

MODIFIED UNIVERSALITY: THE BEST MODEL IN REGULATING CROSS-
BORDER INSOLVENCY

by

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Abstract

Insolvency is an economic fact of life. Some businesses thrive and some businesses fail. The bankruptcies of corporate debtors with assets and liabilities worldwide pose special challenges to governments and insolvency practitioners. In any given case, two questions must be answered. First, where shall the proceeding begin? Second, what law shall be applicable to the proceeding? In addressing these two issues, four approaches have been proposed by the research community: universality, modified universality, territoriality and cooperative territoriality.

For the past few decades, universality is often perceived as the best theory of all in regulating cross-border insolvency. It fits in perfectly with the *ex ante* and *ex post* goals possessed by an ideal insolvency system. However, in recent years, the utility inherent to the theory is being questioned. It is doubtful that states will be willing to sacrifice their sovereignty for the general interests of creditors and debtors. This doubt is substantiated by the invariable failures of international bankruptcy instruments that embraced universality as the theoretical justification.

In contrast, modified universality, the watered-down version of universality, has quietly made its way onto the international scene. Its nature and benefits have received high regard among nations. A general consensus in the international community that modified universality provides the best model for regulating cross-border bankruptcy has been cultivated. The purpose of this paper is to confirm this consensus through a combination of theoretical and practical analysis. The theory will also be feed into the discussion on cross-border bankruptcy between Canada and the United States in predicting the future mode of cooperation between the two countries.

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Modified Universality: The Best Model in Regulating Cross-Border Insolvency

1 Introduction

International corporate bankruptcy is not a recent phenomenon. Since the financial failure of the Ammanati Bank of Pistoja in Italy in the 1300s,¹ the academy has been searching for an optimal solution in dealing with cross-border insolvency.² At one end of the spectrum, bankruptcy proceedings are filed in each jurisdiction where the assets of the debtor lie. This approach is termed “territoriality”, which is also notoriously known as the “grab rule”.³ As the name suggests, the rule contemplates a situation where a state confiscates all the debtor’s assets that are within its territory and administers it according to local rules. No regard will be paid towards foreign proceedings. At the other end of the spectrum stands “universality”. Under this theory, a court where the debtor has its principal place of business controls the entire body of the debtor’s assets wherever located. The result will be one plenary bankruptcy proceeding with assets being turned over from the other countries for central administration. In between universality and territoriality, two subspecies exist. These are modified universality and cooperative territoriality.

For the past few decades, nations have engaged themselves in a search for the best solution in regulating cross-border insolvency. Consequently, with the exception of cooperative territoriality, modern developments have leaped back and forth among the theories. In recent years, however, the pursuit for an optimal solution has slowed down. A general consensus that modified universality represents the best model has slowly

¹ The Papacy was involved extensively in the administration of the bank’s assets for the benefits of the creditors in Italy, Spain, Portugal, Germany and France. The bank was prohibited from making payments on its debts and disposing assets without papal approval. Protection was offered to the owners of the bank until a compromise was reached between the creditors and the bank. The extensive financial system of the Papacy was also used to collect all the monies and transfer them to Rome for a central distribution among creditors. See Kurt H. Nadelmann, “Bankruptcy Treaties” (1944-1995) 93 U. Pa. L. Rev. 58 at 58, 59.

² The non-existence of a widely acceptable solution to cross-border bankruptcies have been regarded by some as a Holy Grail, desirable but elusive, notwithstanding the extensive efforts taken to address it. See Donna McKenzie, “Developments in International Commercial Law: International Solutions to International Insolvency: An Insoluble Problem?” (1997) 26 U. Balt. L. Rev. 15 at 15.

³ Robert K. Rasmussen, “A New Approach to Transnational Insolvencies” (1997) 19 Mich. J. Int’l L. 1 at 2; Kurt H. Nadelmann, “Rehabilitating International Bankruptcy: Lessons Taught by Herstatt and Company” (1977) 52 N.Y.U. L. Rev. 1; Jay Lawrence Westbrook, “Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum” (1991) 65 Am. Bankr. L.J. 457 at 460; Hannah L. Buxbaum, “Rethinking International Insolvency: The Neglected Role of Choice-of-Law Rules and Theory” (2000) 36 Stan. J. Int’l L. 23 at 26.

emerged. The purpose of this paper is to confirm and appraise this consensus through a combination of theoretical and practical analysis.

The theoretical analysis will be presented in Chapters 2 and 3. The operations, advantages and disadvantages of universality, modified universality, territoriality and cooperative territoriality will be examined. A study of the opposing views supporting or denouncing a theory is important to bring forth the message that no theory is perfect. The word, "perfect", should not be in the way of the search for a theory that works well in practice. In other words, the seemingly perfect theory of universality is, by no means, perfect. In contrast, modified universality works remarkably well in practice despite arguments raised against it.

The practical analysis will be presented in Chapter 4 where the solutions applied by nations in regulating cross-border bankruptcies will be studied. Focus will be placed on three international instruments: the Nordic Convention, the European Union Regulation on Insolvency Proceedings and the United Nations Commission on International Trade Law Model Law on Cross-Border Bankruptcy. The solutions embraced by each of the three instruments in solving the complexities posted by cross-border insolvency will be scrutinized. The question of how far states are willing to go in compromising their sovereignty for the collective interests of both the debtors and creditors will be addressed. The answer will tie back to the proposition that modified universality is the best model in regulating cross-border insolvency.

Chapter 5 will apply the findings from the previous chapters to the situation between Canada the United States. Past and current developments in the treatment of cross-border insolvencies between the two nations will be discussed. A forecast will be made in regards to the future mode of cooperation between the two states.

1.1 The Goals of an International Bankruptcy System

One of the recurring discussions throughout the paper is the goals served by an international bankruptcy system. Therefore, it is appropriate to address these before delving into a discussion of the theories. It is interesting to note that these goals or ends to an international bankruptcy system correspond roughly to the theoretical underpinnings of a domestic bankruptcy system. This can be explained by the fact that other than the multinational status of a debtor that triggers special legal problems, such as, a choice of

law issue, both domestic and international insolvencies are plagued by the same problem, namely, the common pool issue.⁴ In a nutshell, in domestic insolvencies, pre-existing relationships between a debtor and creditors generate conflicting claims on the debtor's assets. A similar problem exists in international insolvencies. The only difference is that the latter deals with creditors from more than one nation and assets located in more than one country.⁵ Therefore, similar to a domestic bankruptcy system, the goals of an ideal international bankruptcy system can be classified into two categories: the *ex ante* goal of predictability and the *ex post* goals of economic efficiency, equity and finality.

1.2 The *Ex Ante* Goal: Predictability

As compared to the *ex post* goals, the *ex ante* goal deals with the non-bankruptcy aspect of bankruptcy law. In other words, the *ex ante* goal does not concern the administrative aspect of insolvency. Instead, it addresses the external contributions made to the market by having a set of accessible bankruptcy laws.⁶ As identified by the report released by the Australian Law Reform Commission, better known as the Harmer Report, one of the nine objectives of modern insolvency law is to support the commercial and economic processes of the community, so far as is convenient and practical.⁷ Translating the objective into the international context, it refers to the proposition that insolvency law should enhance business efficacy by creating predictability in the credit market.⁸

The formula upon which a credit institution prices its commercial loans is not a trade secret. In any standard loan arrangement, the interest rate can be broken down into two segments: a risk free interest rate and a risk premium. The risk free interest rate is the rate a credit institution will receive if its money is invested in risk free ventures, such as, government bonds. Risk premium is the additional interest rate a creditor demands to

⁴ The theoretical basis for insolvency law is provided by a game theory known as "prisoner's dilemma". The theory is premised on three grounds. First, the participants are unable to cooperate and make a collective decision. Second, the participants are self-interested. Third, the outcome generated by participants' individual actions is worse than a collectivized solution. See Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge: Harvard University Press, 1986) at 10.

⁵ Westbrook, *supra* note 3 at 466.

⁶ Lucian Arye Bebchuk & Andrew T. Guzman, "An Economic Analysis of Transnational Bankruptcies" (1999) Vol. 42:2 J. Law Econ. 775 at 778.

⁷ Austl., Commonwealth, Law reform Commission, *General Insolvency Inquiry* (Report No. 45) (Canberra: Australian Government Publishing Service, 1988) at para. 33.

⁸ Liza Perkins, "A Defense of Pure Universalism in Cross-Border Corporate Insolvencies" (2000) 32 N.Y.U. J. Int'l L. & Pol. 787 at 804; Westbrook, *supra* no 3 at 7; Thomas M. Gaa, "Harmonization of International Bankruptcy Law and Practice: Is It Necessary? Is It Possible?" (1993) 27 Int'l Law 881 at 888.

compensate a specific risk associated with a credit arrangement. To determine the proper risk premium to be levied on a credit transaction, the possible bankruptcy of the debtor company is taken into account. The priority scheme and related legislation on perfection of security interests will assist credit institutions in predicting the extent of recovery in the case of a default. In essence, the informative aspect of bankruptcy legislation is at the heart and soul of credit markets and must not be overlooked.⁹

For domestic credit arrangements, creditors can refer to domestic insolvency legislation in pricing the loans. However, the issue is not as clear cut for international credit arrangements. What should creditors refer to in predicting the outcome of the failure of a debtor who operates businesses and owns assets worldwide? Though it is true that creditors commonly ask for collateral, the risk is there that security interests held by the creditors will not be recognized under the laws of particular countries.

Due to the additional risks of unpredictability and unenforceability of collateral in cross-border lending arrangements, creditors will ask for higher than normal interest rates.¹⁰ A company's capital structure will likely be impacted by the high interest, affecting its capital accumulation and investment decisions. For example, rather than raising capital through debentures, a corporation may be forced to issue stocks or not borrow at all. Another way of describing this problem is the deterioration of the autonomy of corporate entities. Ultimately, debtor companies will bear the costs of unpredictability. The irony is that most companies that borrow will not go through insolvencies ever! In view of the possible disruption to the international credit market affecting both financially sound and unsound companies, an ideal international bankruptcy system should provide for predictability to facilitate creditors in pricing their loans accurately and reasonably.¹¹

1.3 The *Ex Post* Goals: Economic Efficiency, Equity and Finality

As compared to the *ex ante* goal of a bankruptcy system, the *ex post* goals focus on the administrative aspect of bankruptcy. They are geared at those corporations that are

⁹ Lawrence A. Weiss, "Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims" (1990) 27 J. Finan. Econ. 285 at 285.

¹⁰ Perkins, *supra* note 8 at 810.

¹¹ A reduction in the costs of borrowing has also been associated with the creation of incentives for firms to maximize value and to fund projects that will generate a greater return. See Alan Schwartz, "Contract Theory Approach to Business Bankruptcy" (1998) 107 Yale L.J. 1807 at 1813.

in financial distress. Two *ex post* objectives are identified in the Harmer Report. First, insolvency law should enable both debtor and creditors to participate with the least possible delay and expense. Second, it should provide a convenient means of collecting or recovering property that should properly be applied towards the liabilities of the debtor.¹² In simpler terms, an ideal insolvency system should minimize expenses and delays¹³ and maximize the values of a debtor's remaining assets,¹⁴ reserving a larger pie for all. These goals could be tagged as the efficiency concern.¹⁵

Administrative costs for corporate bankruptcies are high.¹⁶ These costs include fees and compensation paid to third parties involved in the reorganization or liquidation of a debtor.¹⁷ Just imagine the number of professionals involved in a bankruptcy proceeding under the Canadian Bankruptcy and Insolvency Act ("B.I.A."). In any typical case, the Superintendent of Bankruptcy may direct a person to deal with the property of a debtor as he/she sees fit.¹⁸ Therefore, the more complicated a case is, the more officials and professionals, such as, trustees and receivers are involved. The more that professionals are involved, the higher the administrative costs. Since professionals enjoy priority over other creditors in the participation of the debtor's estate,¹⁹ it is not difficult to deduce that the pie available to other creditors will be significantly reduced.

