105] *See* Model Law's Guide to Enactment at 97.
[106] The Model Law's guide to enactment stresses that article 11 serves to give standing and procedural legitimisation to the foreign representative before the enacting forum. Undoubtedly, the law of the state of opening should always dictate the conditions for the commencement of proceedings. This is the primary premise upon which both the Regulation and the Model Law are founded. However, the drafters of the Model Law have attempted to confer a given right to the foreign representative and laid down the rationale for its exercise, whereas the exercise of such a right may not at all be available to the foreign representative pursuant to the provisions of the *lex concursus*.

merit of enabling foreign creditors to either cross-file their claims, or to obtain prompt conservatory measures when the circumstances so require.

Although the benefits of cross-filing may seem marginal compared to the advantages conferred to foreign creditors pursuant to a cross-priority system, justice and equality objectives would be better served on the global level if countries followed uniform and predictable rules enabling the filing of foreign claims before national courts. This would constitute a substantial step towards cooperation in cross-border insolvency cases. Recent developments in international and domestic insolvency principles seem to head in this direction, where acknowledging that foreign creditors may have legitimate expectations and an undisputed right to participate in the proceedings is a pre-requisite for effective coordination among courts located in different countries.

This being said, Professor Westbrook argues that a cross-filing system would be more beneficial to foreign creditors if associated with a cross-priority scheme. The interplay between the two systems would, to a greater extent, produce the same effects as a system built on modified Universalism. While this assumption is probably true, it does not imply that the combination of cross-filing and cross-priority is the only way to achieve a satisfactory result. The Regulation for instance, allows cross-filing and does not provide for cross-priority, yet the insolvency system it created within the EU Community is nonetheless promising and deserves further analysis.

B. Enhanced Cooperation through Cross-Priority

Cross-priority is a system where foreign creditors are treated as local creditors with respect to the distribution of the liquidation proceeds. In other words, foreign creditors benefit from the same priority of claims domestic creditors of the same class enjoy. For instance, an employee in country A will be entitled to file a claim against the employer (debtor) in multiple forums (cross-filing). The court in country B before which the claim is lodged grants the same priority of payment to the employee from country A as it would to employees from country B. As discussed above, cross-priority compels

domestic courts to recognize foreign categories of creditors and treat them as domestic creditors of the same category.

1. Pre-requisites of a Cross-Priority System

Although cross-priority facilitates cooperation between domestic courts on the global level, a domestic insolvency regime that grants "national treatment" to foreign claims does not seem to exist. The issues of priority and the need to protect domestic creditors have long impeded the creation of a more equitable approach to multinational's insolvency. Professor Westbrook argues "*the discussion of priorities with cross-border insolvencies has been to note the difficulties that variations in priority present for harmonization or cooperation*"[107]. To highlight this problem, he envisages the application of cross-priority to both the Universal and Territorial insolvency regimes, and concludes that such a system would systematically result in a substantial degree of predictability and equality among creditors under either regime[108]. Thus, according to Professor Westbrook, cross-priority in cross-border insolvency cases would be the most effective method to address the differences between the various domestic priority claims.

While the analysis advanced by Professor Westbrook brings forth a number of advantages associated with a system that implements cross-priority, the difficulties he refers to arise from the differing categories of claimants and priority rankings that exist in each forum. As a consequence, non discriminatory treatment of foreign creditors would not only require the forum of opening to cast off all patriotic considerations, but would also require that priority rankings between countries are identical. Without such pre-requisites, the forum of opening may be led to grant foreign creditors more rights than would their home court, while impeding the rights of its own domestic creditors.

If for instance, the law in a given forum granted employees a fourth priority ranking and the law in the state of opening grants its employees a first priority ranking,

[107] *See* Westbrook, Universal Priorities, supra note 4 , at 30-31
[108] *Id.*

the implementation of a cross-priority system in the state of opening would compel the latter to treat foreign employees on a first priority basis, ("national treatment") despite the lower priority their home forum would have conferred to them. In turn, and as noted by Professor Westbrook, unless priority rankings among countries are identical, the implementation of a cross-priority system will increase the discrimination between classes of creditors, rather than between domestic and foreign creditors[109].

Although most countries have in common certain categories of claimants that are privileged as regards the distribution of proceeds, the underlying public and social policy requirements in each forum produce different priority rankings, no matter how slight such differences may be. Thus, a cross-priority model will always amplify the inequalities on the domestic level between the different categories of claimants, thereby advancing further reasons for its rejection by most jurisdictions.

Insofar as each country has its own priority rankings, a system of cross-priority may seem difficult to implement. The drafters of the Model Law for instance, have allowed considerable exceptions to the application of the non-discrimination principle because it was understood and agreed that affording national treatment to foreign creditors would imply that harmonization among the various insolvency laws is well-underway. This, unfortunately, is not the case and it may take long before policymakers in each country perceive and handle insolvency related matters, including the issue of priority claims, in the same manner.

A last testimony to the rather difficult implementation of a cross-priority system lies within the EU insolvency regime itself. The EU model illustrates that even a substantial degree of legal, social and political integration among EU member states is insufficient to shape an insolvency regime that would enforce the non-discrimination principle throughout the EU community and favour foreign creditors with national treatment. Instead of pursuing the seemingly difficult objective of implementing cross-

[109] *See* Westbrook, Universal Priorities, *supra* note 4, at 31.

priority within the EU community, the Regulation focused on a more pragmatic and feasible choice of law provisions, whereby certain categories of foreign claimants still enjoy their home priority ranking.

2. The EU Alternative to Cross-Priority

Although some of the exceptions to the application of the *lex concursus* have been discussed above, along with their underlying rationale, it is important to understand how the overall EU priority system operates and how the Regulation has created an alternative model to cross-priority, while fostering cooperation among European forums. As previously mentioned, the Regulation allows cross-filing through the liquidator in charge; yet it contains no specific provisions regarding the equal treatment of foreign creditors. Cross-priority is not applied within the European insolvency regime.

Instead, the Regulation designates the foreign law that typically determines the priority of the aforementioned claims[110] through conflict of law rules. It identifies a number of privileged (unsecured) categories of creditors to which the application of a law other than the *lex concursus* would be possible, and sometimes even compulsory. This method circumvents the establishment of cross-priority within the European insolvency regime. The court of opening will apply the law that creates these priorities to certain foreign claims, thereby ensuring that foreign creditors' rights and predictability are secured throughout the community.

It can be argued that this alternative model to cross-priority complicates insolvency proceedings and may burden domestic courts with the application of foreign laws. While this may be true, it should be noted that the European alternative to cross-priority presents the same advantages as the home treatment model studied above. This system offers a substantial level of protection to the most sensitive categories of creditors, with respect to the priority of their claims. It also increases the chances of creditors to

[110] Instead of opting for cross-priority per se and exporting a pre-established categorization of creditors to the court of opening, the Regulation chose to keep the priority claim of certain creditors under the protective shelter of their domestic law.

collect from foreign insolvency proceeds when the debtor has little or no assets located within the reach of their home court. Finally, this method increases the incentives of at least certain categories of claimants to cross-file their claims, without imposing pre-established categories of foreign creditors on domestic courts. The court of opening simply accepts the classification of foreign creditors that took place pursuant to the provisions of the foreign law[111] and applies priority rules contained in such a law.

Undoubtedly, the European insolvency regime was adeptly designed to accommodate priority claims in more than one country and to find an acceptable compromise among several forums so as to ensure their cooperation in resolving cross-border insolvency cases within the EU Community. Perhaps the most interesting provisions in the Regulation pertain to the choice of privileged categories of creditors and claims that should receive home treatment when the multinational debtor is subject to insolvency proceedings in multiple forums. Because the Model Law fails to provide for an effective system to handle priority issues, foreseeable improvements in this regard may require choosing between a system of cross-priority and an alternative system based of conflict of laws (such as the EU insolvency regime). In light of the current structure of the Model Law and the various public policy issues that arise under the different domestic insolvency laws, the following section will attempt to shed light on the most effective and realistic path to follow in order to enhance the Model Law, and to make it more responsive to priority issues.

C. Prospects under the Model Law

After establishing that the Regulation has come closer than the Model Law to achieving a system rooted in transparency, predictability and equality between domestic and foreign creditors, it may be appropriate to envisage potential methods whereby the Model Law can be enhanced. As such, one obvious approach may be the establishment of a universal system of cross-filling/cross-priority so as to ensure equal treatment between

[111] When the court of opening applies the provisions of the foreign law for the classification of creditors, it creates a certain atmosphere of trust and confidence in the proceedings. Thus, there is an important psychological effect that ensues from that method, even if in certain cases, the allocation of proceeds is not much enhanced to the benefits of foreign creditors.

domestic and foreign creditors. Although such an approach would present many advantages, several arguments discredit its feasibility, at least in the short or medium term. The second approach, which is an alternative to a universal cross-filling/cross-priority scheme, could be similar to the EU model and equally based on a conflict of law solution. The subsequent parts will explore the possibility to implement either approach under a revamped Model Law.

1. Towards Universal Cross-Priority?

As traditionally argued by scholars and academics, the idea of an international order of priorities is appealing[112]. Certainly, the creation of such a worldwide consensus would significantly improve the prospects for a coherent global cross-border insolvency regime, where the distinction between domestic and foreign creditors, along with the identification of the applicable law to govern priority claims would no longer be necessary. This would be the academic ideal to handle cross-border insolvency cases more equitably.

However, in light of the current international legal infrastructure, one can only propose and reflect on a more modest and realistic approach, whereby cross-filing and cross-priority could find a broader scope of application among the different jurisdictions. Therefore, it is important to enquire how likely an international instrument, such as the Model Law, can provide for a global insolvency system based on the cross-filling and cross-priority of claims.

As previously mentioned, most countries place the same categories of claimants at different rankings nonetheless, on the top of their priority list. These are mainly employees, tax authorities and those who have incurred administrative expenses in relation to the proceedings[113]. While each of these categories has an underlying rationale

[112] *See* Westbrook, Universal Priorities, *supra* note 4, at 30.
[113] Stephen D. Hurd, Re-reading Reading: "Fairness to all persons" in the context of administrative expense priority for post-petition punitive fines in bankruptcy, 51 VAND. L. REV. 1459, 1485 -1486 (1998);

justifying its privilege and priority of treatment, a number of other "country-specific" categories exist for which no objective reason, other than national and/or social considerations, justifies such a privilege[114]. As a consequence of these unique categories that exist in almost every jurisdiction, and despite the core similarities between countries regarding the main categories of privileged creditors, a system based on the cross-priority of claims and on a far off vision that would implicate "national treatment" of foreign creditors may seem hardly achievable[115].

Indeed, the first problem that may arise under such a system is that a special category of claimants in one jurisdiction may not be privileged pursuant to the laws of another forum, if at all recognized. In this case, national treatment would mean little to those privileged categories of foreign claimants because the forum of opening would treat them as general creditors who do not deserve any priority.

Furthermore, as stated above, building a system on cross-priority requires that forums have the same categories of privileged creditors that enjoy the same priority ranking. Otherwise, the enforcement of cross-priority may spawn more discrimination among the various classes of creditors. Until today, no domestic insolvency regime has given priority to foreign creditors over its domestic creditors. For this reason, a global cross-priority approach, which would in fact result in the favouring of certain classes of foreign claimants over domestic creditors, would not garnish much support from policy makers and insolvency scholars.

For instance, the European Union is a great example of the irreconcilable priority interest between nations. Even in the European insolvency system, where striking similarities exist between the various domestic insolvency laws regarding the main

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Barbara K. Morgan, Should the sovereign be paid first? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy, 74 AM.BKR.L.J. 461-467 (2000).

[114] *See* Westbrook, Universal Priorities, *supra* note 4, at 31.

[115] *Id.* at 37-38.

categories of privileged creditors[116], no cross-priority regime could be created. The EU Regulation could only remedy this problem and foster cooperation through the exceptions to the application of the *lex concursus* and by ensuring that creditors have the right to lodge their claims in multiple forums. This constitutes a strong inference that a cross-priority system cannot be implemented globally, and that the potential advantages that may derive from such a system are only theoretical at this stage.

In actuality, the Regulation sheds light on the implausibility of a cross-priority system because it only aims at increasing the level of cooperation between EU member states, rather than harmonizing domestic insolvency laws[117]. The drafters of the EU Regulation chose not to harmonize domestic insolvency laws because such a task - aside from being difficult - would have led most EU countries to reconsider their public and social policy choices that underlie their insolvency laws. The same process would apply to the international community, should an international cross-priority system be contemplated.

In light of the above, a realistic improvement of the Model Law cannot entail the creation of a cross-priority system[118]. Although such a system would, in theory, yield more advantages to the insolvent multinational's stakeholders than any other insolvency regime, its feasibility remains questionable at best[119]. For instance, the Regulation did not provide for cross-priority to foreign categories of claimants, and simply sought to establish mindful conflict of law rules; thereby striking an equitable balance between domestic public policies and the interests of foreign creditors. This has helped foster European integration, while faithfully realizing the objectives of the EEC treaty.

[116] *See* Balz, The European Union Convention, *supra* note 14, at 485.
[117] Judge Samuel L. Bufford *et al.*, International Conventions And Other Sources Of International Bankruptcy Law: European Union Regulation on Insolvency Proceedings, INTINSOLV IV.C (2001)
[118] *See* Westbrook, Multinational Enterprises, *supra* note 44, at 35.
[119] Although such a system might seem unrealistic today, the regional convergence and impact of global insolvency proceedings may prod the international community in that direction. As a good example of regional integration in the field of insolvency, *see* Am. L. Inst., Principles of Cooperation in Transnational Insolvency Cases among the Members of the North American Free Trade Agreement (2002).

Chapter Four.