The situation painted above is a vivid picture of the costs issue in domestic insolvency. By analogy, one could easily imagine the doubling or tripling of administrative expenses with the introduction of additional complexities in international insolvency. For example, an uncertainty over enforcement of security in another jurisdiction will lead to additional enquiries and litigation expenses. Incomplete information can also bring dire costs to international bankruptcies where creditors are

¹² *Supra* note 7.

¹³ Gaa, *supra* note 8 at 885.

¹⁴ Westbrook, *supra* note 3 at 465; Gaa, *supra* note 8 at 885.

¹⁵ Rasmussen, *supra* note 3 at 4.

¹⁶ The English liquidators of BCCI, Deloitte & Touche LLP, charged \$200 million in fees in the bankruptcy of the BCCI. See Joe Ortiz, "BCCI Creditors to Get \$ 2.65 Billion Payment Tuesday" *Reuter Euro. Bus. Rep.* (9 December 1996) cited in Lynn M. LoPucki, "The Case for Cooperative Territoriality in International Bankruptcy" (2000) 98 Mich. L. Rev. 2216 at 2251.

¹⁷ James S. Ang, Jess H. Chua & John J. McConnell, "Administrative Costs of Corporate Bankruptcy: A Note" (1982) 37:1 J. Finance 219 at 219.

¹⁸ *Bankruptcy and Insolvency Act*, R.S.C. 1985 c. B-3, s. 14.03(1).

¹⁹ *Ibid.* at s. 136(1)(b).

unable to share information expeditiously.²⁰ Creditors may not be able to reach a consensus on important questions such as whether the continuing value of a company is higher than its liquidation value due to information asymmetry.²¹ The fact that the creditors are physically situated in different parts of the world makes it difficult for creditors to communicate and for information to circulate. The issue of timeliness will also come into play. The longer an insolvency proceeding takes, the higher is the toll on the value of the assets. Thus, an efficient international bankruptcy system will minimize the administrative costs and preserve the value of a debtor corporation during the bankruptcy process.²²

In administering the assets of the debtor company, administrators must be wary of another objective associated with an ideal bankruptcy system: equity. Referring again to the Harmer Report, a bankruptcy system must provide “a fair and orderly process for dealing with the financial affairs of the insolvent companies”, encompassing “the principle of equal sharing between creditors”.²³ In domestic insolvency, a fair and equitable distribution of assets is achieved by the priority scheme set forth in bankruptcy legislation, such as section 136(1) of the B.I.A.. In international insolvency, a debtor’s assets and creditors are spread across different continents. This may make a just and equitable distribution difficult where creditors belonging to the same class will be treated alike. Local favoritism is not unknown in international bankruptcy.²⁴ Courts are keen to protect the rights of their subjects. In doing so, the rights of creditors elsewhere will be compromised. Thus, an international bankruptcy system should encourage an equitable distribution of assets and provide for a common means of proving the claims of creditors.²⁵ Moreover, efficiency can be tied back to the *ex ante* goal. Specifically, if creditors are assured of equal treatment in bankruptcy, an increase in international investment and trade will follow on a macro level.²⁶

²⁰ Perkins, *supra* 7 at 806.

²¹ David C. Webb, “The Importance of Incomplete Information in Explaining the Existence of Costly Bankruptcy” (1987) 54 *Economica* 279 at 279.

²² Lynn M. LoPucki, “Cooperation in International Bankruptcy: A Post-Universalist Approach” (1999) 84 *Cornell L. Rev.* 696 at 703.

²³ *Supra* note 7.

²⁴ Nadelmann, *supra* note 3 at 1.

²⁵ LoPucki, *supra* note 22; Gaa, *supra* note 8 at 885.

²⁶ Jeremy Smith, “Approaching Universality: The Role of Comity in International Bankruptcy Proceedings Litigated in America” (1999) 17 *B.U. Int’l L. J.* 367 at 370.

Finally, a unique attribute to international insolvency is that courts of a jurisdiction may be asked to accept and cooperate in the decisions made by other courts. Conceding to another jurisdiction can be seen as an invasive action tampering with the sovereignty of a state.²⁷ Finality to a bankruptcy case can only be achieved if courts grant legitimacy to the decisions made by a foreign judiciary. In light of this, an international insolvency system should serve to minimize the conflict among nations involved.²⁸

In sum, both the *ex ante* and *ex post* goals to an ideal bankruptcy system have laid a foundation for the academy to construct different models in regulating cross-border bankruptcy upon. The following two chapters will look at four models: universality, modified universality, territoriality and cooperative territoriality. Throughout the paper, emphasis must be placed on the fact that the four models fit into the goals at varying degrees. The reason for this variance is due to the different nature of each theory.

²⁷ Ian Fletcher, *Insolvency in Private International Law: National and International Approaches* (Oxford: Clarendon Press, 1999) at 11.

²⁸ Gaa, *supra* note 8 at 885. The issue of finality was also discussed by Professor LoPucki but in the context of the minimization of conflict among nations involved in a bankruptcy case. See LoPucki, *supra* 22.

2 Universality and Modified Universality

The debate on the theories of international insolvencies has focused generally on two approaches in opposite camps: universality and territoriality. As stated earlier, there are numerous variants branching out from either camp. This part of the paper will look at universality and its watered-down version, modified universality.

Universality is not a new theory.²⁹ Back in 1888, Professor John Lowell shared his foresight with the world by observing that it would be better to have all settlements of insolvent debtors with their creditors made through a single proceeding and at a single place.³⁰ This statement was made in the context of the state of commerce in the late nineteenth century. One could picture a full-blown application or development of such a theory in the twenty-first century where international trade and commerce are commonplace. However, as exposed in subsequent chapters, the opposite is true. There remains a gap between theory and practice. This being so, universality has remained a favourite among academics for the past few decades.³¹

2.1 Universality: The System

As mentioned earlier, universality refers to a system where a single court ("court of the home country") administers all the assets of a debtor and makes distributions to creditors accordingly. The question as to which court has jurisdiction over a bankrupt depends on where the debtor corporation is domiciled or has its principal place of business.³² It follows that the court of the home country will have jurisdiction over all the assets of the debtor company wherever located. The role played by other courts within whose territories a debtor's assets are located is restricted to turning over those assets for central administration.³³ By the same token, creditors from all across the world are required to file their claims in the home country.

²⁹ Universality is sometimes referred to as "unity". See Buxbaum, *supra* note 3.

³⁰ John Lowell, "Conflicts of Law as Applied to Assignments for Creditors" (1888) 1 Harv. L. Rev. 259 at 264.

³¹ Rasmussen, *supra* note 3 at 17.

³² L. Joseph Latham, "Cross-Border Bankruptcies: Standards for International Cooperation" in R. McLaren, ed., *Corporate Restructurings and Insolvencies: Issues and Perspectives. Queen's Annual Business Law Symposium 1995* (Kingston, Ontario: Carswell, 1996) at 344.

³³ *Ibid.*; LoPucki, *supra* note 22 at 706. A nation's willingness to turn over assets for a central administration provides a good measure of a nation's adherence to universality. See Bebchuk & Guzman, *supra* note 6 at 782.

In administering the estate of the bankrupt, the home country applies its own domestic bankruptcy regime to all the central issues. These include priority among creditors, reorganization, set-off of debts, wrongful trading, preferences and avoidances.³⁴ Foreign legislations may be involved from time to time as the court deems appropriate, such as, in determining the validity and perfection of interest.³⁵

To illustrate how universality functions in practice, assume a failed Canadian company, Company C. Company C has assets in Canada, the United States ("U.S.") and Mexico with creditors from the U.S. and the United Kingdom ("U.K."). Under universality, the Canadian courts will have jurisdiction in the bankruptcy of Company C.³⁶ Courts in the U.S. and Mexico will merely play an ancillary role and give whatever assistance asked for by the Canadian court, which can involve a turnover of assets to Canada. Creditors from the U.S. and the U.K. will prove their claims in Canada. Moreover, issues such as priority among creditors or the rules upon which Company C is to be liquidated or reorganized will be decided under the B.I.A. or the Companies' Creditors Arrangement Act ("C.C.A.A.").

2.1.1 The Case for Universality

Proponents for universality premise their case upon five grounds. First, universality offers predictability to creditors in pricing their loan agreements. As identified by Professor Westbrook, "one body of law must be applied to the maximum extent if relative default priorities are to be predicted accurately".³⁷ By identifying the home country of a debtor, universality makes it possible for creditors to find out the set of insolvency rules with reasonable reliability that will apply if the debtor company becomes insolvent. If creditors do not know which set of rules will apply, they will impose a higher than normal interest rate to compensate for the additional risk. In addition, the possibility of multiple proceedings, each with different substantive laws, makes contracting complex. A costly evaluation of the possible outcome in bankruptcy

³⁴ LoPucki, *supra* note 22 at 706; Latham, *supra* note 32.

³⁵ Jay Lawrence Westbrook, "Universal Priorities" (1998) 33 Tex. Int'l L. J. 27 at 29.

³⁶ For simplicity, this example rests on the assumption that the Canadian courts assume jurisdiction over Company C because the company was incorporated in Canada. However, in reality, the choice of forum will rarely be as clear cut as currently presented.

³⁷ Westbrook, *supra* note 3 at 469.

will put additional pressure on interest rates.³⁸ As this impacts all companies that borrow, not merely those that run into financial distress in the future, universality minimizes the net social loss by offering predictability.³⁹

Second, as opposed to other theories, universality will not skew investment decisions made by companies.⁴⁰ In a perfectly informed market, different creditors, wherever located, will likely make the same projections regarding the risk associated with a particular lending arrangement. Since the interest rates demanded from different creditors will be more or less the same, debtor companies will not be able to benefit from strategic borrowing.⁴¹ This can be better explained by referring to the model drawn by Professors Lucian Bebchuk and Andrew Guzman.⁴²

In the model, a debtor company with existing debts and assets in a country is faced with the choice of making a new investment in either the current location or a new country. The new country will offer a new priority to the new debt, assuming there is a difference between the priority rules of the two countries and universality does not apply. Thus, borrowing from a credit institution inside the new country can be seen as granting the new debt at a priority higher than its existing creditors. In effect, the downside risk to this new investment is transferred to existing creditors, creating an inequitable situation. Furthermore, companies will not choose to invest in a country that carries the highest rate of return, accepting a lower rate of return resulting from a lower interest rate on loans. A deadweight loss for society will then be generated.⁴³

Third, the administrative costs associated with a single administration are lower.⁴⁴ In any given cross-border insolvency case, the administrative costs can be classified into three categories: the costs incurred by the receivers and trustees in handling the debtor's estate, the costs incurred by foreign creditors in proving their claims in the court of the home country and the costs incurred by local creditors in filing their claims in the local proceeding. If a territorial approach is adopted in dealing with an insolvent debtor, the overall administrative costs will be a function of the sum of the costs of all three

³⁸ Perkins, *supra* note 8 at 807, 808.

³⁹ Rasmussen, *supra* note 3 at 17.

⁴⁰ Bebchuk & Guzman, *supra* note 6.

⁴¹ *Ibid.* at 779.

⁴² *Ibid.*

⁴³ *Ibid.* at 790.