Professor Westbrook's article entitled "Universal Priorities[120]" indirectly implicates the impossibility of creating a truly universal priority order. In his article, he stresses that a number of countries have the same categories of privileged creditors and explains how best the combination of cross-filing and cross-priority would serve the interests of these creditors[121]. Perhaps if nations could afford cross-filing, along with cross-priority to foreign claimants in the long run, it would significantly improve the prospects of creating an effective cross-border insolvency regime. In the meanwhile however, one should not disregard the EU alterative to a cross-priority system, namely an insolvency regime that contains elaborate conflict of law provisions.

2. A Foreseeable Choice of Law Solution

In essence, the UNCITRAL commission sought to obtain the commitment of the highest number of countries by drafting a flexible and non-binding Model Law. Such an objective was achievable so long as each forum can treat foreign creditors in the manner it sees fit. There are no obligations under the Model Law to treat domestic and foreign creditors of the same class equally and far less so, to grant foreign creditors their home country priority of claim. As a consequence, the Model Law fails to offer an acceptable degree of protection to foreign claimants, thereby foregoing stronger commitments on behalf of each enacting forum to cooperate when circumstances so require. As seen, the degree of cooperation under the Model Law always depends on the provisions of the *lex concursus* and the discretion of each forum to accommodate foreign claims. Because such a system has, over almost a decade, changed little of the primary territorial approach in resolving transnational insolvency cases, one should consider the alternative choice of law models, as adopted by the Regulation, and further enquire on its feasibility, practicality and the advantages that may ensue from its implementation under a revamped Model Law.

[120]It should be noted that the term "universal priorities" is misleading because a prospective global "cross-priority" system would not aim at harmonizing domestic insolvency laws. Domestic social policies need not be reviewed in order to create a global cross-priority model; adjudicating courts would simply recognize the status of foreign privileged creditors in the course of the proceedings. Their actual priority of payment however, would not be that of their home country; rather, the proceeds from liquidation would be distributed pursuant to the laws of the adjudicating forum.
[121] *See* Westbrook, Universal Priorities, *supra* note 4, at 43.

A choice of law solution to overcome the problem of priority claims implies that the Model Law provides for certain exceptions to the application of the *lex concursus*. In other words, in certain instances, and with respect to pre-defined categories of foreign claimants, the enacting forum may be required to apply the provisions of a foreign law, including its classification of creditors and their priority rankings, notwithstanding any contrary disposition in its domestic law. As under the Regulation, this approach ensures that certain categories of creditors enjoy their home priority ranking, even before foreign courts. As noted by Professor Westbrook however, under a dominantly territorial system, the most internationalist policymaker would not apply a foreign law unless there is a compelling reason to do so[122]. Thus, the possibility to include elaborate choice of law provisions under an enhanced Model Law, where the enacting forum could occasionally apply a foreign law, would arise out of necessity rather than choice.

Although achieving equitable and fair insolvency proceedings may theoretically seem a compelling reason for the application of a foreign law, concepts of equality and fairness are seldom taken into consideration by the domestic policymaker[123]. As discussed in the previous Chapters, potentially compelling reasons based on reciprocity, rough wash or prisoner dilemma arguments have not prodded forums to adopt a fairer approach to resolve cross-border insolvency cases, and far less so to apply a law other than their own to safeguard the rights of foreign claimants. Rather, what has proven effective in triggering the responsiveness of a given forum is the necessity to protect domestic creditors, especially the most fragile.

As such, where a number of domestic social policies favour the same categories of claimants, it can be argued that each forum desires to ensure that such a protection is extended to these special categories of creditors, even before foreign courts. In the case of employees' privileges for instance, the domestic legislator will certainly want domestic

[122] *See* Westbrook, Universal Priorities, *supra* note 4, at 40.
[123] *Id.*

employees to enjoy their home priority ranking before domestic courts, as much as they would before the courts of another country. Hence, the objective of protecting special categories of creditors is independent from the location of the court of opening. This is the premise upon which the Regulation was built, which presumes that countries share an equal interest in protecting their most fragile trenches of creditors and ideally ensure that such classes benefit from their home priority ranking throughout the EU community.

Based on such an assumption, it could well be feasible to include special choice of law provisions in the Model Law, requiring the enacting forum to set aside the application of the *lex concursus* in favour of certain categories of foreign claimants. The latter may accept such progressive provisions not in the objective of protecting the interests of foreign creditors, rather to maintain the home priority of its own creditors when their claims are lodged in foreign jurisdictions where the debtor may possess more valuable assets. Such a rationale is similar to the rough wash argument presented by Professor Westbrook[124], except that in the present situation, neither a stay nor a deference of proceedings would be required from the court of opening. Instead, the court of opening could be required to apply a law other than the *lex concursus*, in order to determine the ranking of a few categories of foreign claimants.

Although a medium term solution to the issue of priority may lie within effective choice of law provisions, the identification of those special categories of creditors and claims may prove the most difficult at this stage. As noted in the various discussions leading to the final version of the Model Law, there exists a potential for at least certain categories of claimants to enjoy special treatment, irrespective of the domestic law in the forum of opening[125]. Perhaps, as highlighted by Westbrook, a case for choice of law rules, along with cross-filing and cross-priority, could be made as the "*most urgent item on the international reform agenda*".

[124] *See* Jay Lawrence Westbrook, Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum, 65 AM. BANKR. L.J. 457, 464-465 (1991).
[125] One obvious class of creditors that may benefit from the home priority ranking is employees.

V. Conclusion

The above analysis of choice of law provisions under the Regulation illustrates how predictability and cooperation among forums may be improved, even without any deferral to foreign proceedings and/or transfer of local assets to foreign courts. While these provisions entail that the court of opening applies, in specific instances, a foreign law, thereby foregoing the simplicity of applying its own law, the rights of certain categories of domestic and foreign creditors would be better preserved with this method.

For obvious reasons, the protection of foreign creditors, along with the issue of priority claims, was discussed at length by the UNCITRAL working group[126]. Various provisions of the Model Law reflect the correlation between the rights of foreign creditors and the extent to which each forum would be willing to cooperate. Nevertheless, a decade ago when the future of the UNCITRAL initiative was uncertain, neither cross-priority nor conflict of law rules could be contemplated by the working group so as to foster cooperation and to improve predictability. In this respect, the contribution of a fairly recent insolvency instrument, such as the Regulation, was to show that an effective cross-priority system requires significant harmonization among the various domestic insolvency laws, especially in relation to their priority ranking dispositions. Despite a number of international initiatives aimed at identifying best practices and principles in the area of cross-border insolvency, it is unlikely that a sufficient degree of harmonization is attainable in the near or medium term, so that a cross-priority system becomes feasible.

As the advantages that may derive from cross-priority remain theoretical to this day, attention should be given to an alternative and more realistic system to overcome the problems related to the priority ranking of foreign claims. A system based on conflict law rules may provide for a medium term solution where each forum could ensure that its most fragile classes of creditors enjoy their home priority treatment, even in the course of

[126] *See* Report of the Working Group on Insolvency Law on the Work of the Eighteenth Session, U.N. GAOR, 29th Sess., at 5, U.N. Doc. A/CN.9/419 (1995); Report of the Working Group on Insolvency Law on the Work of the Nineteenth Session, U.N. GAOR, 30th Sess., at 5, U.N. Doc. A/CN.9/422 (1996); Report of the Working Group on Insolvency Law on the Work of Its Twentieth Session, U.N. GAOR, 30th Sess., at 5, U.N. Doc. A/CN.9/433 (1996).

proceedings held before foreign jurisdictions. Perhaps the most difficult task in this respect is to identify which categories of claimants do the various domestic laws commonly favour the most, and how the Model Law can ensure that such categories enjoy special treatment before any enacting forum.

Finally, it should be noted that potential improvements to the Model Law and its prospects of further maturing, depend on many factors. The first is the incentives and willingness of the UNCITRAL commission to refine the objectives of the Model Law, increase its effectiveness as regards the issues it already covers, and broaden its scope to unaddressed problems directly arising from the default of multinationals. Second, it is important to acknowledge the role of comparative studies in the area of cross-border insolvency and the useful lessons that may be drawn from other regional and/or international efforts and initiatives. This and the previous chapter have attempted to draw such lessons, while taking into consideration the policy underpinnings of the Model Law. And finally, the maturity of the Model Law also depends on finding complementary or alternative vehicles and/or institutions capable of channelling meaningful reforms in the area of cross-border insolvency.

Chapter Five.
Concluding Observations: Instrumental and Institutional Solutions to the Cross-Border Insolvency Dilemma

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I. Introduction

As developed throughout the previous chapters, the EU insolvency system is built substantively upon a series of measures and provisions that were debated for a long time among insolvency scholars and practitioners. Indeed, the long-known approach of allowing the opening of two sets of proceedings (main and secondary), and the application of adequate conflict of law rules are the key substantive approaches shaping the EU insolvency system. It has been suggested that various lessons might be learned from the EU substantive provisions in revising and enhancing the UNCITRAL Model Law.

In parallel, it has been explained how the EU Regulation, through a rather pragmatic approach but within a special "quasi-constitutional" environment, fosters a substantial degree of cooperation among member states. Although the Regulation does not establish, nor seek harmonization among the various domestic insolvency laws, it creates a predictable set of rules to deal with the default of multinational debtors. Further, the Regulation can be implemented and enforced with certain ease, while ensuring the

protection of domestic and foreign creditors, which in turn has resulted in the first binding regional arrangement of its kind. The author recognizes that it is most improbable that the special "quasi-constitutional" framework and related legal instruments of the EU can be translated or transplanted into an international insolvency regime; but, the key point the author wishes to make is that regularized interstate judicial cooperation and cross-border enforcement needs to be pursued pragmatically under any revamped international insolvency structure through whatever existing internal instruments and vehicles that might possibly be available. In this latter context, this Chapter attempts "to stretch" in consider what these possible instruments and vehicles might be. The author does not believe this "stretch" is an unrealistic one in the medium-term as he will discuss further in this chapter the impact of *globalization* on economic markets may be bringing to the surface new instruments and vehicles that might be utilized in advancing an international insolvency regime.

In order to capitalize on the possible lessons from the Regulation and to assess the potential of achieving similar or approximate results under a revamped Model Law, however, one may need to follow a deconstruction mechanism[1] so as to identify the steps that led to the success of the EU insolvency system. A first step might be to determine what legal notions, precepts and compromises are needed to accomplish what the Regulation has achieved. Previous chapters have attempted to fulfil this task and have highlighted these legal principles and have analysed their rationale, drafting and effect among EU member countries, along with the limitations of the Regulation.

[1] Such a mechanism is believed vital because a mere analysis of the "black letter law" is insufficient to fully justify the results achieved under the Regulation. Indeed, previous tentative instruments - either regional or international - have failed to create such a degree of cooperation among courts located in different countries. It is ever more surprising that such previous legal undertakings contained similar provisions to those stipulated in the Regulation. In other words, the Regulation did not create new legal concepts; rather, it created a binding insolvency framework where forums are obliged to cooperate with one another. Even if one assumes the Regulation fashioned new legal precepts, such as original avoidance power rules and the manner whereby it avails an alternative to a cross-priority system, it remains uncertain why cross-border insolvency proceedings are most effectively handled within the EU and not elsewhere. This is why one should consider additional factors - other than the Regulation, its principles and drafting - that have contributed to the creation and effectiveness of the EU insolvency system.

Chapter Five.

A second step might consist of identifying what additional factors have contributed to the apparent viability of the Regulation and whether the international community possesses similar incentives and tools to address the shortcomings of the Model Law. This Chapter will undertake this task by positing that while the EU insolvency regime relies on the motivation of each individual state to realize the objectives of the EC Treaty and to establish an "internal market" conducive to liberalised investments, trade and corporate activities; the international community - nowadays pursuing those very objectives and pressured to face the rapid pace of globalisation and its demands - might be able to use the current international legal infrastructure to find the incentives, instrumental and institutional support to enhance the Model Law and to endow the latter with the necessary "binding" effect it currently lacks and otherwise to significantly generate the needed degree of interstate judicial cooperation on insolvency matters.[2].

Differently said, the creation of a global insolvency regime, whether or not under the form of a revamped Model Law, may rest on the "de facto" international market resulting from globalisation and from the drive to create a more liberalised international environment that promotes trade and investment. Even without a legal instrument, comparable to the EC treaty, that creates an "internal market" on the global level, there still may exist alternative instrumental and institutional vehicles through which certain improvements to the provisions of and some form of "binding" component to the Model Law might be channelled[3].

The first part of this Chapter will treat a shortfall of the Model Law, namely the Model Law's failure to provide for an automatic, or quasi-automatic, system for the

[2] Although this Chapter will not propose the definitive components of a binding insolvency treaty, it will envisage certain instruments and institutions that could, possibly through the Model Law, facilitate the enactment of more responsive cross-border insolvency principles or framework.
[3] *See* Westbrook J. Lawrence, A Global Solution to Multinational Defaults, 98 MICH. L. REV. 2276, 2328 (2000) [hereinafter Westbrook, Global Solution] (arguing that "It is highly significant that the EU Regulation states that its adoption is necessitated by the integration of the internal market...that is, as the market moves toward global dimensions, insolvency law must also become steadily more global.").

recognition of foreign insolvency judgments[4]. This stands in stark contrast with the Regulation, pursuant to which, insolvency judgments rendered by European courts are readily recognizable and enforceable in and by other European forums.

The second Part will consider bilateral trade and investment treaties as possible conduits for the Model Law to further mature. Since the insolvency process of large multinationals can affect the objectives sought by such treaties[5], it is suggested for further consideration that using these bilateral instruments to achieve meaningful reform in the area of cross-border insolvency might be feasible. To do so, this Part will highlight the correlation among insolvency, trade and investment, will seek common grounds for tying such areas together and will evaluate preliminarily the contributions of such a linkage on a bilateral (or regional) level. In turn and ideally, the Model Law could be enforced by and against sovereign states through such instruments, which would constitute a milestone in reducing the discretion of the enacting forum to recognize and to enforce foreign insolvency judgments.

To maximize the benefits from an improved Model Law, without legal distortions and misapplications from one forum to the other, the EU experience appears (at this early stage in its active history) to demonstrate that a central judicial authority is desirable for preventing non-compliance and for ensuring uniformity of implementation. Under the European model, the European Court of Justice (ECJ) is designed to fulfil this role. The extent of the ECJ's powers has made most - if not all - legal undertakings within the European Union feasible[6]. Therefore, the last Part of this Chapter will highlight the

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[4] On the distinction between the recognition of foreign proceedings and the recognition of foreign insolvency judgments, see Chapters Two and Three.

[5] Insofar as BITs and FTAs aim respectively at easing market access to foreign investors and facilitating free trade, the insolvency of a multinational corporation can produce considerable ex-ante effects on the latter's decision to integrate a foreign market or to engage in trading activities beyond the borders of its home country. *See* Chapter One "the effects of insolvency laws on investment incentives".

[6] It should be noted that compliance with EU regulations was not always ensured; the primacy of EU regulations over domestic laws was necessary. Therefore, the relationship between Community and domestic laws should not be disregarded. This will broaden the debate to the issue of compliance with international legal standards and how a global insolvency arrangement may fit within this complex mechanism. Indeed, the externalities created by the formation of an EU internal market have empowered

institutional channels that might contribute to the enhancement of the Model Law, with special emphasis on the role of a central judicial authority in promoting and supervising the implementation of sound cross-border insolvency principles. Also importantly, this Part enquires into whether an institution, such as the World Trade Organization (WTO) and its Dispute Settlement Body (DSB), might play some form of role in regards to this process. Primary attention will be drawn to the trend of adopting an "international public law" approach so as to find practical and medium-term solutions to private international law issues.

II. Recognition and Enforcement of Insolvency Judgments

The EU Regulation, although not flawless, seems to create a viable insolvency regime among EU member states. Though substantively sound, the functionality of this system, however, relies on the EU internal market and the legal instruments that contributed to its development, on a special mechanism for the automatic recognition and enforcement of judgments[7] and on a central judicial authority, such as the ECJ, to ensure that domestic courts duly implement the Regulation. Therefore, the first section of this Part II will highlight the peculiarities of the EU internal market along with its governing instruments. The second section will explain this automatic system of recognition, which ensures a uniform application of the Regulation throughout the EU Community. And the third section of this Part II will draw attention to the important role of the ECJ in supervising domestic judiciaries in regard to their implementation of Community laws and norms. Again, while the author does not envision the replication of this special EU framework on a global basis, he does suggest that lessons can still be learned as to how better to achieve enforcement mechanisms and greater interstate judicial cooperation

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the ECJ and assigned primacy to European Union laws over domestic laws. This might also explain the success of the Regulation, which requires minimal judicial supervision (*infra*).

[7] *See* Bob Wessels, European Union Regulation on Insolvency Proceedings, 20-NOV.AM. BANKR. INST. J. 24, 31 (2001) [hereinafter Wessels, European Union Regulation]. *See also* Ian F. Fletcher, The European Union Convention on Insolvency Proceedings: An Overview and Comment, With U.S. Interest in Mind, 23 BROOK. J. INT'L L. 25, 35 (1997) [hereinafter Fletcher, The European Union Convention]

Chapter Five.

A. The EU Internal Market and its Governing Instruments

To understand the reasons underlying the success of the European insolvency regime, one cannot neglect the importance of the European internal market. Early European instruments refer to the creation of this market[8] and have since enunciated a number of principles to ensure its proper functioning[9].

Alongside the measures taken to create this common area of free trade and services, European institutions, as much as member states, endeavoured to provide the most suitable legal and regulatory framework in support thereto. On the Community level for instance, an impressive number of regulations and directives were promulgated to address various issues pertaining to the economic and social impact resulting from this undertaking[10]. On the domestic level, governments were required - pursuant to the EC treaty[11] - to prevent any conflicts that may arise between their individual interests and the objectives sought by the internal market.

Although these ongoing concerns have been grappled with for over four decades, an effective, albeit late, agreement on cross-border insolvency proceedings could be reached within the Community recently. The very process of reconciling Community objectives with domestic legal traditions - also known as the integration process - has in turn permitted the adoption of an insolvency regulation acceptable to all participants.

[8] The Treaty Establishing the European Economic Community [EC Treaty], art. 8a, para. 2, as amended by the 1987 Single European Act [SEA], defined the internal market as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty." *See* Pieter VerLoren van Themaat, Some Preliminary Observations on the Intergovernmental Conferences: The Relations between the Concepts of a Common Market, a Monetary Union, an Economic Union, a Political Union and Sovereignty, 28 COMMON MKT. L. REV. 291, 293 (1991).

[9] *See* Trevor C. Hartley, The Foundations of European Community Law 138 (3rd ed. 1994) [hereinafter Hartley, Foundations].

[10] There are basically two approaches whereby European Institutions can ensure the construction of the European Union and its proper functioning. These are either harmonizing European domestic laws or by promoting cooperation among European countries. *See* Udo Di Fabio A European Charter: Towards a Constitution for the Union, 7 Colum. J. Eur. L. 159, 160 (2001); Horatia Muir Watt, Choice of Law in Integrated and Interconnected Markets: A Matter of Political Economy, 9 COLUM. J. EUR. L. 383, 397 (2003).

[11] *See* EC Treaty at art.2. Available at http://europa.eu.int/eur-lex/lex/en/treaties/dat/12002E/htm/12002E.html (last visited March 2006).

This was possible to achieve because of the European legal system, which is formed by both primary and secondary sources of law[12]. Primary sources consist of all the constitutive treaties and their periodic amendments, which enjoy the highest hierarchic ranking and form the core of the European legal system. Secondary sources correspond to norms negotiated and agreed upon between European countries and are issued by European institutions. Subject to article 249 of the EC Treaty, they can either be of a binding or unbinding nature. For the purpose of this thesis however, only binding norms will be considered, as these norms gave structure to the European internal market and imposed fundamental rules on participating member states.

Perhaps the most powerful instrument European institutions dispose of is the regulation. Indeed, a regulation is the most chief method to ensure the proper functioning of the internal market, as a regulation presents a number of attractive characteristics that would compel all European countries to abide by its provisions. The regulation is not subject to any amendments and far less so to selective implementation. All the provisions it contains are obligatory and are directly applicable in all EU member states. This means that a regulation requires no act of transposition onto the domestic laws of European countries and individuals can directly enforce its provisions before their domestic courts. Hence, it is not surprising that the issue of insolvency was handled through the enactment of a regulation. The latter has deterred European countries from waving its most detrimental provisions to their domestic creditors. Because the regulation is the ultimate binding instrument with direct applicability, it could ensure that domestic courts in

[12] Even the classifications of authoritative sources show considerable variation. See Josse Mertens de Wilmars, The Case-Law of the Court of Justice in Relation to the Review of the Legality of Economic Policy in Mixed Economy Systems, 10 Legal Issues of European Integration 1 (1983); Josse Mertens de Wilmars, Reflections sur l'ordre juridico-économique de la Communauté européenne [hereinafter Mertens de Wilmars, Reflections], in Interventions Publiques et Droit Communautaire (Jacqueline Dutheil de la Rochere & Jacques Vandamme eds., 1988); Pierre Pescatore, Les objectifs de la Communauté européenne comme principes d'interprétation dans la jurisprudence de la Cour de Justice, in Miscellanea Ganshof van der Meersch. Tome deuxieme (1972); John Temple Lang, Article 5 of the EEC Treaty: The Emergence of Constitutional Principles in the Case Law of the Court of Justice, 10 FORDHAM INT'L L. J. 503 (1987); John Temple Lang, The Constitutional Principles Governing Community Legislation, 40 Northern Ireland Legal Quarterly 240 (1989).

member states would cooperate altogether so as to efficiently address the insolvency of large multinationals[13].

In contrast, the "Directive" - also a normative instrument proper to the European Union - targets specific countries, for which it sets an end result they must achieve. A directive however, does not define the means to be used in order to achieve the end result. Member states have a limited period of time to comply with the directive, upon expiry of which, non-compliant countries may be subject to a judgment in default, and possibly sanctions by the ECJ. A directive can also be enforced directly by individuals before their domestic courts. However, a directive must be transposed onto the domestic laws of member states. The act of transposition should be transparent and must provide for guarantees to individuals[14]. This is unlike a circular, which is of a purely administrative nature.

Perhaps, the more remarkable aspect of Community law is its "primacy" over domestic laws. This means that community laws - whether primary or secondary- possess a higher hierarchic ranking than domestic laws. Needless to say, this was essential to ensure the survival of Community law; otherwise, member states could promulgate domestic laws and regulations that would hinder the creation, objectives and development of the internal market.

Such a primacy ensures the uniform application of community norms and principles. It obliges domestic authorities, including courts, to wave domestic laws that run against Community principles[15]. Furthermore, the primacy of Community law affects the interpretation of domestic laws in a substantial manner[16]. Insofar as such an

[13] Nonetheless, it should be noted that a regulation is issued upon the consent of EU countries. Even though the issuing authority is the Council of Europe, one cannot forego the long negotiation process between European Countries to reach an agreement on insolvency matters. In other words, a consensus-based approach underlies each regulation and the compulsory nature of the latter is seldom used coercively to compel countries to adopt a certain course of action.
[14] *See* EC Treaty at art. 255-256.
[15] *See* 106/77 Simmenthal (1978) ECR 629
[16] *See* 14/68 Walt Wilhelm and others (1969) ECR 1.

interpretation should comply with Community principles, it would enable individuals to require the domestic judge to apply domestic laws accordingly.

It should be mentioned that member states in breach of the principle of primacy are liable before the ECJ[17]. An individual can directly invoke such a breach before domestic courts and can claim damages against his own government for the latter's non-compliance with Community norms. For the award of damages in this case, there is a three-prong test that must be satisfied. First, the Community principle (or law) that was breached must confer subjective rights to the individual. Second, the breach must be so categorized by Community law. For instance, the failure of a state to transpose a directive from which derives a subjective right would often constitute a breach. Thirdly, there must be causation between the breach and the damage incurred. This being said, if the domestic law in force imposes less stringent conditions for the liability of the state, that domestic law would apply to determine whether or not the state has failed to comply with community law and whether the state will be held liable. In either case, the principle of procedural autonomy applies, whereby the adjudicating forum would always follow its own domestic procedures[18].

In fact, European legal instruments have tremendously contributed to the creation of the internal market. They have built the foundation of a system that revolves around the rule of law; without which, individual states may have been tempted to infringe Community laws and principles to their advantage. In addition, individuals, as much as corporations, operating within this internal market were afforded adequate protection in the course of their activities[19]. In connection with these market regulatory efforts, the European Community was able to add the missing link that is, an apparently sound

[17] *See* Joined Cases C-6 Francovich and 9/90 Bonifaci (1991) ECR I-5403. On the uniform application of EU Law, *see* C-393/92 Gemeente Almelo (1994) ECR I-1477.
[18] In the Rewe-Zentralfinanz eG and Rewe-Zentral AG v. Landwirtschaftskammer für das Saarland case of 1976, the ECJ pointed out the principle of national procedural autonomy, according to which, "it is the national courts which are entrusted with ensuring the legal protection which citizens derive from the direct effect of the provisions of Community law".
[19] *See* Pall A. Davidsson, Legal Enforcement of Corporate Social Responsibility within the EU, 8 Colum. J. Eur. L. 529, 545 –546 (2001); Joel R. Paul Free Trade, Regulatory Competition and the Autonomous Market Fallacy, 1 COLUM. J. EUR. L. 29, 32 –33 (1995)

insolvency regime able to cope with the very nature of cross-border commercial activities.

B. Automatic Recognition of Main and Secondary Proceedings

Due to the direct applicability and effect of the Regulation as explained above, it is easier to understand how a domestic court in a member state is bound to unconditionally give full effect to the proceedings opened before and decided by other EU courts[20]. Such an automatic recognition also applies to other insolvency-related proceedings, namely those that derive from the insolvency of the debtor and are closely related thereto, even if adjudicated by other EU member state courts. Similarly, automatic recognition is also granted to preliminary relief and protective measures taken by ancillary courts after the opening of main proceedings.

1. The Effect of Automatic Recognition

Under the Regulation, the principle of automatic recognition has important consequences, especially when applied to the opening of main insolvency proceedings. Upon recognition, such proceedings would produce the same effect in all EU member states that they produce in the state of opening[21]. Although these effects are subject to the provisions of articles 5 and 7 of the Regulation, and are similarly subject to the restrictions that apply when secondary proceedings have been initiated in other member states, the general principle is that the opening of main proceedings in one member state would divest the debtor of its assets. Importantly, automatic recognition would entail the issuance of a moratorium (or stay) against all creditors so as to prevent individual suits against the debtor and to ensure that creditors, irrespective of their location and ranking,

[20] *See* Regulation at art. 16. It should be noted however, that member states in which the debtor has an establishment may request a mandatory publicity of the commencement of proceedings from the liquidator, or from the competent authority in the sate of opening of main proceedings.
[21] A recent application of this principle can be found in Re Probotec Ltd. (Tribunal de Luxembourg, 27.05.2005 (II No.549/05)), where the court recognized and enforced an English judgment bearing on the insolvency of a Luxemburg subsidiary and its English parent company.

are treated equally with respect to the satisfaction of their claims[22]. In this regard, article 20-1 of the Regulation provides that once main proceedings have been initiated against the debtor, *"a creditor...who obtains by any means total or partial satisfaction of his claim...shall return what he has obtained to the liquidator"*.