⁴⁴ LoPucki, *supra* note 22 at 708.

categories multiplied by the number of proceedings that are opened. Under universality, however, only the creditors foreign to the court of the home country are burdened with the extra litigation expenses by hiring foreign counsels and the inconvenience of treading into unfamiliar territory. It is reasonable to assume that the number of foreign creditors will represent merely a small portion in the overall body of creditors. Bearing in mind the jurisdictional rule under universality, a proceeding will only be opened in a country where a debtor has its main interest. It is logical to infer that most credit transactions will occur in the debtor's centre of main interest. Thus, a majority of creditors will likely be local creditors who only need to resort to a familiar bankruptcy system in substantiating their claims. In sum, the cost savings under universality emanate from the prevention of duplicated administrative costs for both the debtor and most of the creditors by imposing one central proceeding.

Fourth, for a company to reorganize, a coordinated use of the entire body of assets located in various countries is needed.⁴⁵ Universality allows the court of the home country to assert jurisdiction over a debtor's assets universally. This will allow a single representative to take advantage of the synergies among the assets and submit a viable proposal. Professor Westbrook developed this argument further by stating that without a coordinated effort under one proceeding, creditors in countries with a high asset-to-claim ratio will have less incentive to participate in reorganization, affecting the overall interest of the body of creditors.⁴⁶ Moreover, the aggregate value of the assets of a company sold as a going concern will always be higher than the value sold on a piecemeal basis. Hence, more money will be available to creditors.

Finally, creditors, regardless of the origins of their claims, will be able to participate in an equitable distribution of the assets. Within any class of creditors, the fairest distribution is pro-rata. Universality achieves such distribution by ensuring that all

⁴⁵ Melissa K.S. Alwang, "Steering the Most Appropriate Course between Admiralty and Insolvency: Why an International Insolvency Treaty Should Recognize the Primacy of Admiralty Law over Maritime Assets" (1996) 64 Fordham L. Rev. 2613 at 2625.

⁴⁶ Professor Westbrook gave an example of an integrated company with its marketing, manufacturing and distributing sections in several countries: X, the United States and the United Kingdom. However, the asset-to-claim ratio is highest in the U.S. so creditors will fair better under a local distribution rather than a worldwide reorganization. In other word, there will be no incentive for the U.S. creditors to join the global reorganization effort. See Westbrook, *supra* note 3 at 465. The logic to this theory is questioned by Professor LoPucki. The latter argued that the creditors do not control the decision to organize or liquidate. See LoPucki, *supra* note 22 at 707.

creditors file their claims in one central proceeding. This will allow the court of the home country to classify the creditors using the same measure. An equitable distribution can also be met by having one court distribute the assets, thus eliminating the chance of double recoveries by creditors.⁴⁷

In addition to the advantages presented in the above, universalists have made a concession that not all creditors will benefit under a universal regime in any given case.⁴⁸ For example, creditors in locations where there is a high asset-to-claim ratio may fair better under a territorial regime that does not require a turnover of assets to the court of a home country. To respond to this shortcoming, Professor Westbrook presented his rebuttal through the Rough Wash and Transactional Gain theories. In particular, he is of the opinion that “the benefits offered under a universalist rule will roughly even out the benefits and losses for local creditors, who will gain enough from foreign deference to the local forum in one case to balance any loss from local deference to the foreign forum in another”.⁴⁹ Therefore, rather than assessing the benefits associated with universalism on a case to case basis, the net positive effects brought by the theory should be focused upon. Assuming that a majority of creditors are repeat players, any disadvantage suffered in a particular case will be offset by advantage gained in another cases. Regarding creditors who are not repeat players, it must not be forgotten that the premise of a bankruptcy system is directed towards solving the common-pool problem. The nature of a common-pool problem means that not everyone’s interest can be fulfilled. Some compromise is always necessary to generate the most returns from a system. Therefore, the fact that universality will result in discontent for a few creditors should not be seen as dealing a blow to the overall benefit generated by the theory.

2.1.2 The Case against Universality

Based on the strong case for universalism discussed above, there is little wonder why universalists have been winning the battle in the past few decades. Yet, the landscape is changing. The faith in universality once shared by the academia is weakening. This part of the paper will discuss the pitfalls to the theory. As Professor

⁴⁷ LoPucki, *ibid* at 708.

⁴⁸ Latham, *supra* note 32.

⁴⁹ Westbrook, *supra* note 3 at 465.

Lynn LoPucki is at the forefront in identifying the absurdity of universality, a large part of the discussion will be based on his work.⁵⁰

2.1.2.1 Governance of Domestic Relations by Foreign Courts

It is well documented that there is an intimate correlation between the insolvency law of a nation and the social order from which inspiration is drawn.⁵¹ Depending on the *situs* of creditors and debtors, for the same set of facts and circumstances, a wide variety of treatments may result as each nation's bankruptcy regime differs in both substance and form. Universality could create an inequitable situation through defeating the legitimate expectations of domestic parties by forcing the bankruptcy rules of the home country upon those parties. Four relationships will be reviewed to highlight the anomalous situation created by the governance of domestic relations by foreign courts.

First, consider the case of debtor in possession ("D.I.P.") financing. In the U.S., D.I.P. financing is clearly set out under section 364 of the Bankruptcy Code. A clear delineation between pre-bankruptcy and post-bankruptcy creditors allows the development of a full-fledged D.I.P. financing system in the U.S.. Super-priority can easily be obtained by institutions offering post-petition credit lines.⁵² One of the most important features of D.I.P. financing in the U.S. is the retention of pre-petition management in dealing with the daily operation of the troubled company in a post-petition stage.

In contrast, D.I.P. financing is non-existent in the U.K.. Thus, most British creditors will find the idea of allowing pre-petition management to remain in power appalling. This perception will unlikely change even if particular D.I.P. financing arrangements place the directors and officers under scrutiny for every major decision made. Under the Insolvency Code in the U.K., an administrator takes charge and replaces pre-petition management under all circumstances. The variance in the treatment of D.I.P. financing and the fate of the management is associated with different philosophical

⁵⁰ LoPucki, *supra* note 22.

⁵¹ Austl., Commonwealth, Law Reform Commission, *supra* note 27 at 4.

⁵² Richard J. Stewart, "Practice Points - Reconciling International Insolvency Law - with Money Global Businesses in Turmoil, an Examination of the Differences between U.S. and U.K. insolvency Procedures" (2002) LSG 99.05(31).

underpinnings of the two systems.⁵³ Specifically, the U.S. is drawn to a corporate rescue regime and the U.K. to a liquidation regime.⁵⁴

To illustrate, assume a situation where an American company incorporated in Delaware owns a manufacturing plant in the U.K.. The manufacturing venture in the U.K. is financed by an institution headquartered in London. Under universality, the Delaware court will have control over all the assets and liabilities of the American company. If D.I.P. financing is allowed by the U.S. court, the London creditors will be frustrated by the U.S. decision in allowing the board of directors in the U.S., which also controls the U.K. branch, to remain in power. The domestic relationship governed by the U.S. court in this scenario is one between the London creditors and the management of the manufacturing branch.

In brief, other types of domestic relationships that will be impacted by the overriding of local rules in favour of foreign rules are those between debtor and tort claimants, debtor and employees and debtor and tax agencies. Regarding tort claimants, countries like the U.S. allow tort claims to share *pro rata* with other commercial creditors notwithstanding the fact that they did not arise in the contract.⁵⁵ In other countries, tort claims may not be recognized at all or they are simply subordinated to commercial claims.⁵⁶ Thus, the priority offered to tort claimants in the U.S. will be overridden if another state is the home country of an insolvent debtor. This is particularly absurd considering the fact that the judgment awarded to an American tort claimant is handed down by a U.S. jury.

Between debtor companies and employees, nations such as Mexico provide a generous distribution to employees for wages, benefits and potential severance pay.⁵⁷ The Mexican law requires employees to be paid before both secured and unsecured creditors if the decision is made by a labour tribunal before a bankruptcy court intervenes and

⁵³ G. Moss stated, "In England, the judicial bias towards creditors reflects a general social attitude which is inclined to punish risk takers when the risks go wrong and side with creditors who lose out. The United States is still in spirit a pioneering country where the taking of risks is thought to be a good thing and creditors are perceived as being greedy." See G. Moss, "Chapter 11: An English Lawyer's Critique" (1998) 11 *Insolvency Intelligence* 17, cited in Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge: Cambridge University Press, 2002) at 197.

⁵⁴ Nick Brainsby, "Insolvency: Money matters Money matters" *The Lawyer* (24 March 2003) 23.

⁵⁵ *Bankruptcy Code*, 11 U.S.C. § 726(a)(2).

⁵⁶ LoPucki, *supra* note 22 at 709.

⁵⁷ *Ibid.*

distributes the debtor's assets. In Canada, however, the B.I.A. limits the priority of employees for wages, salaries, commissions for services rendered during the six months immediately preceding the bankruptcy to \$2,000.⁵⁸ Thus, a Mexican employee working for the packaging branch of a Canadian company in Mexico will likely be frustrated by the lesser recovery he or she would receive under the B.I.A. than under its Mexican counterpart.

Regarding the relationship between a debtor company and a tax collector, the situation is even more strange. Most insolvency legislation, such as the B.I.A., grants a priority to federal, provincial and municipal revenue collection agencies. The problem here is how will a property tax in arrears for the Mexico packaging branch of a Canadian company be treated by a Canadian court? It is well documented that foreign tax claims are not given much, if any, regard in an insolvency proceeding.⁵⁹

As demonstrated in the above, the undesirability of having a foreign court governing domestic relationships is twofold. First, tension will be created among the citizens and courts of different nations. Despite Professor Westbrook's ingenious Rough Wash and Transaction Gain theories, which focus on the overall positive outcome brought by universality, one cannot help but raise the question as to whether the purported aggregate positive outcome will be shared equally by nations adopting the universal doctrine. It is not difficult to imagine that the courts of most developed nations will always be designated as the home country due to the fact that most companies in developed nations are the main source of foreign investments in developing countries.⁶⁰ Consequently, domestic insolvency regimes of developing countries will be overshadowed by foreign bankruptcy systems, leading to tensions between developed and developing nations.⁶¹

⁵⁸ *Bankruptcy and Insolvency Act*, *supra* note 18 at s. 136(1)(d).

⁵⁹ LoPucki, *supra* note 22 at 709.

⁶⁰ The industrial countries have long dominated the foreign direct investment inflows and outflows with 94 percent of outflows and over 70 percent of inflows in 2001. See International Monetary Fund, *Foreign Direct Investment Trends and Statistics: A Summary* (28 October 2003) at 6, online: International Monetary Fund <<http://www.imf.org/external/np/sta/fdi/eng/2003/102803s1.pdf>>.

⁶¹ This assumption is raised in the absence of forum shopping activities among the management. The other side of the coin where the law of a developing nation will be exported to a developed nation will be discussed at 20, below.

Second, since the foreign bankruptcy courts of the home country will have jurisdiction over many aspects of domestic relationships, local creditors will have to petition or prove their claims in foreign courts. For example, a Mexican worker working for the packaging branch in Mexico of an American corporation may have to litigate in a U.S. bankruptcy court to prove his status as a creditor and the extent of his claim.⁶² Assume an unrealistic situation where the Mexican employee is well off. He can afford a legal representative in the U.S. and communicate at a distance. Now assume a realistic situation where the Mexican worker cannot afford a legal representative. He will have to spend time and study the U.S. legal system and the relevant employment standards legislation. He will have to appear unrepresented, assuming an unlikely situation where he can enter the U.S. at will. To top it off, he may experience prejudice.⁶³

2.1.2.2 Indeterminacy of the Home Country Standard

The determination of where the central proceeding commence under universality is of crucial importance. After all, it is the bankruptcy regime belonging to the debtor's home country that dictates the eventual fate of a debtor and the respective rights of creditors. At present, there are two approaches in ascertaining the nationality of a corporation: the state of incorporation and the real seat theories. As each theory belongs to a different legal tradition, courts with common or civil law backgrounds might find themselves asserting jurisdictions over the same debtor.