Other than the recognition of a court order to open main insolvency proceedings against the debtor, the recognition of the authority of the main liquidator is also ensured by the same principle. Indeed, a liquidator who has been duly appointed by the court of opening of main proceedings would automatically enjoy the same rights and prerogatives in all member states as those in the forum of opening. Hence, the liquidator would be able to seize the debtor's assets and to proceed with their liquidation in all member states, while respecting domestic enforcement procedures. Likewise, an interim liquidator designated to take preservation measures and to ensure that the debtor's assets are not disseminated will be able to solicit all protective measures and preliminary relief necessary in all member states until the opening of main insolvency proceedings takes place.

It should be noted that the powers of the main liquidator are restricted by a number of provisions. Aside from the situation where secondary proceedings have been initiated and preservation measures have been already undertaken by the secondary liquidator; the main liquidator cannot, by his actions, affect creditors' and/or third parties rights *in rem* or breach a reservation of title clause between the debtor and his creditors. Also, the liquidator may not use *"coercive measures or the right to rule on legal proceedings or disputes"*[23]

Notwithstanding the breadth of the Regulation to enable automatic recognition and enforcement of insolvency proceedings and judgments among EU member states, there are means to challenge automatic recognition. Aside from the public policy

[22] *See* James H.M. Sprayregen *et al.*, International Issues: Are You Ready for the New European Union Regulations?, 041802 ABI-CLE 287 (2002).
[23] *See* Regulation at art. 18-3.

exception previously discussed[24], the recognizing forum may raise the incompetence of the adjudicating forum when the latter mistakenly asserts main jurisdiction over the entirety of the debtor's estate, and fails to accurately identify the debtor's centre of main interests. Furthermore, recognition may not be granted if the proof of designation of the liquidator does not satisfy the requirements of article 19, namely, the production of a "*certified copy of the original decision appointing the liquidator*". Lastly, courts may deny recognition and refuse to enforce an insolvency judgment issued by other EU member state courts if the recognition of such a judgment would result in a "*limitation of personal freedom or postal secrecy*"[25].

2. Cross-Border Judicial Cooperation

Two consequences result from the automatic recognition of judgments. The first relates to the obligation of the courts to cooperate with one another so as to ensure that main and secondary proceedings do not reach conflicting outcomes[26]. The second entails that creditors will be able to lodge their claims before multiple forums only if they did not already receive - from parallel insolvency proceedings or otherwise - more than what other creditors of the same ranking received[27].

Alongside the creation of sound model for the automatic recognition of insolvency judgments, the EU Regulation promotes coordination among EU courts in order to equally distribute the insolvency proceeds among creditors. The principle of equality among creditors is ensured through article 32 of the Regulation, which enables creditors to lodge their claims before the main and secondary proceedings[28]. Furthermore,

[24] *See* Chapter Three on the restrictive definition of "public policy" under the Regulation.
[25] *See* Regulation at art. 25-3.
[26] *See* Ulrik Rammeskow Bang-Pedersen, Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests, 73 AM. BANKR. L.J. 385, 433 (1999)[hereinafter Rammeskow, Predictability and Protection].
[27] In order to ensure equal treatment of creditors, the distribution of proceeds between creditors in the main and secondary proceedings is co-coordinated by the statutory embodiment of the "hotchpot" rule. Accordingly, each creditor will be entitled to keep what he has received in the course of any insolvency proceedings but is entitled to participate in the distribution of total assets in other proceedings only if creditors of the same ranking have obtained satisfaction of the same portion of their claims.
[28] *See* "Cross Filing and Cross Priority", Chapter Four.

if the proceeds from the liquidation in the secondary proceedings were sufficient to satisfy the claims of the creditors in such proceedings, the secondary liquidator must transfer any surplus to the liquidator of the main proceedings[29]. Lastly, article 20-2 of the Regulation stipulates, "*A creditor ...who has obtained a dividend on his claim shall share in distributions made by other proceedings only where creditors of the same ranking...obtained an equivalent dividend*".

The Regulation goes even further in setting up a substantial degree of equality among creditors. For instance, in reference to foreign creditors, the Regulation does not mention the nationality of these creditors; rather it takes into account their residence in a forum other than the forum of opening. Its objective is to improve the situation of foreign creditors who face the difficulties pertaining to the territoriality of publicity measures, the distance, the foreign language used in the course of the proceedings and their unfamiliarity with such domestic proceedings. As a result, and in order to facilitate the flow of information to foreign creditors, the liquidator may demand that the court order to open main or secondary proceedings, and eventually, the court decision designating him as liquidator, be published in other EU member states pursuant to the formalities of article 21 of the Regulation. Furthermore, the liquidator may demand that the court order opening the proceedings be registered in a public register kept in other member states. Finally, each state in which the debtor possesses an establishment can compel the liquidator in the main proceedings to effect the publicity and/or registry mentioned above. The objective of this provision is to ensure that secondary proceedings are coordinated with the main proceedings.

Foreign creditors that are known must be informed without delay, either by the court of opening, or by the liquidator. The Regulation provides for a mechanism of disseminating information, where a notification is sent to these creditors and indicates the time limits for foreign creditors to lodge their claims, the sanctions for not doing so in a

[29] *See* Regulation at art. 35.

timely manner and the authorities mandated to receive and distribute the proceeds resulting from the liquidation of the debtor's assets. This notification also includes the evidence secured creditors must produce before the court of opening[30]. The Regulation also stipulates that foreign creditors include fiscal authorities and social security organizations in member states and that these categories of claimants are also invited to lodge their claims.

In actuality, the Regulation encompasses a series of measures to ensure that foreign creditors, regardless of their status, are given a fair opportunity to participate in the insolvency proceedings of their debtor throughout the EU community. This was in part possible because of the existence of the ECJ and its important role of supervising the implementation of the Regulation by domestic courts.

C. Central Judicial Authority: the ECJ

As previously mentioned, article 16 of the Regulation provides for a system built on automatic recognition of insolvency judgments rendered within the EU. Surprisingly, the Regulation contains only two relatively simple[31] articles regarding the recognition of insolvency judgments and their effects within the EU. Because this simple process retrieves the European practice of automatic recognition of judgments in commercial and civil matters, one may refer to the internal market so as to explain judicial cooperation within the Community. However, it could be misleading to confer all the merits of the European insolvency system (as well as other legal achievements) solely to the internal market. To a greater extent, the uniform implementation of EU law owes its success to

[30] This notification shall be written in the language of the sate of opening; however, in order to facilitate the task for foreign creditors, a standard format is used to that end, and includes the instructions and procedures to be followed in all official languages in the EU.

[31] By comparing the provisions of the Regulation on the recognition and enforcement of foreign judgments (art.16 and 17) with other international agreement, one may come to the conclusion that these provisions are overly simplified and brief. The reliance of European countries on these provisions as regards the recognition and enforcement of judgments demonstrates a certain confidence in the European system. More importantly, it proves that member countries can rely on the ECJ to enforce Community law throughout the European Union. This necessary judicial intervention underlies Member States' compliance with the rule of law.

the ECJ. Indeed, the ECJ enjoys significant powers of interpretation and implementation of Community law pursuant to article 220[32] of the EC Treaty, which confers sufficient prerogatives to the ECJ to ensure that member-states will comply with the acts of the Community. To achieve this, the ECJ has two duties to be used under specific procedural rules. These are: providing uniform interpretation of Community law and enforcing Community acts in member states.

1. Preliminary Rulings

The first task of the Court - that of interpretation and construction - finds its source in article 234 (ex 177) of the EC Treaty. According to this article, the ECJ has competence to give preliminary rulings - on the request of domestic courts or European institutions - on the meaning of community acts, either issued by the European Council or by the Commission. This role however is not limited to the interpretation of community acts insofar as the ECJ has also the power to determine the validity of such acts. Such prerogatives are especially important within the European context, where European instruments often stipulate general principles that should be specifically and uniformly implemented[33].

In this regard, the ECJ has fashioned a number of precepts, values and policy objectives that are not expressly stipulated in the EC Treaty. Indeed, although such preliminary rulings were primarily conceived of as an optional recourse[34] when the application of community law is uncertain and a domestic court has to decide a case pending before it, the practice has developed a "duty" to refer to the ECJ when these uncertainties arise[35]. Most importantly, ECJ interpretations of Community law are

[32] Article 220 reads: "*The court of justice shall ensure that in the interpretation and application of this treaty the law is observed*".
[33] See Rasmussen Hjalte, *European Court of Justice*, Gadjura, (1998), at 128; see also Mads Andenas (ed), article 177 References to the European Court – Policy and Practice, Butterworths, 1994.
[34] Article 234 (ex 177) of the EC Treaty provides that domestic courts "*against whose decisions there is no judicial remedy under national law*", must bring the matter to the ECJ through a preliminary ruling.
[35] *See* Blankenburg Erhard and Harm Schepel, Mobilizing the European Court of Justice, in The European court of justice, ed. Weiler J.J. and G. De Burca, Oxford University Press (2001), at 13 (the authors perceive the increasing number of preliminary rulings is a consequence of the mandatory character of the

binding on the domestic courts in each member state. In addition, individuals can rely on prior interpretations given by the ECJ with respect to the same community act/provisions[36], thereby decreasing the number of abuses[37] in the application of community law.

Because various community instruments handle sensitive issues such as insolvency proceedings for instance and their effects throughout the Community, the existence of an interpretation mechanism is crucial. Indeed, previous parts of this thesis have demonstrated that the Regulation lacks precision with respect to some of its provisions. Its effective implementation is thus conditional on the uniform interpretation and application of its ambiguous elements. In virtue of article 234 of the EC Treaty, the ECJ can give its own interpretation of the Regulation so that the Regulation's elusive provisions do not affect its clarity. Within the European institutional setting, the ECJ will ensure that the Regulation is uniformly understood and duly implemented by domestic courts.

2. Enforcement and Sanctions

Relegation to the role of a mere interpretive body would be insignificant without enforcement tools. Thus the EC Treaty endows the ECJ with enforcement mechanisms through the infliction of sanctions against incompliant member states. Pursuant to the procedure set in articles 169-170 of the EC Treaty, the ECJ acts in concert with the EU Commission to ensure the implementation of its rulings. Without analysing the evolvement of the power of the ECJ in inflicting sanctions, it is noteworthy to mention

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procedure). *See* also the unconditional recourse to the ECJ and the theory of Act Clair in Rockfon A/S v Specialarbejderforbundet i Danmark, C-449/93 ECR (1995) I-4291.

[36] *See* Paul Craig, The Jurisdiction of The Community Courts Reconsidered, 36 TEX. INT'L L.J. 555, 564 (2001).

[37] In this respect, it is important to mention that the primary procedure to control the infringement of community law is based on article 226 (ex 169) of the treaty. This article empowers the commission to pursue individual countries before the ECJ when infringements occur. However, the commission has seldom carried on the full procedure foreseen in this article. To avoid this complex and uncertain procedure however, an alternative recourse has often been made to article 234 of the EC Treaty, which is known to produce fewer constraints. On how progressively article 234 replaced article 226, see Debousse Renaud, The European Court of Justice: the politics of judicial integration, st. Martin's Press New York (1998), 51-52.

that under previous versions of the EC Treaty, the court rarely used its coercive powers[38].

However, as the body of laws of the community grew in magnitude and complexity, the newly amended article 228[39] of the EC Treaty allows the ECJ to lay sanctions against infringing states. While the co-operative approach would be more preferable, especially when attempting to realize the common objectives of member states, the ECJ propensity to inflict sanctions increased as a result of a tighter agenda regarding the legal and economic integration of the Community.

By analogy, the proper application of the Regulation by domestic courts can give rise to a number of infringements such as refusing the recognition of other insolvency proceedings, averseness to cooperate and to transfer assets when the latter are necessary for the reorganization of the debtor's business, or even expanding the scope of secondary proceedings beyond winding-up proceedings[40]. Because all these practices constitute indirect infringements of states towards their legal and Community duties, the ECJ and the EU Commission can directly reprimand them.

In light of the advanced stage of the Community in terms of judicial cooperation, it is not surprising that the EU insolvency regime stands more chances than any other system, whether regional or global, to function harmoniously. The interplay between the different European institutions has developed to ensure that the rule of law is effectively respected in the Community. Once a legal instrument is ratified by member states, the duties contained therein will be uniformly implemented and enforced by the ECJ. This

[38] On the reluctance of the ECJ to inflict sanctions against member states despite infringement of EC law *see* Case 182/89, Commission of the European Communities v French Republic, (1990) ECR I – 4337. Also on the non-compliance and suspension of sanctions, *see* case C-334/94 Commission of the European Communities v French Republic I-01307. On the application and evolvement of the same provisions of the EC Treaty, *see* case T-334/94 Sarrió SA v Commission of the European Communities, (1998) II-01439

[39] Article 228 (ex 171) of the EC Treaty provides for a more stringent supervision on behalf of the ECJ and the Commission. There is a special procedure to inflict sanctions against incompliant states. *See* EC Treaty at art. 17-2.

[40] "The member states are bound to respect the verdicts of the ECJ, as they are responsible for the implementation of EU law, both directly and indirectly, and *they can be sued for any failure in their country to enforce EU law*". *See* Jan-Erik Lane, Substance of EU Law, available at www.spp.nus.edu.sg/docs/wp/wp22.pdf (last visited November 2005).

also explains why the process leading to the adoption of the Regulation was a long and arduous one. Member states needed to ensure their ability to comply with European insolvency arrangements. States' ability to comply resulted partly from the enactment of less intrusive insolvency rules and a series of special provisions for the protection of domestic creditors. While this special setting has facilitated the adoption of the Regulation, the binding character of the latter is the result of a sui generis legal system, only affordable among countries that have embraced a supranational model of integration. Because achieving these exact same results on a global level would be, not only impossible, but unrealistic, the following parts will envisage the instruments and the channels through which meaningful insolvency reforms can take place without resorting to the EU supranational model of integration.

III. Instrumental Channels to Improve Cooperation

The following parts will respectively study Bilateral Investment Treaties (BITs) and Free Trade Agreements (FTAs) so as to ascertain whether or not these instruments are suitable to further cooperation between courts, or more generally, whether they can provide an adequate support to domestic insolvency reform efforts.

A. Bilateral Investment Treaties

The last decade has witnessed a significant surge of Bilateral Investment Treaties (BITs), which aim at facilitating market access to foreign investors. These instruments, executed between the investor's home country and a host country, commonly protect the investor against potential unfriendly or illegal conduct from the host country, such as an irregular expropriation of the investors' assets or undue restrictions on capital transfers. The increasing use of BITs during the last decade[41] demonstrates that the gap left by the absence of a multilateral investment instrument should be filled[42]. BITs are primarily created to build an atmosphere of trust between host countries and foreign investors by defining the rights and duties of each party. More importantly, BITs form the basis for

[41] *See* L. Eric Peterson, Emerging Bilateral Investment Treaty Arbitration and Sustainable Development, International Institute for Sustainable Development 3 (2003).
[42] *Id.*

resolving investment disputes between the host country and foreign investors. In doing so, they create a binding obligation (more so for the host country) whose breach not only constitutes a breach of treaty with the investor's home country, but also a violation of international law, with the ensuing consequences and negative effects vis-à-vis the host country's reputation[43]. The subsequent sub-sections will attempt to determine whether or not BITs present sufficient ties to multinationals (and arguably to their insolvency processes) so as to serve as a potential vehicle capable of enhancing cooperation between courts involved in a cross-border insolvency case.

1. Scope and Suitability

By considering the most common BITs' definitions of an investment while taking into account BITs' core principles, the subsequent parts will test the aptness of BITs to serve as potential insolvency cooperation and/or insolvency reform vehicles.

a. Defining Investment

In searching for the proper foundation that may justify a potential linkage between BITs and reform in the area of cross-border insolvency, one must stop at the definition of investment and ascertain whether a subsidiary of a multinational corporation constitutes an investment in light of BITs. Although the term "investment" can take various forms depending on its definition in each treaty, there are commonly five characteristics of an investment[44].

First, "*an investment has certain duration*"[45]. This first condition excludes all business and trade exchanges that are temporary and/or transitory in nature and those that are not built upon a viable long-term infrastructure. In this respect, a subsidiary of a multinational corporation established in the host country fulfils this durational requirement. Even when a foreign multinational establishes a special purpose vehicle in

[43] *Id.* at 19.
[44] Calvin A. Hamilton & Paula I. Rochwerger, Trade and Investment: Foreign Direct Investment through Bilateral and Multilateral Treaties, 18 N.Y. INT'L L. REV. 1, 12-13 (2005) [Hereinafter Calvin, Trade and Investment].
[45] *Id.*

the host country so as to achieve its short term objectives, such a structure remains governed by the laws and regulations of the host country, enjoys a full-fledged legal personality and most significantly, could - in the course of its operations - cumulate debts and experience financial difficulties.

Second, "*an investment involves a certain regularity of profit and return*"[46]. In the case of a subsidiary, this second condition forms the very reason why a multinational would establish a separate legal entity in a host country. As the development of the international market is driven by competition, further market access and integration[47], the subsidiaries of a multinational constitute the primary network to channel such integration and to realize profits from foreign markets. Hence, it is only a natural assumption to believe that the very reason for the existence of multinationals is to derive profits and revenues from the exploration of foreign markets. Absent such an incentive, corporations would simply limit their scope of activities to their home market, something that proved unfounded insofar as multinationals conduct their operations on an increasingly global level[48].

Third, "*an investment typically involves an element of risk for both sides*"[49]. While the risks associated with the establishment of a subsidiary may be obvious, such as the total loss of assets and/or capital, or a fierce domestic competition that would drive the foreign subsidiary outside the host's market, the risks for the host country are of a different nature. When the host country enacts pro-investment laws to encourage investment flows and allows a foreign corporation to establish a domestic subsidiary in its local market, several types of risks accrue. One type of risk is the potential threat to national corporations that are in the same line of business as the foreign subsidiary. Another type of risk is the financial default and liquidation of such a subsidiary resulting

[46] *Id.*
[47] Kevin C. Kennedy, Foreign Direct Investment and Competition Policy at the World Trade Organization, 33 GEO. WASH. INT'L L. REV. 585, 587-589 (2001).
[48] *Id.*
[49] *See generally* Detlev F. Vagts, The Multinational Enterprise: A New Challenge for Transnational Law, 83 HARV. L. REV. 739 (1970); *see also* Cynthia Day Wallace, The Multinational Enterprise and Legal Control: Host State Sovereignty in an Era of Economic Globalization 1082 (2002).

in the abrupt unemployment of national employees. So long as the underlying rational to BITs is to satisfy the mutual interests of the foreign investor and of the host government, both players will bear a certain amount of risk throughout the investment period.

Fourth, "*an investment involves a substantial commitment or contribution*"[50]. When a multinational corporation decides to establish a subsidiary in a host country, thereby expanding its own network of subsidiaries and increasing its chances to realize more profits, it incurs substantial costs to that end. Indeed, the costs related to the study of a foreign market and the costs necessary for the creation of a separate legal entity in a foreign forum, such as capital requirements, assets and personnel, not only present a testimony to the contribution made by the multinational but also highlight a long term commitment to the host country and to its domestic market. As previously mentioned, the forbearance of these costs is justified by the profitability multinationals stand to realize by expanding their operations to foreign markets.

Fifth, "*an investment should be significant for the host state's development*"[51]. In this regard, it can be argued that the establishment of a subsidiary in any given market results in a number of gains for the host country. Among such gains one can mention the ability of the host country to attract the positive spillover of employment, to increase foreign capital flows, and more generally, to mobilize their internal and international resources to attract further foreign investments. Indeed, the latter is thought to be the dominant form of resource flows and the primary source of private capital for low-income countries[52]. It is therefore not surprising to consider the drastic legal and judicial reform programs developing countries undergo so as to be competitive in attracting foreign capital flows and to ensure of their non-volatility. Absent such measures, developing countries will be unable to foster their own development. Thus, the presence

[50] *See supra* note 27.
[51] *Id.*
[52] *See* Ewe-Ghee Lim, Determinants of, and the Relation Between, Foreign Direct Investment and Growth: A Summary of the Recent Literature 12-15 (IMF, Working Paper No. 01/175, 2001).

of a foreign subsidiary in the host country represents the idyllic form of investment able to create more job opportunities and to channel foreign capital flows into the domestic market.

In many respects, the subsidiary of a multinational corporation fulfils the characteristics of an investment as commonly defined in BITs. Because the latter aim at easing market access for these foreign corporations, it would not be absurd to think that the insolvency regime the foreign subsidiary will be subject to may greatly impact on its level of integration and operations in the host's market. As mentioned in the previous chapters, domestic insolvency laws can produce non-negligible ex ante effects on investment incentives, which may result in more or less efficient capital placements. Therefore, BITs may be used not only to ease market access and to ensure equal non-discriminatory treatment to foreign investors, but also to ensure that equality of treatment is extended to the insolvency liquidation and/or reorganization of the foreign subsidiary. This may further the cooperation between the host's courts and the home courts leading to a more equitable and predictable insolvency process.

b. Furthering Cooperation through BITs Core Principles

Aside from the above characteristics that may justify the inclusion of insolvency provisions in BITs, the latter contain a number of principles capable of advocating a more equitable process for the resolution of cross-border insolvency cases. Most BITs provide for the right to national treatment, which entails that foreign investors enjoy the same rights and privileges as national investors. Should the national treatment principle be extended to and implemented in insolvency proceedings, this means that domestic corporations and foreign subsidiaries should be treated in the same manner. As such, it comes as no surprise that when a domestic corporation faces financial difficulties, it enjoys in practice a more favourable regime for its liquidation[53] and most significantly, it enjoys increased chances for its restructuring, whether through formal or informal

[53] Erin K. Healy, All's Fair In Love And Bankruptcy? Analysis of the Property Requirement for Section 109 Eligibility and its Effect on Foreign Debtors Filing in U.S. Bankruptcy Courts, 12 AM. BANKR. INST. L. REV. 535, 538 –540 (2004).

reorganization plans[54]. Indeed, a domestic corporation carrying the national flag and employing nationals of the host country will always garnish more support from either the legislator or from the judicial court system.

In order to extend that same favourable treatment to a foreign subsidiary, and to provide the latter with equal chances to be rescued, coordination with the subsidiary's home forum may be necessary. Indeed, insofar as the assets of a multinational corporation are usually located in several forums and that an effective liquidation or reorganization of the financially distressed subsidiary may call for a complete evaluation of the subsidiary's estate and possibly, the repatriation of its assets located overseas, the host's courts would be well-advised to refer to foreign jurisdictions. In parallel, by taking into account the international nature of the foreign subsidiary, the hosts' court will be able to strike a more equitable balance between the interests of domestic and foreign creditors.

From a different viewpoint, there are other commonly used principles in BITs that may justify a linkage between investment and insolvency. For instance, the fair and equitable treatment principle, which remains subject to ongoing controversies, may be used to support the rational of such a linkage. While an equal treatment principle aims primarily at achieving equality between foreign and domestic investors, it would not be far-fetched to consider that creditors and shareholders of both domestic and foreign investments should also be treated equally. This could be accomplished by extending the equal treatment principle to those parties whose rights vest in the operations of such investments entities, whether domestic or foreign. Needless to mention that a differential treatment between the creditors of domestic and foreign investors will in term increase the difficulty for foreign investors to find suitable business partners within the host's market. Insofar as this can render the objectives of BITs - namely easing the integration and operations of the foreign investor in the host's market - more difficult to achieve, the inclusion of transparent insolvency principles in BITs can be further justified if such

[54] *Id.*

principles can ensure that equal treatment is implemented in a way that would not place foreign investors at a disadvantage.

2. LDCs' Efforts to Attract Foreign Investments

The inclusion of insolvency standards and principles in BITs may seem ambitious in many respects. First, BITs signed between developed and developing countries have long been criticized as creating an unequal bargain to the advantage of developed countries[55]. Thus, broadening the scope of BITs so as to include the insolvency processes of large multinationals is not a simple task at hand. Second, should such insolvency principles entail the deference to the proceedings held in the multinational's home country, an even greater reluctance from Least Developing Countries (LDCs) is to be expected. Indeed, as explained by the critics of the rough wash argument, LDCs will not reap the advantages of universality[56] as much as developed countries because LDCs are not the home country of as many multinationals as developed countries, and hence, they will more often defer to foreign insolvency proceedings rather than asking for the stay of foreign proceedings to their advantage.

This being said, the use of BITs as potential reform vehicles is believed plausible. The subsequent parts will expose the incentives of LDCs to accept such a proposal with special emphasis on those incentives that result from the drive to compete and to attract Foreign Direct Investment (FDI). Subsequently, it will be explained how the inclusion of insolvency standards in BITs can address the critics to the rough wash argument.

a. Liberal Economy Theory: Competition

Despite LDCs growing resistance to the enactment of a multilateral investment treaty, an exponentially growing number of BITs were signed between developed and

[55] *See* Inaamul Haque, DOHA Development Agenda: Recapturing the Momentum of Multilateralism and Developing Countries, 17 AM. U. INT'L L. REV. 1097, 1111 n.60 (2002); see also Duncan E. Williams, Note, Policy Perspectives on the Use of Capital Controls in Emerging Nations: Lessons From the Asian Financial Crisis and a Look at the International Legal Regime, 70 FORDHAM L. REV. 561, 614 n.446 (2001).
[56] *See* Rammeskow, Predictability and Protection, *supra* note 16, at 426.

developing countries in the last decade. As such, Foreign Direct Investment (FDI) in LDCs is primary governed by BITs and the successful integration and performance of these foreign investments depend on the extent to which LDCs are able to create a favourable domestic environment rooted in transparency and respectful of the rule of law[57].

A number of theories were developed to explain LDCs reform efforts and most importantly, to elucidate LDCs' acquiescence of BITs despite the often unequal bargain the latter entail to their disadvantage[58]. One of the most convincing theories to elucidate the widespread execution of BITs between the North and the South derives from liberalism. This theory argues that competition in attracting foreign capital flows constitutes the primary motivation for LDCs to sign BITs and to engage in far-reaching legal and judicial reform efforts[59]. As FDI remains the main source of foreign capital flow into low-income countries, LDCs have become pre-disposed to making considerable concessions so as to appeal to foreign investors.

In this regard, it could be argued that LDCs' legal reform efforts to capture a significant share of foreign capital flows would be more successful if such efforts included sound cross-border insolvency principles, resulting in more cooperation between the host's and parent's courts. Since multinationals are the main channels to foreign investments and BITs are nowadays the overriding instruments to regulate the treatment of these foreign entities within the host's market, the inclusion of insolvency principles in BITs may be justified so as to resolve any potential dispute that may arise if and when these foreign experience financial difficulties.