The state of incorporation theory belongs to the common law family. Questions such as the formation, existence and the dissolution of a corporation are determined by the laws under which the corporation is formed. Thus, the laws of the state of incorporation are used to decide on matters such as, the capacities and powers of directors, the rights and duties of the members, and the liabilities of the company and its members. This principle stands notwithstanding that all of the members are foreign nationals or a substantial portion of the businesses are conducted overseas.⁶⁴

In contrast, the real seat theory belongs to the civil law family. It provides that a legal personality can only subsist on the basis of a genuine and sustained association

⁶² LoPucki, *supra* note 22 at 713.

⁶³ Alwang, *supra* note 45 at 2627.

⁶⁴ Fletcher, *supra* note 27 at 117.

between the company and the country whose laws supply its life force.⁶⁵ To prove this association, it must be demonstrated that the real centre of the company's financial and business lies within the jurisdiction where it claims to enjoy its corporate entity.⁶⁶

Universalists have typically identified the nation where a debtor company is incorporated as the home country of a debtor. As such, the theory of incorporation is endorsed.⁶⁷ It is unclear why the real seat theory is not accepted over the theory of incorporation in determining the home country. The fact that a company's registrar and other important documents are stored in the country where the company is incorporated cannot be interpreted as substantiating a lifeline between a company and a particular country. After all, it is the business activities and not the constituting documents that cause a company to enter into credit arrangements. The only plausible explanation behind the preference for the state of incorporation theory is that the application of such theory is much simpler than the real seat theory. Just imagine a situation where a company has its business spread across different countries. What basis should be used in determining the real seat of such company? Even if scholars can arrive at a solution, whether states will respect the formula is another issue. After all, the liquidation or reorganization of a company can generate millions of fees for the professionals within the home country.⁶⁸ Consequently, there is a financial incentive for states to see themselves as the home country of an insolvency proceeding.

In supporting the state of incorporation theory, universality takes refuge in the idea that the identity of the home country will be obvious in the majority of cases. The debtor will usually have both its headquarters and its centre of main interest within the same country.⁶⁹ As examined by Professor LoPucki in the bankruptcy of Maxwell Communication Corporation and BCCI, this assumption is flawed.⁷⁰ The headquarters of Maxwell Communication Corporation was located in the U.K. while the majority of the assets were in the U.S.. Similarly, BCCI was incorporated in Luxembourg but its business spanned across different continents.

⁶⁵ *Ibid.* at 118.

⁶⁶ *Ibid.*

⁶⁷ LoPucki, *supra* note 22 at 714.

⁶⁸ Ortiz, *supra* note 16.

⁶⁹ Donald T. Trautman, Jay Lawrence Westbrook & Emmanuel Gaillard, "Four Models on International Bankruptcy" (1993) 41:4 Am. J. Comp. L. 573 at 581, 582.

⁷⁰ LoPucki, *supra* note 22 at 713, 714.

For debtor companies where the locations of their headquarters do not coincide with their centre of main interest, universalists have undermined the costs reduction advantage by maintaining that the court belonging to the state of incorporation has jurisdiction over a bankrupt debtor. There is little economic appeal in seeking to have all the assets transferred to a home country where there is a lack of the entity's assets relative to other jurisdictions. If costs are to be minimized, assets should be turned over to the country where the majority of the debtor's assets are located.

Another issue not addressed by the universalists stems from the irreconcilable difference between the state of incorporation and the real seat theories. By nature, international insolvency involves courts in multiple countries. Inevitably, some jurisdictions will belong to the civil law system. In such instances, it is difficult to predict the home country of the debtor entity with reasonable assurance. For example, for a company which held a "brass plate" headquarters in the U.K. while the bulk of its assets is located across the Channel in France, the courts in the U.K. will deem itself to be the court of the home country. If a bankruptcy proceeding commences in France against the company, it is questionable whether the English court will recognize orders made in the French proceeding. Likewise, if a proceeding is filed in the U.K., it is questionable if France will grant any assistance to the English court. After all, in the eyes of the French who advocate the real seat theory, France should be the proper forum for the proceeding.⁷¹

Fortunately, while recognizing the inherent tensions of the two competing theories, courts are not rigid in applying the home country standard. For example, the House of Lords in the U.K. referred to the "place where the persons who control and direct the destinies of the corporation meet and exercise their functions, or where the central control and management abides" to assist the determination of a debtor's home country.⁷² Similarly, section 304 of the Bankruptcy Code in the U.S. authorizes deference to insolvency cases commenced in the debtor's place of incorporation, headquarters or

⁷¹ Professor LoPucki found that once an insolvency proceeding begins, it becomes deeply rooted in a jurisdiction. This is natural considering that once a petition is filed, a court takes control with various parties appearing in front of it making representations. In such circumstances, a court will be unwilling to accede control to another jurisdiction. In this example, even if the British court subsequently realized that the French court has proper jurisdiction over the debtor, it will unlikely turn the case over. See *ibid.* at 722.

⁷² *De Beers Consolidated Mines Ltd. v. Howe* [1906] A.C. 455 at 458 (H.L.) *per* Lord Loreburn.

where the principal assets are located. Through the application of a flexible approach, both the courts in the U.K. and the legislature in the U.S. recognize the need to exercise jurisdiction to wind up a company that is not formed under their corporate legislation or to cooperate in a foreign proceeding involving a company of their nation.⁷³ However, flexibility generates uncertainty. It is difficult to articulate a set of rules to segregate central administration from supplementary administration and principal assets from secondary assets.

Furthermore, there is the unsolved issue of re-incorporation. Under the American corporate legislation, companies are allowed to possess more than one domicile. Re-incorporation merely extends the list of states capable of being defined as the home country.⁷⁴ Also worthwhile to point out is the issue of corporate groups. It is a fact that most multinational corporations use subsidiary companies as vehicles to carry out businesses overseas. For corporate groups, the issue of which jurisdiction should be the home country of the failed entity, whether it is the place of incorporation of a parent or an independent subsidiary, gets even more complicated.⁷⁵ The above discussions all point to the indeterminacy of the home country standard. Without resolving this deadlock, universality will be prevented from revealing its advantages as exemplified earlier.

2.1.2.3 Internationalization of the Delaware Syndrome

While it is true that the Delaware Syndrome is commonly associated with competition among states in the U.S. to attract new incorporations, the same may result from the application of the universality theory. Under the Syndrome, management of a company will engineer for the formation of a company, or 'forum shop' for the most favourable forum for incorporation. The final selection may rest on a combination of lax control on company's management, judiciary's indulgence towards management, and favourable taxes, trusts and corporate law.⁷⁶

As mentioned earlier, according to the universalists, the issue of solving the home country of a multinational enterprise is relatively straightforward. The answer rests on the

⁷³ *Supra* note 27 at 121.

⁷⁴ Roland Lehner, "Waking from the Jurisdictional Nightmare of Multinational Default: The European Council Regulation on Insolvency Proceedings" (2002) 19 *Ariz. J. Int'l & Comp. Law* 975 at 980, 981.

⁷⁵ LoPucki, *supra* note 22 at 718-720.

⁷⁶ William C. Cary, "Federalism and Corporate Law: Reflections upon Delaware" (1974) 83 *Yale L.J.* 663 at 663; Fletcher, *supra* note 27 at 118.

state of incorporation of the failed entity, regardless of the location of the bulk of the company's assets. Assuming that this view is flawless, an artificial creation of predictability can lead to two undesirable outcomes.

First, in view of the large professional fees generated by a multinational insolvency, countries may bend the insolvency rules for companies in order to attract more incorporations. Most insolvency and supplementary legislation, such as, employment standards acts, impose particular personal liabilities on directors upon bankruptcy of the corporate entity.⁷⁷ By strategically selecting to incorporate under a certain forum or changing the state of incorporation on the eve of bankruptcy, the management can avoid certain liabilities. From a political standpoint, multinational companies may exert pressure on the legislatures of the competing states to craft out new avoidance, priority and perfection of security interests rules. Therefore, rather than vesting the creditors with the power to decide on a wide variety of bankruptcy issues because they are the true residual owners in insolvency, the balance will be tilted to favour the management and shareholders. Professor LoPucki also raises the issue of bringing insolvency cases to countries with corruptible judges, different languages, different treaty relationships or locations inconvenient to creditors.⁷⁸ While this claim is criticized by universalists as being far-fetched,⁷⁹ it may nevertheless hold true especially if the home country is a developing nation.

A second undesirable outcome associated with forum shopping is the tension or discontent which will result among states if one or two states became the jurisdictions where the majority of international insolvencies are litigated. This is not difficult to imagine. Just as it is common for more than half of the U.S. bankruptcy cases to be filed in Delaware, most cases in a universalist world may be litigated in Bermuda or the Cayman Islands.⁸⁰ This would mean that the legislators of these bankruptcy havens would dictate the bankruptcy regime for all international bankruptcies. It is questionable

⁷⁷ For example, directors and officers in Canada are liable for wage in arrears among other liabilities. See Janis P. Sarra & Ronald B. Davis, *Director and Officer Liability in Corporate Insolvency* (Ontario: Butterworths Canada, 2002) at 83-121.

⁷⁸ LoPucki, *supra* note 22 at 721.

⁷⁹ Perkins, *supra* note 8 at 816.

⁸⁰ LoPucki, *supra* note 22 at 721.

whether countries, especially developed nations, will adhere to universality if doing so would translate to a permanent deterioration of their jurisdictions.

2.1.3 Universality: A Reality Check

As illustrated, the case for universality is strong as substantiated by the advantages discussed. In fact, they fall squarely within the goals of an efficient international bankruptcy regime. Yet, the case against the theory is just as strong. In fairness to universality, it must be emphasized that doubts cast against the theory are not based upon the system advocated. Rather, the mere fact that no universalist has articulated the bankruptcy rules to be applied under universality has distanced the theory from reality.⁸¹ Discussions have always focused on the framework and how it would benefit the parties involved. In other words, universality is a body without a soul. Applying a reasonable degree of skepticism, one must question whether universality will ever be brought into being.

Universality, in its purest form, requires nations to surrender part of their jurisdictions through a treaty. States must agree to the substance of the rules such as those governing the procedural and substantive aspects of cross-border insolvency ahead of time. Issues such as the selection of forum where the main proceeding will be held and the vehicle or the means for resolving disagreements among states need to be decided on. This exercise requires considerable self-abnegation, bearing in mind possible conflict among nations regarding substantive bankruptcy rules.⁸²

Even if the immensurable difficulty in drafting an acceptable treaty is overcome, one must not forget that for there to be pure universality, most states must submit themselves to the treaty. It is questionable whether states will submit themselves if it cannot be demonstrated that some form of economic benefit will be accumulated. Up to this point, there is no empirical research conducted on the benefit, in fiscal terms, brought forth by universality. It may well be that the gains associated with such theory are outweighed by the costs stemming from the implementation and application of the theory.⁸³ Furthermore, at the end of the day, who will bear the costs of drafting such a

⁸¹ Rasmussen, *supra* note 3 at 19.

⁸² Thomas C. Baxter, Jr., Joyce M. Hansen & Joseph H. Sommer, "Two Cheers for Territoriality: An Essay on International Bank Insolvency Law" (2004) 78 Am. Bankr. L. J. 57 at 61.