Doing so would result in more advantages to both investors and to the host country. For the former, the inclusion of insolvency principles in BITs may create further

[57] *See* Calvin, Trade and Investment, *supra* note 27, at 10-11.
[58] *Id.*
[59] *See* Victor Mosoti, Bilateral Investment Treaties and the Possibility of a Multilateral Framework on Investment at the World Trade Organization: Are Poor Economies Caught in Between?, 26 NWJILB 95 (2005).

assurance as regards the commitment of the host country to create a suitable environment where the rule of law is respected not only throughout the life of the foreign entity, but also at the time of its eventual liquidation or reorganization. Hence, foreign investors will be more confident that the host's courts will extend them a fair treatment, thereby increasing the chances for the foreign subsidiary to either be rescued or more effectively liquidated. By the same token, the host country will be able to attract more foreign investments into its domestic market; and most importantly, it will gain a competitive edge over other LDCs that did not grant further assurance as regards the insolvency processes of foreign subsidiaries.

Perhaps the most distinct advantage BITs offer so as to improve cooperation in cross-border insolvency cases is that LDCs are ready to make further concessions so as to attract FDI[60]. In other words, by using LDCs motivational urge to attract FDI, BITs could be a suitable vehicle to enhance cooperation in transnational insolvency cases. Incidentally, this method would address the most common critics to Westbrook's "Rough Wash" argument.

b. Defeating the "Rough Wash" Critics

As mentioned in the previous Chapters, Westbrook is supportive of a cross-border insolvency regime based on universality, or on any lesser form thereof in the short term. This system would entail greater cooperation between several forums through deference to foreign proceedings and/or through the transfer of local assets from one jurisdiction to another. Because such deference and/or transfer of local assets are associated with greater risks to be born by the deferring forum[61], it has been argued that compliance with this potential transnational insolvency regime will be difficult to achieve. In this regard, Westbrook advanced the "rough wash" argument so as to defend the feasibility of such a framework of cooperation, which retrieves some essential characteristics of Universalism. Put in simple terms, the "rough wash" argument means that the risks and

[60] *Id.*
[61] One such eminent risk for the deferring forum is to offer less protection to its domestic creditors if and when local assets are transferred overseas.

costs of deference and/or transfer of local assets by a given forum will "*be evened out by foreign deference of local assets in other cases*"[62].

Although the "rough wash" argument may increase the incentives to cooperate among forums, it is built on the assumption that each country, whether developed or developing, is the home country of an equal number of multinationals. Because such an assumption is certainly not true, the rough wash argument has been criticized as being unfounded or incomplete at best[63]. Thus, deference and/or transfer of assets from one forum to the other will only take place if the deferring forum can draw certain advantages from cooperation or is compelled to do so, or both. By translating these parameters into the fora of bilateral investment relations, it becomes easier to contemplate the use of BITs as an effective medium to channel cross-border insolvency principles, thereby fostering cooperation especially between the North and the South. Doing so may address the shortfalls of the rough wash argument. Indeed, whether or not deferring forums stand an equal chance among each other to even out the risks and costs associated with deference and/or with the transfer of local assets in other cases, each forum will be bound to cooperate with the foreign subsidiary's home forum if and when that foreign subsidiary, recognized as a foreign investment, faces financial distress. Other than imposing a duty to cooperate on the court-to-court level, BITs may serve as a suitable insolvency reform vehicle insofar as they place the objectives of LDCs, namely enhancing their ability to attract further foreign capital flows, at the forefront of the debate.

While this proposal may require a substantially different approach in negotiating and drafting BITs, and that the foreseeable opposition of LDCs to such an undertaking should not be taken lightly, it is believed that the linkage between foreign investment and multinationals' insolvency is a most plausible venture. This being said, in the face of globalisation and in the absence of a binding cross-border insolvency framework, the

[62] *See* Jay Lawrence Westbrook, Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum, 65 AM. BANKR. L.J. 457, 464-465 (1991) [hereinafter Westbrook, Theory and Pragmatism]
[63] *See* Rammeskow, Predictability and Protection, *supra* note 16, at 426.

foreign investment path may not be the sole conduit to achieve more cooperation between courts respectively located in the host's and in the investor's country. The pressures resulting from international trade and the ever-increasing number of Free Trade Agreements (FTA) signed between countries should also be considered as a potential vehicle to improve cooperation in cross-border insolvency cases.

B. Free Trade Agreements

As an alternative or parallel way to achieve meaningful reform in the area of cross-border insolvency, one should not disregard the trade path. Indeed, as the last decade could be accurately described as the era of trade and investment, responsible policymakers and academics have constantly attempted to create the most adequate legal environment to contain and to encourage the ever-increasing rate of trade and investment[64]. Within a bilateral context, the following parts will expose how sustained trade relations between two nations can significantly facilitate the issuance of insolvency guidelines and principles, thereby improving court-to-court cooperation. To do so, special attention will be drawn to the North American experience and how the North American Free Trade Agreement (NAFTA) was an important medium to enhance cross-border insolvency cooperation between the United States, Canada and Mexico.

1. Trade and Cross-Border Insolvency

As compared with BITs, using bilateral trade relations to address the lack of cooperation between courts in cross-border insolvency cases may be founded on a substantially different reasoning. Unlike FDI where there is a market presence of a foreign entity in the host country, trade does not necessitate market presence or integration. Nevertheless, the development of trade relations between two nations can create strong incentives for each one of them to avail a suitable legal environment,

[64] *See generally* Aaron Judson Lodge, Globalization: Panacea for the World or Conquistador of International Law and Statehood?, 7 ORRIL 224 (2005).

including predictable and fair insolvency rules, so as to support their trade liberalization efforts[65].

Insofar as multinational corporations are the primary traders on the global level[66] and so long as continued and regular trade exchanges entail a significant number of debtors and creditors in several forums, the adjudication of insolvency cases would require a solid framework of cooperation between the various courts involved. For instance, as it was argued in the previous parts, the issuance of the Regulation was necessary to encourage and facilitate trade exchanges within the EU internal market, an objective clearly spelled out in the EC treaty. Similarly, NAFTA countries had to make considerable efforts in crafting a coherent insolvency regime able to facilitate the liquidation and/or reorganization of corporations having assets and operations in the United States, Canada and Mexico.

By purporting such an analogy on the bilateral level and taking into account that each nation, whether developed or developing, stands to gain considerably from an increased rate of trade, it may be realistic to think that FTAs can lay the groundwork for a more rational cross-border insolvency framework. Because FTAs aim at promoting a free circulation of goods and services across the borders of two countries (or a group of countries), each and every aspect of these trade exchanges should be meticulously taken into account, including the financial distress of an entity engaged in trade transactions and cumulating debts and credits on each side of the borders. Within this trade context, it could be feasible to institute insolvency proceedings that are more universal in nature, where the interest of stakeholders (creditors and debtors), regardless of their location, will be equitably and fairly addressed.

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[65] *See* Frank J. Garcia, "Americas Agreements"--An Interim Stage in Building the Free Trade Area f The Americas, 35 COLUM. J. TRANSNAT'L L. 63, 106 –107 (1997).
[66] *See* Daniel W. Schenck, Jurisdiction over the Foreign Multinational in the EEC: Lifting the Veil on the Economic Entity Theory, 11 UPAJIBL 495 (1989).

Perceiving the increase of trade and the surge of FTAs as a potential to promulgate sound cross-border insolvency principles resulting in more cooperation between forums is to acknowledge that the foundation of a free market economy, an objective pursued by most nations, can only be achieved through holistic reform efforts. Perhaps, because FTAs are rather specific to a limited number of countries and that their objectives are debated and agreed upon between their signatories, it is easier to advocate more cooperation thereunder on the court-to-court level. A prime example of this readily achievable objective between countries participating in free trade areas is the NAFTA model, from which certain lessons can be transmitted to policymakers, who are looking forward to furthering their insolvency reform efforts.

2. <u>The North-American Experience</u>

Although a potential linkage between trade and insolvency may be naturally conveyed in order to further insolvency reform efforts between nations involved in significant trade exchanges, the NAFTA experience gives a live illustration of the benefits, and also of the difficulties, that ensue from pursuing such a venture. The objectives set by NAFTA include, among other things, the elimination of trade barriers and the facilitation of cross-border movement of goods and services between NAFTA signatories[67]. Importantly, these trade liberalization efforts should take place in a system that implements national treatment, most-favoured-nation treatment and which is rooted in transparency[68].

Aware that these objectives can be more effectively reached with the enactment of guidelines to enhance cooperation between NAFTA courts in cross-border insolvency cases, the American Law Institute (ALI) launched in 1994, one year after the signature of NAFTA, its Transnational Insolvency Project (the Project)[69]. Short of harmonizing the insolvency laws in NAFTA countries, the Project aims at producing *"a framework for*

[67] *See* NAFTA at art.102. Available at http://www.nafta-sec-alena.org (last visited January 2006).
[68] *Id.*
[69] *See* Am. L. Inst., Principles of Cooperation In Transnational Insolvency Cases Among The Members Of The North American Free Trade Agreement (2003), available at https://www.ali.org/ali/trans_insolv.htm (last visited January 2006).

close cooperation, and some integration, in the management of insolvencies having effects in more than one of the NAFTA countries"[70]. Although the Project has undergone a number of phases and has been the subject of numerous studies, it has not been adopted as the official instrument to resolve cross-border insolvency cases that arise between the United States, Canada, and Mexico. Despite its non-ratification, however, the Project has exerted a major influence on NAFTA participants to reconsider certain aspects of their bankruptcy laws[71], resulting in more cooperation and coordination among NAFTA courts to overcome the problems that traditionally arise from transnational insolvency cases[72].

While several contributions may be drawn from the guidelines of cooperation contained in the Project, the most interesting aspect is how the Project could influence NAFTA countries to amend their bankruptcy laws despite the significant differences that exist between the United States, Canada and Mexico. Indeed, the difference between the legal systems of the NAFTA participants is sufficient to render any insolvency reform efforts rather difficult. First, there is the cleavage between common law and civil law jurisdictions that separates the United States and Canada from Mexico. As in a traditional civil law jurisdiction, the role of the judge in Mexico is more restricted compared to his counterpart in common law countries, such as the United States and Canada, where the judge enjoys greater flexibility to accommodate the demands of foreign creditors. Second, the bankruptcy regime in the United States and Mexico is more pro-debtor-oriented whereas the Canadian system is clearly in favour of creditors. These different orientations can have a major consequence on a court's decision whether to liquidate or to reorganize a financially distressed corporation. Third, the degree of specialization in bankruptcy is much higher in the United States and Canada than Mexico. For instance, in the United States, bankruptcy judges usually are originally bankruptcy lawyers who have cumulated extensive expertise on bankruptcy related issues and are able to advance flexible market-oriented solution to adjudicate insolvency cases submitted before them.

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[70] Jay Lawrence Westbrook & Jacob S. Ziegel, The American Law Institute NAFTA Insolvency Project, 23 BROOK. J. INT'L L. 7, 7 (1997).
[71] E. Bruce Leonard and Jacob Ziegel, International Statement of Canadian Bankruptcy Law – ALI, Juris Publishing, 163, 2004.
[72] *Id.*

Further, and not surprisingly, the bankruptcy laws of NAFTA participants greatly differ from each other as regards the formalities of the proceedings, the substance of the law and most importantly the priority of claims.

Notwithstanding these seemingly irreconcilable differences, important insolvency reform efforts have taken place in each of the NAFTA countries in the last decade. Differently said, the drive to create a free trade area between the participants was key to foster insolvency reform efforts and closer cooperation in cross-border insolvency cases. Hence, it could be argued that a FTA between two nations can result, directly or indirectly, in insolvency reform efforts leading to greater cooperation, regardless of the legal disparities that may exist between the parties. This conclusion could be useful in considering whether trade and FTAs can be used as insolvency reform vehicles in the short or medium term.

3. FTA Network and Regionalization

Another significant advantage in resorting to FTAs to promote closer cooperation between courts is the widespread use of FTAs on a regional level. In fact, increased trade exchanges between neighbouring nations have encouraged the formation of free trade groups among which, the promulgation of cooperation guidelines in cross-border insolvency cases may be easier to achieve than on a global level. Undoubtedly, the most successful trading group so far is the European Union and this is one of the reasons why the study of the Regulation has been central throughout this thesis. This being said, without espousing the European insolvency model, which is built upon a real process of political, economic and legal integration among its members, sustained trade exchanges along with strong political will have also resulted in regional free trade coalitions. Aside from the NAFTA model, an overview of which was given above, one can cite the Andean Common Market (ANCOM)[73], the Southern Cone Common Market[74], the Association of

[73] Among Bolivia, Colombia, Ecuador, Peru and Venezuela.
[74] Among Argentina, Brazil, Paraguay and Uruguay.

South-East Asian Nations[75](ASEAN), and many other regional trade arrangements aimed at eliminating trade barriers and promoting the free circulation of goods and services across the borders of the participating nations.

In light of the correlation between free trade and insolvency, the problems that arise from the liquidation or reorganization of a debtor presenting ties with more than forum have been, or soon will be, addressed by these regional efforts aiming at creating a free trade area among their constituencies. Thus, trade may not only serve as a potential vehicle for insolvency reform, but will also play an important role in increasing the awareness of cross-border insolvency matters and their incidence on effective trade liberalization. Not surprisingly, the most advanced regional models in advocating free trade, such as the EU and NAFTA, have already dedicated considerable time and resources to finding a viable solution to the cross-border insolvency dilemma. It is also believed that other free trade groups, in pursuing their trade liberalization efforts, will face the hurdles created by the insolvency of a multinational debtor.

As the world becomes increasingly entangled in webs of FTAs and regional trade arrangements, several cross-border insolvency instruments, protocols, and court-to-court communication techniques are bound to surge, thereby enhancing cooperation. While such a projection may fulfil a short-term ideal in promoting sound regional insolvency practices, it advances little in a way of creating a uniform and truly global insolvency framework. Indeed, as explained above, governments are pre-disposed to make certain concessions only with their regular trading partners, from which foreseeable trade benefits may derive. Furthermore, due to the rather limited number of countries participating in a regional or bilateral free trade arrangement, a thorough consideration is given to the insolvency regime of each participant. For instance, in the phases leading to the issuance of the ALI Project, each of the United States, Canada and Mexico had the

[75] Among Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam.

opportunity to present a detailed statement of their bankruptcy regime[76]. It is needless to mention that the process of building a global consensus on a cross-border insolvency framework may prove even more difficult if the peculiarities of each domestic insolvency system were taken into account.