⁸³ Rasmussen, *supra* note 3 at 19, 20.

treaty? Will the cost bearing nations be able to be objective and create a treaty which is both beneficial and acceptable to the non-cost bearing nations as well? A possibility is that the drafting nations will export their own versions of bankruptcy legislation to other countries. Unfortunately, there are no definite answers to both questions. Yet, unless both questions are answered satisfactorily, states will not embark on a universal approach in regulating cross-border insolvencies.

2.2 Modified Universality: The System

Modified universality⁸⁴ is sometimes seen as a natural middle step in the progression from territoriality to universality.⁸⁵ It bears some characteristics akin to universality while adopting a hint of protectionism associated with territoriality. Yet, unlike universality, which states often pay lip service to, modified universality has been adopted by several nations, such as, Switzerland and the U.S..⁸⁶ Since a practical example of modified universality can be provided by a study of the U.S. Bankruptcy Code (“Code”), the Code will be referred to in demonstrating how modified universality functions in practice and the advantages and disadvantages associated with it.⁸⁷

Under the 1978 and 1982 rounds of amendments to the Code in the U.S., a foreign representative is given three options to protect the assets of a foreign debtor located in the U.S.. First, the debtor may begin a Chapter 7 liquidation or a Chapter 11 reorganization proceedings voluntarily provided that it satisfies the requirement under subsection 109(a) of the Code, which requires a place of business or property in the U.S.. Second, if the debtor is in a bankruptcy proceeding in a foreign territory, the foreign representative of the estate can file an involuntary liquidation or reorganization proceeding under paragraph 303(b)(4). Third, the foreign representative of the debtor’s estate may ask for

⁸⁴ The theory is sometimes referred to as “modified territoriality”. See Baxter, Hansen & Sommer, *supra* note 82 at 62. This paper will use the term “modified universality” because it presents a more accurate picture of the nature of the theory. “Modified territoriality” connotes a presumption that cooperation with a foreign state is an exception to the territorial norm. This is not what modified universality is premised upon. States have realized the importance of cooperation in cross-border insolvencies decades ago. Thus, the theory is built upon the embracement of the universality model to an extent that is acceptable to the states.

⁸⁵ Perkins, *supra* note 8 at 795.

⁸⁶ Lehner, *supra* note 74 at 987.

⁸⁷ It must not be forgotten that the ancillary proceedings discussed in the U.S. context is merely one of the many approaches to modified universality. Secondary bankruptcies, where more than one proceeding is held concurrently in multiple countries, can also be seen as a form of modified universality. For further discussion, see Chapter 4, below.

the court's assistance by applying for an ancillary proceeding under section 304. For the purpose of this paper, focus will be placed on the third option. It is the only section in the Code that authorizes cooperation between the local and foreign courts in regards of the same proceeding. The other two options are chiefly concerned with a petition for a plenary proceeding in the U.S. parallel to a foreign proceeding.

Section 304 comes in handy when a multinational debtor or its creditor files a petition in the home country of the debtor, which results in an appointment of a representative of the debtor's estate. This representative is authorized to take possession of and sell or reorganize the assets of the debtor wherever they are located.⁸⁸ In seizing the assets located outside the home jurisdiction, he or she may encounter resistance from local courts or bailiffs who are representing local creditors in an action against the same debtor. In view of such conflict, the representative may petition for an ancillary proceeding under subsection 304(a).

The representative must satisfy the court that the foreign proceeding takes place in a jurisdiction where the debtor's domicile, residence, principal place of business, or principal assets is located.⁸⁹ Once a petition is granted, the court may enjoin the commencement or continuation of an action against the debtor (subparagraph 304(b)(1)(A)), enforce any judgment against the debtor or any act or commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate (subparagraph 304(b)(1)(B)), the turnover of the property to the foreign representative (paragraph 304(b)(2)), or any other appropriate relief (paragraph 304(b)(3)). In essence, the court is given the power to "[mold freely] the appropriate relief in a near blank check fashion"⁹⁰ save the restrictions listed under subsection 304(c).

In deciding whether to grant a relief under subsection 304(b), the court is guided by what will best assure an economic and expeditious administration of the estate. Subsection 304(c) provides six factors towards this end:

- (1) just treatment of all holders of claims against or interests in such estate;
- (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;

⁸⁸ LoPucki, *supra* note 22 at 728.

⁸⁹ *Bankruptcy Code*, *supra* note 55 at § 101(23).

⁹⁰ *In the Matter of Culmer*, 25 B.R. 621 at 624 (Bankr. S.D.N.Y. 1982).

- (3) prevention of preferential or fraudulent dispositions of property of such estate;
- (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
- (5) comity; and
- (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

Upon a closer reading, it becomes apparent that these six factors represent a combination of universality and territoriality. Factors one and three are inclined towards universality in meeting the equity goal. In contrast, factors two and four imply a protectionist approach under territoriality. Factor five is problematic because it requires reference to the pre-Code case law, which could be in favour of either territoriality or universality depending on the interpretation by the court.⁹¹ While it is beyond the scope of this paper to criticize section 304 of the Code, it is important to highlight the fact that the factors listed in the above are not explicitly exclusive nor is it clear that if one factor will be attached more weight than another.

To illustrate the difference between universality and the U.S. version of modified territoriality, assume a situation where an English debtor company owns assets in both the U.K. and the U.S.. Applying the state of incorporation rule, the U.K. will be seen as the proper forum for the commencement of a proceeding. Under universality, the U.S. courts will be obliged to turn over the debtor's assets for central administration in the U.K. even if the rights of the local creditors will be prejudiced. In contrast, under

⁹¹ Latham, *supra* note 32 at 352; Perkins, *supra* note 8 at 794. The U.S. courts in the pre-code context had issued mixed interpretations on the degree of cooperation with a foreign jurisdiction. In *Harrison v. Sterry* 159 U.S. 113 (1895), the court gave a decision to the effect that no country's laws would be given effect in another jurisdiction. This view shifted in *Canada Southern Railway Co. v. Gebhard* 109 U.S. 527 at 539 (1883) when comity was introduced into the formula. The court stated that "unless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to have legalized, the scheme may fail. All home creditors can be bound. What is needed is to bind those who are abroad. Under these circumstances the true spirit of international comity requires the schemes of this character, legalized at home, should be recognized in other countries". In a later case, *Hilton v. Guyot* 159 U.S. 113 (1895), the position was reversed and the court retreated to territoriality and defined comity as the due regards to both international duty and convenience the rights of its own citizens. By means of the convenience, the court was referring to local protectionism found under territoriality. Furthermore, the court also found that a requirement of reciprocity was needed before recognition would be given to a foreign jurisdiction. See Richard E. Coulson, "Choice of Law in the United States Cross-Border Insolvencies" (2004) 32 Denv. J. Int'l L. & Pol'y 275 at 284 - 288; Stuart A. Krause, "Annual Survey Issue: International Insolvencies: Colloquium: Relief under Section 304 of the Bankruptcy Code: Clarifying the Principal Role of Comity in Transnational Insolvencies" (1996) 64 Fordham L. Rev. 2591 at 2597 - 2601.

modified universality, the courts in the U.S. will be given the discretion in deciding whether the rendering of assistance to a foreign proceeding will be consistent with the six factors under subsection 304(c).

2.2.1 The Case for Modified Universality

Since modified universality is seen as a working compromise between universality and territoriality,⁹² there is little wonder why states have incorporated provisions to that effect in their domestic insolvency regimes. Two benefits are brought forth by such inclusion. First, it reveals a state's determination in realizing universality. Even if it may be a little optimistic to say that universality will be the ultimate end, at least states are determined to retract from territoriality to an extent that is acceptable to them. Second, through such incorporation, judges are vested with the legislative power to cooperate with a foreign proceeding.

One of the most important benefits to modified universality is the ability to refuse cooperation with a foreign administration.⁹³ Other advantages of modified universality include the possibilities of joint proceedings and cooperation between courts. This is potentially a powerful tool as it allows courts to negotiate with foreign representatives before agreeing to turn the case over. Borrowing from the previous example involving the English debtor, if one of the creditors involved is a tax collection agency which normally is granted a super priority under domestic bankruptcy legislations, the court may negotiate with the foreign representative for the local tax agency to participate equally in the debtors' estate as the tax agency of the home country. Another illustration will be a scenario where the court realizes that if the assets are not turned over to a foreign administration, local unsecured creditors will receive a greater return on the dollar than otherwise. Under this circumstance, the court may bargain for these creditors to be placed in a different class, enjoying a higher share on the debtor's assets than the unsecured creditors in the foreign proceeding. Though it is doubtful if the court will ever use its bargaining power in this direction, the example still helps to illustrate how powerful the

⁹² David H. Culmer, "The Cross Border Insolvency Concordat and Customary International Law: Is It Ripe Yet?" (1999) 14 Conn. J. of Int'l Law 563 at 565.

⁹³ LoPucki, *supra* note 22 at 729.

flexibility offers under modified universality indicates.⁹⁴ Other situations where a court may be more comfortable in not cooperating include situations where the bankruptcy of the debtor company is intertwined with public interest, such as, the bankruptcy of a company in the energy sector or where creditors will suffer undue prejudice in a foreign proceeding.

Regarding the goals of an ideal bankruptcy system, modified universality seems to fit in fairly well with the *ex post* goals of economic efficiency, equity, finality and even the *ex ante* goal of predictability despite the flexibility offered. While it is true that the administrative costs will be higher under modified universality in light of the extra costs incurred through the petitioning of ancillary proceeding, similar costs exist in universality. Under universality, assets from other jurisdictions do not simply get transferred to a central administration. Bankruptcy administrators of the home country still have to conduct a search of foreign assets and arrange for transfers. Thus, other than the extra litigation expenses consumed by the petition of ancillary proceeding, the administrative costs of both universality and modified universality will roughly be the same.⁹⁵

On the issue of equal treatment of creditors, modified universality achieves this end by having one court in the main proceeding deciding on claims and distributions.⁹⁶ Even if the court of the ancillary proceeding agrees to cooperate in ways other than a generic turnover of a debtor's assets, the court of the ancillary proceeding will be well informed of the substantive facts and processes in the main proceeding through the foreign representative. This will allow both courts to reach decisions based on the same set of facts.

The issue of finality is unquestionable under modified universality. If a foreign jurisdiction agrees to cooperate in a central proceeding, decisions made in that

⁹⁴ The court will unlikely exercise its power in this manner. If creditors have to be treated in the same manner in a foreign proceeding as they would be in a domestic proceeding, courts will never turn over a case for foreign administration. By nature, no two insolvency systems are alike. In *re Blackwell* 270 B.R. 814 at 829 (Bankr. W.D. Tex. 2001), the court was of the opinion that, "It would be a mistake to construe this provision to mean that a court must find effective congruence between the distribution schemes of the United States and the country in which the foreign proceeding is pending. The problem with such an approach is that every country has its own scheme of priorities, reflecting local public policy...were one to insist on congruence, it is doubtful that any court would ever find it appropriate to grant relief."

⁹⁵ Kent Anderson, "The Cross-Border Insolvency Paradigm: A Defence of the Modified Universal Approach Considering the Japanese Experience" (2000) 21 U. Pa. J. Int'l Econ. L. 679 at 692.

⁹⁶ LoPucki, *supra* note 22 at 729.

proceeding will be enforced and legitimized in the foreign jurisdiction. Disputes over the decision made by the court of the home country will unlikely be challenged bearing in mind the factors that a foreign court must be satisfied before acceding part of its jurisdiction.

It may seem absurd to some to suggest that the *ex ante* goal of predictability is not compromised by the flexibility offered under modified universality. Though it is true that flexibility and predictability do not normally go hand in hand, consider modified territoriality as an exception to the general rule. In international insolvency, predictability is referred to in the context of allowing creditors to make projections regarding the insolvency risks of a particular borrower and price their loans accurately on that basis.