For the most part, bilateral and regional trade liberalization efforts, and naturally FTA networks, may provide for near-term and geographically limited improvements in cooperation in cross-border insolvency cases. Their propensity, however, to advance the creation of a global insolvency arrangement, in the form of an enhanced Model Law or otherwise, is believed uncertain. Here stands the distinction between the desirability of bilateral (or regional) reform vehicles and multilateral channels to improve cooperation.

IV. Market Incentives and Institutional Channels

A comprehensive overview of the channels that could be used to develop a better cross-border insolvency framework requires careful consideration of both bilateral and multilateral instruments. The latter have taken the form of multilateral trade agreements and have multiplied alongside the development of the international market. Thus, considering the current multilateral trading system as a potential conduit to create a more viable cross-border insolvency framework, whether or not under the form of an enhanced Model Law, will necessitate a thorough understanding of this international market, its dynamics and driving forces. By doing so, the following sections will demonstrate that the international market can provide strong incentives to innovatively address the cross-border insolvency dilemma through the multilateral trading system and its lead institution: the WTO. By furthering the contributions of the European experience pursuant to which, a central judicial authority such as the ECJ is necessary to oversee the implementation of a cross-border insolvency arrangement (*supra*), it will also be enquired

[76] *See* American Law Institute, Transnational Insolvency Project: International Statement of United States Bankruptcy Law (Discussion Draft, Apr. 17, 1996); American Law Institute, Transnational Insolvency Project: International Statement of Canadian Bankruptcy Law (Council Draft No. 1, Nov. 26, 1996); American Law Institute, Transnational Insolvency Project: International Statement of Mexican Bankruptcy Law (Preliminary Draft No. 1, Sept. 11, 1996).

whether the WTO/DSB might fill some level of the international judicial gap and might extend more adequate institutional support to a more coherent transnational insolvency system.

A. The International Market

Alongside the development of the EU internal market, globalisation has created a "de facto" international market where the rule of law is expanding on a regional and international level. Globalisation encourages cross-border commercial activities and by the same token, limits the powers of sovereign states to scrutinize the operations of multinational corporations. The first part of this Section will examine the creation and development of the international market, where borders are ever more fluid and the participation of countries in the international market has expanded to include many LDCs that were initially excluded. Another important aspect of this international market is the presence of international institutions capable of regulating trade and non-trade issues effectively. Through harmonization, standard-setting mechanisms and assessment programs, the international community has witnessed a rapid expansion of the tools necessary to supervise commercial activities within this international market. A preliminary understanding of these tools is essential to ascertain whether the international market will, on the long term, follow a similar pattern of development as the EU internal market. More importantly, this might give an indication on whether a comparable viable cross-border insolvency arrangement may be created on the global level[77].

1. Globalization and Elapse of Borders

Pundits often proclaim the dissolution of borders and the rapid advance of globalisation with all its cultural, economic and political implications for the nation-state. Similarly, within the legal sphere, globalisation has had a profound impact on 'internationalising' the domestic legal systems of countries. Classical economists such as

[77] This will necessitate the examination of the development of the international market, the expanding participation of nation-states within that market and ascertain whether this international market shares the same developmental trends as the EU internal market.

Adam Smith and David Hume have long supported the necessity of a legal order to facilitate market transactions[78]. While their primary focus at that time was the importance of the domestic foundation of law, a mounting body of international law has since developed in response to the growing internationalisation of the world economy, such as the body of law regulating international commercial transactions. Nation states have seen the benefits of an international legal order governing trade in furthering their own trade liberalization efforts and upholding the framework for multilateral trade. The post war legal regime governing international trade has been guided by public international law, evolving from a loose agreement among nations embodied in the General Agreement on Tariffs and Trade (GATT) to an institution with binding contractual obligations and commitments, embodied in the WTO. While there are numerous reasons for the expansion of legalization in international trade, the focus of this section is on the existence of a de facto international market, which will be argued as an important driving force towards the liberalization of international trade and possibly for the promulgation of principles to deal with the insolvency of multinationals.

One important critique however to this international market is the persistent exclusion of LDCs[79] from participating and reaping the benefits of globalisation on the same level as developed countries. The international market primarily included and benefited only the domestic markets of developed countries, creating not an international market, but a club of the privileged. Recently however, the status of developing countries in international trade has evolved from relative exclusion of legal obligations within the GATT, to one based on reciprocity and legal equality in the WTO. For instance, under the GATT system, LDCs sought special and differential treatment by demanding

[78] *See generally,* A. Smith, An Enquiry into the Nature and Causes of the Wealth of Nations, Methuen, London 1961 (1776).

[79] Some of such critics demonstrate how LDC's could not pursue their own economic interest within the international market. *See* for instance, Alexandre-Charles Kiss, Les resources naturelles et le droit international; Conclusions, 45-56 Annuaire de l'A.A.A. 263, 271 (1984-86); Milan Bulajic, Principles of International Development Law, 236 (1986); Paul de Waart, The Right to Development: Utopian or Real?, in Restructuring the International Economic Order: The Role of Law and Lawyers, 99 (Pieter van Dijk et al. eds., 1987); Pieter Verloren van Themaat, The Changing Structure of International Economic Law, 194 (1981).

preferences from developed countries and exclusion from their basic legal obligations. Through their espousal and acceptance of a one sided legal status, developing countries hampered their effective participation and limited the benefits of international trade to those who accepted their limited legal obligations[80], which were primarily developed countries. The mercantilist structure of the GATT reinforced the legal inequality of developing countries, as the GATT was coloured by power politics and government discretion, where protectionism was often the status quo that could only be changed through negotiation and reciprocity.

The nature of international trade law changed drastically with the establishment of the WTO, creating for the first time an international organization with binding legal obligations and an effective dispute settlement mechanism. LDCs also changed course dramatically in both the domestic and international sphere by implementing trade liberalizing reforms and accepting equal legal obligations under the WTO[81]. While some remnants of special and differential treatment persist, there is no longer an imbalance of legal obligations between developed countries and LDCs.

The legal equality of LDCs is of great benefit not only within their domestic political and economic sphere, but legal equality also serves to improve the relations of LDCs with other member states[82]. The international market is now truly international with the inclusion of both developed and developing countries. Thus the expanding international market is evidenced by the growing participation of all nation-states and the expanding body of internationally-agreed upon tools, enforced by a supra-national authority such as the WTO[83]. There are stronger incentives to cooperate and greater

[80] *Id.*
[81] Raj Bhala, Assessing The Modern Era of International Trade, 21 FORDHAM INT'L L.J. 1647, 1658 - 1659 (1998).
[82] Kevin Watkins & Penny Fowler, Rigged Rules and Double Standards: Trade, Globalisation, and the Fight against Poverty 235 (2002).
[83] *See generally* Alice Alexandra Kipel, Special and Differential Treatment for Developing Countries, in The World Trade Organization: The Multilateral Trade Framework for the 21st Century and U.S. Implementing Legislation 617-94 (Terence P. Stewart ed., A.B.A., Section of Int'l Law & Practice 1996);

potential to resolve disputes between sovereigns in the international market, including those that arise from the insolvency process of large multinationals. This being said, a distinction should be made between the types of law that exist in the WTO and which may be of benefit in creating a predictable insolvency framework.

2. Harmonization and Standard Setting

One type of law that governs international trade is "negative" law, or law designed on the 'interface principle'[84]. This type of law restricts excessive government intervention and does not stipulate what governments *must* do; rather, it allows nations to retain their distinct regulatory structures, provided they do not contradict WTO law. For example, a member state can retaliate but must do so within the confines of the dispute settlement mechanism. Another type of law within the WTO is "harmonization" law, which seeks to establish obligatory standards among member states[85], such as the Trade Related Intellectual Property (TRIPs) agreement that requires a minimum level of intellectual property protection[86]. Harmonization law tells governments what they *must* do and restricts regulatory differences among member states.

Whether negative or harmonizing in nature, WTO rules are certainly a good example of hard-law making initiatives because nation-states are compelled to apply these rules and a risk of retaliation exists for those who deviate from such rules. On the other hand, soft-law making initiatives have gained increasing momentum in the last

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Bernard M. Hoekman & Michel M. Kostecki, The Political Economy of the World Trading System: the WTO and Beyond 392-393 (Oxford Univ. Press 2001).

[84] *See* J. H. Jackson, Managing the trading system: the World Trade Organization and the post-Uruguay Round GATT agenda, Managing the world economy: fifty years after Bretton Woods; ed. P.B. Kenen. Washington, D.C.: Institute for International Economics, 1994, at 131. See also Hoekman, B., The WTO: functions and basic principles. Development, trade and the WTO: a handbook, ed. by B. Hoekman, A. Mattoo and P. English; Washington, D.C.: World Bank, 2002, at 41-45.

[85] "Harmonization has already become part and parcel of the existing GATT/WTO regime. But even more so, it seems to have become a central source of contention in the public debate surrounding the WTO's future agenda". *See* Arie Reich, The WTO as a Law-Harmonizing Institution, *25 U. Pa. J. Int'l Econ. L.* 321 (2004).

[86] *See* Louis S. Sorell et al., Changes to U.S. Patent Law Under GATT: Summary and Practice Recommendations, 426 Practising L. Inst. 95 (1995).

decade[87]. These often come under the form of standard-setting efforts or through the identification of best international practices in a given domain. These tools altogether, whether hard or soft, create an arsenal of instruments that simultaneously develop and regulate the international market and can equally serve to fashion an effective cross-border insolvency arrangement.

Though borders and controls surrounding sovereign states have not disappeared, the ongoing process of globalisation has encouraged the creation of internationally applicable regulations and standards and their associated enforcement mechanisms, buttressed by organizational bodies, such as the WTO. Nation-states have acknowledged that their domestic laws and domestic judiciary are unable to effectively supervise cross-border commercial activities; thus, nation-states hosting multinational corporations tend to embrace international standards. While the powers of the nation-state in watching over multinational's activities domestically have certainly not vanished altogether, states with obstructionist domestic policies that shun internationally accepted standards run the risk of corporate flight; as the very nature of the multinational corporation is to be internationally mobile and adaptable. Obstructionist, exclusionist or merely less favourable policies would surely hamper nation-states competitive quest to attract multinationals and all the economic benefits they may bring.

Thus, with the continued pace of globalisation and the demands for a more flexible and dynamic market, international law-making initiatives, whether hard or soft, will continue to play a major role in regulating the international market, thereby affecting the operations of multinational corporations. National legal systems will increasingly be limited to control businesses that are primarily domestic in nature, while multinationals will expect, by virtue of their nature, to comply with international standards and regulations.

[87] *See generally* Professor Gunther F. Handl Et. Al., A Hard Look at Soft Law, 82 AM. SOC'Y INT'L L. PROC. 371 (1988).

Though a more in depth analysis of this issue is without the scope of this dissertation, based on the international market described above and its related sources of law, the potential appears to exist for the eventual creation of a "binding" cross-border insolvency regime. Indeed, from the European experience, the pre-requisites to create such a regime have been established generally and, importantly, the type of necessary legal instruments has been defined. This being said, the issue of what instruments should be used to create a cross-border insolvency system is still open for discussion. The EU, for instance, has clearly opted for an approach comparable to the "hard-law" models, which are compulsory in all their aspects and any infringement by member states would be sanctioned. However, due to the unique regional nature of the EU, this may not be possible on a global level, at least in the short-term or medium-term.

Given the advancement of the international market and the availability of adequate regulatory instruments therein, the insolvency of multinational corporations can and should be addressed on an international scale. Despite that large multinationals today are the key players in the development of international trade, cross-border insolvency matters have not been on the WTO's agenda. This has frustrated the development of a full set of rules to contain and encourage international trade and investment in many ways. In other words, cross-border insolvency matters are seen today as the missing link in a long series of harmonization and standard-setting mechanisms launched by the international community, through the WTO or other international institutions, such as the World Bank and the International Monetary Fund (IMF)[88].

B. Filling the Judicial Gap

Experience in the realm of international law has demonstrated that states do not abide by their commitments, unless rigid enforcement mechanisms - such as sanctions -

[88] On possible linkage schemes, *see* Gianvitti, F., Les rapports entre l'Organisation mondiale du commerce et le Fonds monétaire international: La réorganisation mondiale des échanges (problèmes juridiques). Paris: Pedone, 1996, at 75-86. *See also* B. Hindley, What subjects are suitable for WTO agreement? Political economy of international trade law: essays in honor of Robert E. Hudec / ed. by D.L.M. Kennedy and J.D. Southwick. Cambridge: Cambridge University Press, 2002, at 157-163.

are available. In addition, one may note that despite the development of tools to regulate the international market, there is still no international instrument that possesses the direct applicability feature of an EU regulation. Therefore, state' intervention is more frequently than not required for the transposition of international treaties onto the domestic level. For instance, under the WTO system, multilateral agreements, though ratified by a given state, usually call for the intervention of the executive and/or legislative authorities of that ratifying state to promulgate decrees and/or laws that would give effect to the provisions of these multilateral agreements on the domestic level. Limited by these constraints, a suitable international judicial entity to oversee the implementation of a potential insolvency arrangement must possess the power to compel states to abide by their commitments. This judicial entity should be empowered to oblige states to enact modern domestic insolvency laws that are able to cope with the very nature of multinationals.