Under modified universality, a borrower can probably make an educated guess as to the circumstances where the court may yield to a foreign jurisdiction. For example, in the U.S., the trend in recent years has been the adoption of a deference approach to international bankruptcies.⁹⁷ While it remains true that some courts had declined to cooperate based on a territorial interpretation of section 304, these cases were few. In some extreme cases, the application of universality may still result in a denial of cooperation with a foreign jurisdiction but the reasoning is well-founded.

In *re Hourani*,⁹⁸ the Bankruptcy Court of the Southern District of New York refused to handover the assets of the bankrupt Petra Bank to Jordanian courts because doing so would deprive creditors of important due process rights, including the right of access to information and the opportunity to be heard.⁹⁹ In essence, the bankruptcy proceeding in Jordan does not comport with the American notion of fairness and due process. Upon a careful review of the case law in this area, a lender will be able to predict with reasonable certainty the fate of a bankrupt borrower and the lender's position in a default. The predictability of results will further be enforced with the accumulation of decisions made by the courts.

In addition to the benefits cited in the above, recalling the previous discussion on management's tendency to forum shop under universality, modified universality

⁹⁷ Recent cases where the court declined to cooperate with a foreign proceeding all involved the court adopting a territoriality approach to section 304. These cases are outnumbered by the cases where the courts cooperated. See Krause, *supra* note 91.

⁹⁸ 180 B.R. 58 (Bankr. S.D.N.Y. 1995).

⁹⁹ *Ibid.* at 65.

discourages such practice by limiting the states with which a court will cooperate.¹⁰⁰ For example, if a court is suspicious of the reason behind the selection of a foreign state as the main forum, it can simply refuse to cooperate. This will create a net of safety for creditors and ensure the body of creditors is on an equal balance with the debtor.

2.2.2 The Case against Modified Universality

As with universality, modified universality is burdened with practical issues, such as, the governance of domestic relations by foreign courts and the indeterminacy of the home country standard. Since both issues are addressed earlier, elaborations on either are unnecessary. Yet, it is worthwhile to point out that since modified universality vests the judiciary with the choice of accepting or refusing cooperation with a foreign court, the tension stemming from the governance of domestic relationships with foreign laws is relaxed. If an international bankruptcy case involves sensitive domestic relationships, the court can simply refuse to cooperate.

Other than the above issues, the crux of the case against modified universality is based on the nature of the theory and the manner to which the theory is enforced. The implementation of modified universality in insolvency relies heavily on judicial willingness.¹⁰¹ As the court is given the right to choose, it may make it hard on creditors to predict their respective priorities. Since this contradicts the proposition regarding predictability as alluded to in the case for modified universality, a few cases have been selected from the U.S. jurisdiction to advocate the principle that the judiciary is inclined towards cooperation.

In *re Culmer*,¹⁰² an ancillary proceeding was sought to enjoin creditors from commencing or continuing proceedings against the bankrupt Bahamian bank, which was undergoing liquidation in the Bahamas. The bankrupt did not operate any business in the U.S. but maintained deposit accounts with the financing institutions in the U.S.. In deferring to the Bahamian proceeding, the court was of the opinion that it should generally accord comity to foreign decisions unless judicial enforcement of such foreign-based rights “would be the approval of a transaction which is inherently vicious, wicked

¹⁰⁰ LoPucki, *supra* note 22 at 727.

¹⁰¹ *Ibid.* at 729; LoPucki, *supra* note 22 at 729.

¹⁰² 25 B.R. 621 (Bankr. S.D. N.Y. 1982).

or immoral, and shocking to the prevailing moral sense".¹⁰³ Later cases, such as, *Cunard Steamship Co. v. Salen Reefer Services*,¹⁰⁴ *Victrix Steamship Co. v. Salen Dry Cargo*,¹⁰⁵ and *re Brierley*,¹⁰⁶ all embraced the rationale applied by the court in *re Culmer*. The court in *re Brierley* even stated that chaos would lurk in all transnational bankruptcies if courts ignore the importance of comity.¹⁰⁷

In contrast to the cases granting deference to foreign proceeding, cases denying assistance were all based on a narrow and territorial interpretation of section 304. In *re Lineas Areas de Nicaragua*,¹⁰⁸ the court rejected a turnover of assets to a Nicaragua proceeding based on the inconvenience caused to local creditors to look to Nicaragua for payment, contravening one of the factors listed under subsection 304(c) of the Code. In *re Toga Manufacturing*,¹⁰⁹ the court denied relief to a Canadian trustee in bankruptcy. It was noted that the status of a U.S. creditor as a secured lien creditor would be demoted to an unsecured creditor under Canadian law. Another case where the court rejected the *re Culmer* approach and embarked on an approach of protecting the "rights of the citizens" was *re Papeleras*. It is important to note that the cases in the above where the court negated cooperation were overruled in a recent decision by the Bankruptcy Court of the Southern Division of New York where a majority of section 304 petitions are brought.¹¹⁰ Thus, these cases are no longer good law and the court should look towards *re Hourani* instead. In view of the cases discussed in the above, it becomes apparent that the unpredictability associated with modified universality can only bring harm to international cooperation from a theoretical perspective. From a pragmatic viewpoint, however, such unpredictability does not seem problematic as the courts are inclined towards granting comity other than under special circumstances like those that arose in *re Hourani*.

¹⁰³ *Ibid.* at 629.

¹⁰⁴ 773 F.2d 452 (2d Cir. 1985).

¹⁰⁵ 825 F.2d 709 (2d Cir. 1987).

¹⁰⁶ 145 B.R. 151 (Bankr. S.D.N.Y. 1992).

¹⁰⁷ *Ibid.* at 164.

¹⁰⁸ 13 B.R. 779 (Bankr. S.D. Fla. 1981).

¹⁰⁹ 28 B.R. 165 (E.D. Mich. 1983).

¹¹⁰ *A.I. Trade Finance, Inc. v. Petra Bank*, 989 F.2d 76, 81 (2d Cir. 1993).

Other criticisms on modified universality include higher administrative costs than universality and the end result of a modified approach resembles that of territoriality.¹¹¹ The first criticism is self-explanatory but the second criticism deserves a brief discussion. Most insolvency systems that embrace modified universality offer multiple options to a foreign debtor. To illustrate, in the U.S., foreign debtors and the representatives of the estate are given three options to handle the assets located in the U.S., one of which involves the commencement of a plenary proceeding. In effect, this will provide a debtor or a creditor with a so-called “back door” to avoid the modified universal mechanism under section 304.¹¹² The reason for avoiding the section is the common belief that a court would hesitate in providing assistance in support of a foreign regime through ancillary proceeding.¹¹³ As already demonstrated, this belief is flawed. However, the criticism still applies if a case falls under the special circumstances where a court will likely decide against an ancillary proceeding, forcing a foreign representative to seek relief under a plenary proceeding instead. As a result, there will be two plenary proceedings, echoing a territorial approach.

2.3 Universality vs. Modified Universality

An important question that must be answered in any discussion on modified universality is how good the theory is, if placed side by side with universality. At this point, it becomes apparent that there are both advantages and disadvantages associated with either theory. It can even be said that the advantages stemming from universality is much stronger than those related to modified universality. Yet, both theories are plagued with the same problems with even more problems associated to modified universality. So if modified universality is not as valid as universality, why would states choose to pay lip service to universality and advocate a watered-down version instead? The reasons are threefold.

First, modified universality does not require a state to relinquish its jurisdiction. The courts are vested with the power to refuse relief under ancillary proceedings if they are uncomfortable. Thus, the theory allows for a deployment of flexibility, depending on

¹¹¹ LoPucki, *supra* note 22 at 730, 731.

¹¹² *Ibid.*

¹¹³ *Ibid.*

factual circumstances. Second, the implementation of modified universality does not require states to negotiate treaties or means agreements with other states. In essence, states can enact different versions of modified universality as they see fit to their domestic legislation. This is of practical significance as negotiations can be difficult, costly, and time-consuming. Third, in view of modified universality being the international norm in handling international bankruptcies,¹¹⁴ it makes sense for states to avail themselves of modified universality rather than universality, which calls for an exercise of altruism.

In light of the benefits and pragmatism entrenched in modified universality, there is little wonder why modified universality has won support among governments in the world. Interestingly, this is contrasted with the view held by many renowned academics that universality is the only workable solution to cross-border insolvencies.¹¹⁵ By supporting modified universality, however, one does not necessarily denounce the logic of universality. Rather, this represents a concession to the inherent limits of the theory.

¹¹⁴ *Ibid.* at 726.

¹¹⁵ Perkin, *supra* note 8; Westbrook, *supra* note 3; *supra* note 6.

3 Territoriality and Cooperative Territoriality

Territoriality can be seen as the seed to all theories. Before the emergence of theories such as universality and modified universality, it was the default system in international bankruptcy. As the system gradually evolves, however, territoriality is viewed with a suspicious eye. It is often associated with the failure to cooperate and viewed as a pejorative.¹¹⁶ This chapter will discuss territoriality and its improved version of cooperative territoriality.

3.1 Territoriality: The System

Similar to the discussions on universality and modified universality, this part of the paper will look at the system, advantages and disadvantages associated with territoriality. The purpose of this section is to evaluate whether a wholesale rejection of territoriality is justifiable. As mentioned earlier, no theory can be taken at face value. A careful analysis is always desirable before appraising or rejecting a theory.

The operation of territoriality is relatively straightforward. The theory is premised on the territorial notion of sovereignty common in the nineteenth century.¹¹⁷ Under the notion, immovable property falls within the sole and exclusive jurisdiction of the courts of the country where the property is located and foreign courts and orders in pursuance of such properties will not be recognized.¹¹⁸ Therefore, the application of territoriality requires multiple, separate proceedings wherever assets are located. There is no cooperation or recognition of foreign orders or parallel proceedings among states. Foreign creditors are free to file their claims in front of a local court. However, their claims are restricted to assets located physically within the court's jurisdiction. Thus, there is little wonder why territoriality is also known as the "grab rule" because a court will take whatever assets located within its territory and make a distribution accordingly.¹¹⁹

In practice, territoriality is rarely applied to the fullest extent. In any typical insolvency case involving a multinational debtor, a court where a proceeding is filed

¹¹⁶ LoPucki, *supra* note 22 at 742.

¹¹⁷ Baxter, Hansen & Sommer, *supra* note 82 at 60.

¹¹⁸ Latham, *supra* note 32 at 343.

¹¹⁹ Rasmussen, *supra* note 3.

deals with orders made by itself and orders made by foreign courts. Most countries apply universality in the first instance, especially in cases where the debtor's relationship with the country is a close one, and territoriality to the latter.¹²⁰ For example, in the Netherlands, insolvency judgments made by Dutch courts are given universal effects by Dutch insolvency legislation. However, no recognition is offered under the law towards foreign judgments regarding assets located in the Netherlands.¹²¹ This is an absurd arrangement. One can easily imagine a situation where a property located in the Netherlands would be subjected to two conflicting decisions, one made by the local Dutch court and another made by a court elsewhere. This peculiarity serves to highlight the policy objective of territoriality: the protection of local creditors.¹²²

3.1.1 The Case for Territoriality

Referring to the goals of an ideal international insolvency system as alluded to earlier in the paper, territoriality seems to be out of place. As will be discussed in the following section, it is neither an economically feasible nor an equitable way of dealing with the assets of a multinational debtor. However, there is a strong argument for territoriality, for its simplicity does make life easier for some, especially local creditors.