The issue of compliance with international law does not unfortunately depend solely on the ability of forcing sovereign states into adopting a given course of action. As seen under the EU insolvency system, the ECJ exercises tight control over domestic judiciary by way of interpretation. Replicating this model of supervision on the international level may seem particularly difficult, if not impossible. Indeed, it is one thing to ensure that sovereign states would give effect to a binding insolvency treaty onto their national level; and it is another issue to make sure that domestic courts in each country would effectively implement these now national insolvency principles and abstain from favouring domestic creditors. This problem however is not proper to the area of insolvency; rather, it translates the extent to which the rule of law is enforced within domestic legal systems. Thus, it is important to understand what constraints a supranational judicial entity in the area of transnational insolvency is likely to face.

As above discussed, such an entity should preferably have the ability to force states into complying with any potential insolvency arrangement, whether or not under the form of a revamped Model Law. Although examples of international judicial bodies

are nowadays abundant, very few might be able to successfully control or at least temper self-centered and egoistic states. Though numerous methods and theories of compliance have emerged from the disciplines of international relations and world diplomacy[89], the most current and practical experience stems from the international trading system and the powers of the WTO/DSB to compel sovereign states into abiding by their WTO obligations, whether trade or non-trade related. This being said, bringing the WTO/DSB into the cross-border insolvency dilemma is advancing that a viable and justifiable linkage between trade and multinationals' insolvency exists[90].

The following sub-parts of this Section will reflect preliminarily upon the potential of involving the WTO/DSB in the process of reaching a more viable and/or binding cross-border insolvency framework that is rooted in the multilateral trading system.

[89] *See generally* Philip M. Nichols, Corruption in the World Trade Organization: Discerning the Limits of the World Trade Organization's Authority, 28 NYU J Intl L & Pol (1996); Frieder Roessler, Domestic Policy Objectives and the Multilateral Trade Order: Lessons from the Past, 19 U PA J INTL ECON L (1998); Jeffrey L. Dunoff, The WTO in Transition: Of Constituents, Competence and Coherence, 33 Geo Wash Intl L Rev (2001); John H. Jackson, Afterword: The Linkage Problem--Comments on Five Texts, 96 AM J INTL L (2002); Debra P. Steger, Afterword: The "Trade and . . ." Conundrum-- A Commentary, 96 AM J INTL L (2002). *See also* John H. Jackson, The Perils Of Globalization and the World Trading System, 24 FORDHAM INTL L J (2000).

[90] In fact, using trade as a mechanism of compliance with international law is not a new trend. "*Trade and*" issues have existed for a long time in the international trading system. The issue of linkage could be traced back to the inception of the International Trade Organization (ITO), within the confines of which environmental issues and competition policies were included. Although an extensive empirical and academic work has been undertaken on the issue of linkage, none has considered cross-border insolvency matters as a potential area of linkage. Instead, most theories committed to explain and elucidate this phenomenon, whether in support or in rejection, tackled the very nature of the trading system as today managed by the WTO and raised questions of legitimacy, convenience and practicability. While such general studies constitute an important basis for the following parts, articulating a general view or a theory on the feasibility of linking trade and non-trade matters is beyond the scope of this work. Rather, the objective here is to highlight the arguments that may be used to advocate a specific linkage between trade sanctions and a potential cross-border insolvency arrangement, whether or not under the form of a revamped Model Law. *See* Daniel Kalderimis, Problems of WTO Harmonization and the Virtues of Shields over Swords, 13 MNJGT 305 (2004).

Chapter Five.

1. Insolvency and Trade: A Natural Linkage

Pursuant to the "purposeful enterprise"[91] theory to the linkage dilemma, one may see how a cross-border insolvency system may serve a number of objectives. First, such a system would considerably reduce the uncertainties that arise from international contracting. As previously explained, predictable cross-border insolvency rules would increase the transactional gain when a multinational corporation is conducting business on a global level. By decreasing pre-insolvency costs, a potential cross-border insolvency agreement fulfils a meaningful purpose by enabling more effective capital placements. Second, global insolvency proceedings produce some effects on the domestic social level. Insofar as a global insolvency regime renders the rescue option more feasible, it would thereby preserve jobs, which is an unlikely outcome when a multinational is simply liquidated.

Although the purposeful enterprise approach would be suitable in justifying the linkage between insolvency and trade, other theories of linkage have developed in the course of the WTO negotiation process. Indeed, as argued by a number of scholars, the linkage issue reflects the ongoing bargaining process between developed and developing countries[92]. For instance, LDCs accepted a linkage between intellectual property and trade in exchange of cut-offs from developed countries with respect to textile quotas[93]. Applying this strategic linkage approach to insolvency is to presume that LDCs would necessarily oppose the linkage between insolvency and trade; and developed countries would need - in order to achieve such a linkage - to make certain concessions in the course of future WTO negotiation rounds. However, it is believed that this projection may be unfounded in many respects. Previous WTO negotiation rounds have demonstrated that LDCs naturally reject topics that would burden, restrict and/or weaken their economic and social infrastructure. For instance strengthening labour rights and

[91] *See* Frieder Roessler, Diverging Domestic Policies and Multilateral Trade Integration, in Jagdish Bhagwati and Robert E. Hudec, eds, Fair Trade and Harmonization: Prerequisites for Free Trade? Vol 2: Legal Analysis 21, 36 (MIT 1996).
[92] *See* José E. Alvarez, The WTO as Linkage Machine, 96 AM J INTL L 146, 147 (2002).
[93] Id.

imposing minimum labour standards would clearly affect developing countries' ability to manufacture and export cheap products to the developed world[94]. Similarly, an utmost protection of intellectual property would prevent developing countries from manufacturing generic medicines at affordable prices to their citizens.

On that same level, one may ask what reasons might underlie LDCs' rejection of a linkage between insolvency and trade. As discussed earlier, an effective resolution of cross-border insolvency cases would result in more gains on the domestic level, whether social or economic. In addition, the application of fair and predictable insolvency rules on the domestic level would attract foreign direct investments[95], which is a key objective of LDCs. Hence, the fact that most multinationals have their home country in the developed world, and accordingly, domestic courts in LDCs would most often defer to foreign insolvency proceedings, should not constitute a ground for rejecting such a linkage. So long as domestic and foreign creditors are treated equally through a global system of cross-priority; and insofar as secondary domestic proceedings may be initiated in order to protect the interests of domestic creditors, no apparent reasons for rejection exist under the current trading system.

Perhaps, a more direct approach to advocate the linkage between insolvency and trade lies within the very nature of the WTO and the multilateral trading system itself. In fact, one may safely assert that the international trading system heavily relies on the active participation of multinational corporations[96]. On the other hand, the scope of the WTO is not restricted to trade issues per se; rather this scope encompasses all matters that

[94] *See* Gregory Shaffer, WTO Blue-Green Blues: The Impact of U.S. Domestic Politics on Trade-Labor, Trade-Environment Linkages for the WTO's Future, 24 FORDHAM INTL L J 608, 647-48 (2000).

[95] The area of investment finds a direct support from recent WTO negotiation rounds. Since the Singapore round, the WTO has set two separate working groups to explore the issues of competition and investment, and how the latter would relate to the promotion of free trade.

[96] "An indication of how closely trade is linked with investment is the fact that about one third of the $6.1 trillion total for world trade in goods and services in 1995 was trade within companies - for example between subsidiaries in different countries or between a subsidiary and its headquarters." See http://www.wto.org/english/thewto_e/whatis_e/ (last visited July 2005).

may affect free trade[97]. As the insolvency of multinational corporations, which are important participants to the development of the multilateral trading system, produces considerable ex-ante and ex-post effects on the operations of such multinationals; the task of promoting global corporate insolvency rules should naturally be incumbent on the WTO.

Linkages for less obvious reasons and relevancy to trade, such as intellectual property rights, could find a concrete implementation under the auspices of the WTO. Hence, it could be argued that multinationals' insolvency, a topic more related to trade than intellectual property rights, ought to be linked with trade under the supervision of the WTO. This would represent the most practical solution because of a number of reasons. First, the rule-making process under the WTO will favour a consensus-based approach on cross-border insolvency, with expected, yet useful, North/South debates on the issue. These debates will shed lights on the concerns of each country to abide by a global insolvency arrangement and to defer to foreign insolvency courts when doing so would result in a fairer liquidation or reorganization process. Although an eventual consensus on these matters may take long to concretise, significant advantages will result from the inclusion of cross-border insolvency matters into a readily functional and effective structure such as the WTO. Second, the WTO could use its own dispute settlement mechanisms so as to ensure that the consensus reached among the participants is duly enforced. By analogy, though analogies are often incomplete, the WTO and its DSB would respectively fulfil the same role as the Counsel of Europe and the ECJ.

2. Prospects and Advantages under the WTO/DSB

Undoubtedly, the primary advantage of linking insolvency to trade is to benefit from the WTO/DSB and its ability to compel nation states to respect their WTO

[97] *See* Markus Krajewski, Democratic Legitimacy and Constitutional Perspectives of WTO Law, 35 J. World Trade 167 (2001); Ernst-Ulrich Petersmann, The WTO Constitution and Human Rights, 3 J. INT'L ECON. L. 19 (2000); Ernst-Ulrich Petersmann, How to Constitutionalize International Law and Foreign Policy for the Benefit of Civil Society?, 20 MICH J. INT'L L. 1 (1998); Neil Walker, The EU and the WTO: Constitutionalism in a New Key, in The EU and the WTO: Legal and Constitutional Aspects (Grainne De Burca & Joanne Scott eds., 2001).

commitments. Theoretically, the previous parts have attempted to find a plausible justification of how and why the insolvency of multinational corporations and the rules pursuant to which these entities are liquidated or restructured may hamper trade liberalization efforts as advocated by the WTO. This part will envisage, to the extent possible, the prospects of linking insolvency to trade, and most importantly, the prospects of resorting to the WTO/DSB to ensure that WTO member states enact an instrument such as an enhanced Model Law, thereby boosting cooperation trends between forums in resolving cross-border insolvency cases.

To date, the international community has made no proposal or efforts to include cross-border insolvency into the WTO agenda. This lack of initiative may seem even more surprising when one considers that the WTO aims at regulating all aspects affecting the liberalization of trade, in relation to which, multinationals are the key players. It is more probable, however, that the area of insolvency did not attract much attention in the course of the WTO negotiation rounds because the implications of cross-border insolvency have traditionally been thought of as investment rather than trade-related. In light of the absence of a multilateral investment treaty, it can be understood why so little attention has been given to create or resort to a supranational entity, which objective is to enforce a more viable insolvency framework and/or standards. As such and despite the various justifications to link insolvency with trade, and notwithstanding the advantages that are likely to result from such a process, the prospects of transposing the Model Law, or any similar instrument, onto the form of a multilateral agreement on trade-related aspects of cross-border insolvency seem rather bleak. Insofar a multilateral investment treaty is now and remains under consideration at the WTO level and so long as a vivid opposition between the North and the South exists and will continue to delay the advancement of this project[98], it is realistic to acknowledge that the cross-border insolvency dilemma stands little of a chance to be resolved through the WTO, at least in the short-term.

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[98] *See* Paul Civello, The Trims Agreement: A Failed Attempt at Investment Liberalization, 8 MINN. J. GLOBAL TRADE 97, 97-100 (1999).

This being said, in today's global economy, the distinction between trade and investment is increasingly loose and even convergent[99]. Rules affecting and regulating international trade affect investment, and vice versa, investment agreements between nations affect their WTO free trade commitments[100]. Hence, it is foreseeable that the scope of the WTO will ultimately be broadened so as to cover investment related issues and ideally this will take the form of a binding multilateral investment treaty benefiting from the WTO Dispute Settlement Understanding. Perhaps, at that stage and within this investment context, the promulgation and ratification of cross-border insolvency principles may become more easily achievable under the auspices of the WTO. Until then, the international community may have valuable years ahead to refine the Model Law and to address its shortcomings, thereby improving its chances to serve as the instrument of reference for a more rational, viable and perhaps "binding" cross-border insolvency regime.

V. Conclusion

The debate over the policy underpinnings for an effective cross-border insolvency framework has unfortunately occupied much of the literature in this area. Although achieving a meaningful advancement in this domain requires a complete and thorough understanding of such an extensive literature, it is believed that the cross-border insolvency dilemma is yearning for a more pragmatic and incremental (phased) solution, one that can reconcile conflicting theories while fully utilizing and benefiting from the international legal order. Undoubtedly, the Model Law marks the first step in the way of this pragmatic solution, but regrettably, it remains too weak to change the *status quo* of territoriality; not to mention its lack of binding effect. Accordingly, this last Chapter has attempted to browse and sift through the range of instruments and institutions, which by virtue of their nature and powers, are thought capable of achieving and channelling significant insolvency reform and binding principles, on both bilateral and multilateral level. While the prospects of using such channels have been discussed, this Chapter does not aim at proposing the definitive components of an international insolvency treaty.

[99] *See also* Calvin, Trade and Investment, *supra* note 27, at 13.
[100] Id.

Chapter Five.

Rather, it has attempted to broaden the debate on cross-border insolvency so as to involve potential reform vehicles not previously contemplated. Perhaps, more difficult than finding a viable solution to the cross-border insolvency dilemma is shifting the focus from theory to practice and to acknowledge that the international market is now sufficiently developed and mature to embrace global insolvency standards and/or framework.

Admittedly the modest, interim and incremental (phased) approach ("Modified Universalism") suggested by this thesis does not address satisfactorily, in the short and medium term, a number of the lingering international corporate insolvency issues and probably only a True/Pure Universalist framework would, but as pointed out in Chapter One and reaffirmed here in conclusion, "there needs to be a 'practical' start-point that can be incrementally enhanced and perfected over time, while exiting from the unproductive theoretical deadlock between Universality and Territoriality and unrealistic visions of harmonized national insolvency laws.

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