By keeping the assets within a nation, local creditors are spared the inconvenience of petitioning their claims in a foreign court. This is particularly important for local unsophisticated creditors. In contrast, multinational creditors are vested with the resources and legal expertise in litigating in foreign jurisdictions. Moreover, local unsophisticated creditors will probably be able to recover more under local proceedings relative to foreign proceedings. This is a logical prediction assuming that there is a direct correlation between a creditor's familiarity with a bankruptcy legislation and recovery rate. In essence, creditors' familiarity with the domestic bankruptcy legislation and fluency in the local language make it easier for them to prove and dispute their claims.¹²³

Other than benefiting local creditors, the transactional simplicity associated with territoriality yields four additional advantages. First, legislatures are spared the debating

¹²⁰ Fletcher, *supra* note 27 at 12.

¹²¹ Lehner, *supra* note 74 at 998.

¹²² Territoriality has been described as a self-serving doctrine where a nation claims plenary power over assets located in other jurisdictions while paying no attention to what the other nations may claim regarding assets located within its territory. See Trautman, Westbrook & Gaillard, *supra* note 69 at 574, 575.

¹²³ Latham, *supra* note 32.

sessions in introducing any form of cooperation into their domestic bankruptcy legislation.¹²⁴ The operation of universality requires treaties or bilateral agreements. Likewise, modified universality requires the incorporation of cross-border provisions into domestic bankruptcy laws. Yet the operation of territoriality depends only on existing bankruptcy legislation. Second, a territorial rule affords more respect towards foreign legal systems. By nature, the theory does not require a court to deny recognition of a foreign proceeding or bar the commencement of an ancillary proceeding.¹²⁵ Third, territoriality, unlike universality and modified universality, will not strain relationships among states. Sovereignty will be preserved to the maximum extent. Domestic relationships will not be governed by foreign legislations. Countries will not be asked to surrender control of assets that they have power over.¹²⁶ Fourth, territoriality better reflects the reality that global businesses are usually conducted by independent companies that are owned by the same parent while operating in different countries. By limiting corporate entities to political regions, companies have already opted for a territorial approach.¹²⁷

3.1.2 The Case against Territoriality

As opposed to the brief case for territoriality that is premised on local protectionism and transactional simplicity, the case against territoriality is multifold. In fact, the shortcomings of territoriality are the reasons for developing the universality model. Viewed in a different light, the case against territoriality is exactly the flip side of the case for universality.

First, territoriality does not offer the degree of predictability as found under universality. Recalling the earlier discussion on the case for universality, predictability has lent fundamental support to the theory, allowing lenders to price their loans accurately. It has been argued that territoriality offers a higher degree of predictability than universality because lenders know exactly which entities are indebted to them. However, the shortcoming of the argument above rests in the fact that lenders will have to be well informed of the countries where their debtors' assets are to learn of their

¹²⁴ LoPucki, *supra* note 22 at 698.

¹²⁵ *Ibid.*

¹²⁶ *Ibid.* at 752.

¹²⁷ *Ibid.* at 751.

respective priorities. This will result in additional transaction costs and consulting fees. These costs will then be passed on to creditors, which will lead to higher borrowing costs. Another issue that must be dealt with is the international movements of assets. Though it is possible to incorporate covenants into lending agreements restricting the movement of assets, this measure attracts additional contracting and monitoring costs that could be avoided under universality.

Second, territoriality is inefficient. Under the theory, there will be multiple proceedings in various jurisdictions wherever the assets are located. This will lead to duplicative costs for both the debtors and creditors, thus, lowering the proceeds available.¹²⁸ For the same set of facts, creditors will have to prove their claims and litigate in multiple jurisdictions to maximize their recoveries. This does not mean that the creditors will receive double recoveries for the same claim due to the operation of the hotchpot rule.¹²⁹ Yet filing claims in more than one jurisdiction will avail creditors to claims on more than one pool of assets. Consequently, the chance of recovering more is greatly enhanced. Though this is the prevailing practice, there is an inherent flaw in the logic behind such practice. It can well be that the benefit of a higher recovery resulting from filing in multiple jurisdictions is outweighed by the higher litigation expenses, especially when there is homogeneity in the distribution schemes among the nations! In any case, however, territoriality will likely lead to a lower recovery rate than universality because creditors will have to incur extra legal costs in conducting a cost-benefit analysis between filing in one or multiple jurisdictions, or searching for the jurisdiction where most of the debtors' assets are located. Though it has been submitted by Professor LoPucki that these problems are merely clerical and can be easily overcome with computer technology,¹³⁰ one must still realize there are costs associated with such practice. Language barriers would also negate technological solutions.

¹²⁸ Westbrook, *supra* note 3 at 460, 461.

¹²⁹ The rule involves creditors filing in each court where assets are located. The claims will be approved by the various courts pursuant to the local distribution schemes. The final amount that the creditors are entitled to will be adjusted depending upon the amounts received under other proceedings. See *Neale v. Cottingham* (1764) 125 E.R. 81; *Sill v. Worswick* (1791) 1 H. Bl. 665; Fletcher, *supra* note 27 at 16.

¹³⁰ LoPucki, *supra* note 22 at 761.

Third, territoriality is not concerned with maximizing the return other than for local creditors.¹³¹ Due to the lack of cooperation among courts where assets are located, reorganization of a failed enterprise is out of place. Furthermore, the going concern value of the debtor will be destroyed by selling the assets on a piecemeal basis rather than collectively. The value of the synergies among various assets will also be lost.

Fourth, the *pari passu* principle endorsed by universality through treating all creditors equally and equitably will unlikely result under territoriality.¹³² Foreign creditors may not be given effective notice of proceedings. They may also experience difficulties due to unfamiliarity with foreign laws and procedures, resulting in their claims being made late, thus, irrecoverable. This is particularly true for unsophisticated creditors, such as, trade suppliers and employees, who will lack the financial means and knowledge to file for claims in foreign jurisdictions. In addition, with the advance of modern technologies, debtors can remove assets from a jurisdiction to another with ease on the eve of bankruptcy in preference for particular creditors. Fraudulent preferences are outlawed under almost all insolvency regimes with the result of such transactions being a claw back of the transferred assets to the debtor. However, by taking advantage of the inexistence of cooperation among states, debtors can effectively legalize all fraudulent preferences. With the absence of a treaty and the variant treatments in reviewable transactions under different countries, assets will unlikely be repatriated to the originating country. The difficulty in tracing the assets across borders will also play itself out.¹³³

Fifth, in contradiction to one of the alleged benefits of territoriality, namely, one where international relations will not be strained, the nature of territoriality may breed disharmony in international relations. By adopting the “go-it-alone” attitude and denying ancillary assistance to other countries,¹³⁴ especially in cases which are of specific concern to some nations, such as, the insolvency of a company in the energy sector, international relations may be harmed.

¹³¹ Paul Omar, “The Landscape of International Insolvency Law” (2002) 11 Int’l Insol. R. 173 at 177.

¹³² *Ibid.*

¹³³ *Ibid.*

¹³⁴ Anderson, *supra* note 95 at 699.

3.2 Territoriality vs. Universality

Describing territoriality as a solution to international insolvency is somewhat anomalous. After all, there is nothing international about territoriality. Unlike universality and modified universality where cooperation on the international front forms the core of both theories, territoriality merely maintains that each nation works within its borders without tramping on the sovereignty of the others. Centuries ago when commerce was confined to a geographical region, territoriality might have been an efficient way to deal with international insolvencies. After all, the benefits of having a universal solution could be outweighed by the costs of drafting treaties or incorporating relevant sections in domestic insolvency regimes, making universality or modified universality impractical. In the modern era where businesses are conducted globally, territoriality represents an expensive solution, in terms of both *ex ante* and *ex post* costs. Interestingly enough, it has been raised that territoriality is appropriate in the realm of international bank insolvency due to the unique nature of the banking business and the characteristic of a bank being a supervised firm.¹³⁵ This may be due to the intricate relationship between financial institutions and a nation's economy. In the bankruptcy of such institutions, a nation will not wish to cooperate with a foreign jurisdiction as foreign intervention will potentially affect the sensitive balance in a nation's financial system. Thus, the utility of territoriality in special circumstances must not be overlooked. In general business terms, however, territoriality is a deficient regime.

3.3 Cooperative Territoriality: The System

Among all the theories in the field of international insolvency, cooperative territoriality is the most recent of all, proposed by Professor LoPucki in 1999.¹³⁶ Since the global trend is inclined towards modified universality, it is indeed shocking to learn of the development of a theory which can be interpreted as a retreat from modified universality to territoriality. Other than a few unique characteristics that are of a cooperative nature, cooperative territoriality suffers from the same pitfalls as territoriality. Rather than alleviating the concerns inherent to territoriality, it serves to highlight the problems.

¹³⁵ Baxter, Hansen & Sommer, *supra* note 82 at 89.

¹³⁶ LoPucki, *supra* note 22 at 742.

Cooperative territoriality and territoriality share the same premise. Insolvency proceedings will commence wherever assets are located. There will be multiple proceedings with none acting as the main, secondary or ancillary forum. Each court will arrive at decisions based on its own laws regarding assets it has *de facto* control over. On top of this territorial foundation, four aspects are highlighted by Professor LoPucki.

First, on the issue of the location of assets, a court can only make decisions regarding these assets only if it has *de facto* power over them.¹³⁷ The mere fact that a particular asset is located within the physical bounds of a country does not necessarily vest the court of that country with the sovereign power over the asset. Through fixing the location of an asset, conflicting claims over assets, a problem commonly associated with territoriality as mentioned earlier, will be reduced.¹³⁸ However, Professor LoPucki did not offer a formula as to how the location or the nationalities of assets will be determined. He relied on the current practice of fixing the location of assets arbitrarily in the international community for bank accounts, debts, franchises, leases and other intangible properties in determining the nationalities of the assets.

Second, regarding the treatment of foreign creditors, a court is to follow the priority and distribution scheme contained in local legislation and prevent creditors from recovering more than the entire debt owed to them.¹³⁹ In his discussion, Professor LoPucki referred to the universal priorities scheme proposed by Professor Westbrook.¹⁴⁰ In essence, universal priority is a system whereby the priority scheme of a jurisdiction will be made available to creditors without regard to nationality, residence or other indicia of foreignness.¹⁴¹ As such, creditors who are similarly situated will be treated alike. It is Professor LoPucki's submission that universal priority is a superficial antidiscrimination regime because equality in international insolvency is of a "chimerical" nature and is tolerated.¹⁴² Therefore, nothing substantive has been sacrificed

¹³⁷ *Ibid.* at 743.

¹³⁸ *Ibid.*

¹³⁹ *Ibid.*

¹⁴⁰ Westbrook, *supra* note 35 at 30.

¹⁴¹ *Ibid.* at 38.

¹⁴² Professor LoPucki is of the opinion that *de jure* discrimination is rare but *de facto* discrimination is common. He refers to the U.S. Bankruptcy Code (11 U.S.C. §545) where priority exists for a wide array for state-created statutory liens for people who have provided food and services within the jurisdiction of the U.S.. A Martinique national furnishing labor and materials for the construction of a building in Martinique will be barred from enjoying a statutory lien under U.S. laws. See LoPucki, *supra* note 22 at 744 – 746.

through the adoption of a principle where a court is required to pay in regards to its local distribution scheme only.

Third, on the issue of avoidance powers, Professor LoPucki equates international movements of assets with transfers to a separate entity in a destination country.¹⁴³ The facts in Maxwell Communication Corporation are used to demonstrate the functioning of his theory. In the case, Maxwell Communications sold the subsidiaries in the U.S. and deposited the funds in its U.S. bank accounts. The money was subsequently transferred to its British bank accounts to settle its debts to both the British and the French banks. If the U.S. laws were to apply to this transfer, it would have been labeled as a preference and the proceeds would have been returned to the trustee. However, since British law applied, the payments were not avoided. Through applying Professor LoPucki's principle, a different result would ensue. The transfer from the U.S. bank accounts would have been deemed fraudulent, thus the whole transaction would not have been authorized to be sent to the British accounts which formed a separate entity. In supporting this rule, states would enter into treaties that would provide for the repatriation of unauthorized or illegal transfer of assets.

Fourth, since the theory does not hinge on a forum being a primary proceeding or a leading court in any international insolvency proceeding, it relies heavily on cooperation among states to reveal the benefits that are normally associated with universality. Cooperation is desirable in establishing procedures for replicating claims filed in one country to other countries, the sharing of distribution lists among the states to prevent double recoveries, the joint sales of assets, voluntary investment by representatives in one country in the debtor's reorganization effort in another, and the repatriation of assets that have been the subject of avoidance transfers.¹⁴⁴

3.3.1 The Case for Cooperative Territoriality

The case for cooperative territoriality matches the case for territoriality. Since the advantages of territoriality have been discussed in great depth earlier, it will not be repeated here. Suffice it is to reiterate the fact that cooperative territoriality does not ask

¹⁴³ *Ibid.* at 748.

¹⁴⁴ *Ibid.* at 750.

for the recognition of foreign authorities. There is no erosion of sovereignty, eliminating the tension among states that is said to arise under universality and modified universality.

Leaving the issue of practicality aside, the goals of an ideal insolvency system are further enhanced by the five areas in which cooperation is called for under cooperative territoriality. First, economic efficiency is attained through the establishment of procedures for replicating the claims filed in other states. Second, the sharing of distribution lists will allow for the equal treatment of creditors, providing additional security on top of the hotchpot rule which territoriality currently employs. Third, the joint sale of assets and the voluntary participation in the reorganization efforts of other states will maximize the value available to creditors. Fourth, the repatriation of assets will provide for equity in a bankruptcy case.

3.3.2 The Case against Cooperative Territoriality

Similar to the case for cooperative territoriality, the theory suffers from all the disadvantages associated with territoriality albeit at a different extent subject to the degree of cooperation among states. On the face of the theory, one must beg the question as to why states would want to cooperate? Though cooperation in this case does not trigger any sovereignty issue, it does represent some form of restriction on the power of a local court. For example, regarding the location of assets, if a bank account is agreed to be within the *de facto* control of a U.S. court, despite the fact that the money is held in an English bank, the power of the British court in dealing with the bank account is fettered. Why would a British court be prepared to tie her hands with such an agreement?

The answer probably rests on a cost-benefit analysis. States will cooperate if they believe that local creditors will receive a greater recovery on their claims but will unlikely cooperate otherwise.¹⁴⁵ Through Professor LoPucki's writing, it seems that he is conveying an idea where governments will have negotiated treaties ahead of time and will apply the treaties anytime as the circumstances arise. Thus, the agreements are not negotiated on a case by case basis.¹⁴⁶ Once treaties have been entered into, states are locked in. It is unfortunate that Professor LoPucki did not provide any explanation

¹⁴⁵ Perkins, *supra* note 8 at 826.

¹⁴⁶ If a case by case approach is taken, the predictability factor that Professor LoPucki has used to support his argument for cooperative territoriality will be compromised.

justifying states' rationale in entering into a treaty.¹⁴⁷ If states are unwilling to enter into a bilateral treaty that calls for cooperation under universality, it is doubtful if they will be willing to enter into the kinds of treaty as perceived by Professor LoPucki, which also requires a degree of cooperation. Other than the theory being less invasive in terms of sovereignty, the powers of the states are still restricted, which may go for or against local creditors in a given case.

Leaving this aside, assuming states enter into treaties as suggested, two problems may arise. First, a party may litigate in multiple jurisdictions due to multiple proceedings. In response to the duplicity of litigation, a solution has been proposed where local claimants would ask the foreign bankruptcy courts to allow their claims to be liquidated in a local court. The result will be one trial for each claim with the decision binding on all of the bankruptcy courts.¹⁴⁸

This is a peculiar arrangement, resembling universality to a great extent. It is difficult to see how courts will submit themselves to other jurisdictions, which can be interpreted as an erosion of sovereignty. The only rationale expounded upon by Professor LoPucki regarding a court's willingness to accept decisions made by another court is based on convenience. He felt that by refusing to accept judgments handed down by other courts, the court would be submitting itself to an enormous burden of trying all of the cases.¹⁴⁹ This proposition is built on the assumption that there are mass-tort actions against the debtor. It is doubtful if this rare scenario will arise in all cases. Courts, after all, may consolidate the actions or the litigants may choose to begin a class action lawsuit. It is equally unconvincing that a court will accede to another court under the label of inconvenience, especially if the other court is renowned for not following rules on procedural and substantive justice. Furthermore, what would happen if a case is tried in two different courts with opposing decisions? How should the other courts, besides the two that tried the case, approach the contradicting decisions? A better justification for Professor LoPucki's argument rests in comity. For reasons of international duty and convenience, courts may feel obligated to defer to other courts in some circumstances. A

¹⁴⁷ A cost-benefit analysis could have been presented to justify states' incentives in entering into cooperative treaties.

¹⁴⁸ LoPucki, *supra* note 22 at 753 – 755.

¹⁴⁹ *Ibid.*

blanket assumption that a court will give up part of its jurisdiction permanently is unjustifiable.

Second, in targeting the removal of assets from a country before bankruptcy, a treaty would be needed for every country to prevent any strategic transfer of assets.¹⁵⁰ If this does not occur, one or two states will be singled out as “fleeing havens”. This could negatively impact some, if not all, the territorial proceedings. Under the current political climate, the ratification of an international treaty involving all nations in the world is unimaginable. Although it was submitted that the problem associated with strategic transfers will not be great because creditors could effectively eliminate these risks with restrictive covenants and criminalization policies if removal occurs,¹⁵¹ contracting and monitoring costs will result from such an arrangement.¹⁵² In addition, this protective measure will only be available to sophisticated and resourceful creditors with a sizeable interest in the debtor while paying no regard to the interests of involuntary creditors.

3.3.3 Cooperative Territoriality: A Reality Check

Despite the criticisms raised in the section above, theoretically, cooperative territoriality is a sound system. It is a diligent way in evading the sensitive sovereignty issue, the source of all evil in international insolvency. Unfortunately, bringing the theory back to reality, cooperative territoriality is unlikely to work. To take full advantage of the acclaimed benefits associated with the theory, cooperation among the states and the players is necessary. Since the case on the cooperation among states as being improbable has been elaborated in the above, it will only be addressed briefly here.

Cooperation requires a high degree of willingness and altruism among states. Governments must be informed of the potential benefit brought forth by having a workable solution to international insolvency. For example, empirical research must be conducted on the marked improvements in the degree of predictability for the financial markets by adopting an efficient cross-border regime. Likewise, players in an insolvency proceeding, such as, judges, insolvency professionals and creditors must also be informed

¹⁵⁰ Perkins, *supra* 8 at 825.

¹⁵¹ LoPucki, *supra* note 22 at 758.

¹⁵² Perkins, *supra* note 8 at 825.

of the benefit brought by joint sales of assets and investment in reorganization efforts in other states.

At this point, it is important to address a remark made earlier concerning the subject that cooperative territoriality serves to highlight the flaws of territoriality. In avoiding the sale of assets on a piecemeal basis, cooperative territoriality encourages creditors to sell the assets jointly when a joint sale would produce a higher price than separate sales in multiple proceedings.¹⁵³ In an attempt to reduce or eliminate strategic transfer of assets on the eve of bankruptcy, cooperative territoriality eliminates this by requiring states to cooperate and enter into treaties.¹⁵⁴ In order to bring down the costs associated with multiple filings, the theory proposes a solution where each country shares its locally filed claims and deems them as being filed in each court.¹⁵⁵

All three solutions hinge on informing the states and players about the potential benefit of formulating a sensible solution to international insolvency. It is questionable whether states and players alike will be convinced by the case for cooperative territoriality. There is no empirical research conducted on the benefit brought by cooperative territoriality. It may be the case that the benefit under cooperative territoriality is outweighed by the costs associated with drafting cooperative treaties. Indeed, even if states can be convinced of the benefit brought forth by having a solution to international insolvency, it is doubtful that they will prefer the theory over modified universality or universality. After all, cooperative territoriality is filled with flaws like territoriality. For example, the issues of duplicated administrative and litigation costs have not been resolved satisfactorily. As the global trend is directed towards a more universal regime, it makes little sense for states to tread backwards into a cooperative version of territoriality that shares the many pitfalls of territoriality.

3.4 Comparison of the Four Theories: The Strongest Link

Before embarking on an examination of the treaties in international bankruptcy in Chapter 4, it is important to compare universality, modified universality, territoriality, cooperative territoriality, and draw a conclusion as to which theory is the strongest link.

¹⁵³ LoPucki, *supra* note 22 at 750.

¹⁵⁴ *Ibid.*

¹⁵⁵ *Ibid.* at 754.

An assessment is important in observing how close or far the treaties are from encompassing the soundest theory. In other words, the optimal theory will provide a basis in evaluating the effectiveness and efficiency of the treaties.

A three-prong test will be applied to test all of the theories. First, since sovereignty is identified as the source of all evil in international insolvency, a preferred theory will be one that is not accused of overriding or invading a nation's sovereignty. Second, the *ex ante* goal of predictability and the *ex post* goal of efficiency must be satisfied to the maximum extent possible. Third, the likelihood of the theory being given the breath of life by states must be looked at. It must be emphasized that no theory is perfect. It is impossible for a theory to fulfill all three requirements for there are always negative attributes associated with each theory. This stands for the proposition that even if a theory does not fit squarely into one of three aspects of the test, it will not be automatically ruled out as being deficient. Rather, a balancing approach should be adopted. The question to be asked is, on balance, how does each theory satisfy the three-prong test? For example, if a theory meets the goals of an ideal insolvency system and is likely to work in practice while treading a little behind on the sovereignty issue, it may still be a good theory nonetheless. While a theory that generates positive results for the first and second prongs to the test but uncertain results for the third prong, the theory may not work. Both examples demonstrate that unequal weight will be attached to each of the three aspects. A heavier emphasis will be attached to the third aspect. This is a logical approach because a theory is only worthwhile if it can be employed in real situations involving real players. The order to which the theories are tested will be in accordance with the order they are presented in this paper.

First, universality is a system whereby one court will rule and decide on all issues dealing with a multinational debtor. There will be one proceeding where all creditors will file and dispute their claims. On the issue of sovereignty, there is no doubt that universality fails miserably through the declaration of universal effect of decisions made by the court of the home country. Little or no consideration is given to the insolvency legislation of other states that are affected by the decisions. Foreign courts simply submit themselves and oblige all decisions. Regarding the goals of predictability and efficiency, universality does an amazing job. This is due to the fact that by having one court apply a

body of bankruptcy legislations comprehensively, the complexity of a case is greatly reduced. This will lead to higher predictability and lower administration and litigation expenses. Referring to the practicality issue, developments in the field of international bankruptcy have repeatedly proved that universality is unacceptable to almost all states, highlighting the importance of sovereignty. Since universality fails under the first prong, there is little surprise that it will not live through the third test. Overall, universality is an excellent theory but its legacy will be restricted to dialogue in the research community..

Second, modified universality is a system where a court is vested with the discretion to deny assistance or to decide on the degree of recognition that will be given to a foreign proceeding. On the issue of sovereignty, states are shielded from a permanent deterioration of their jurisdictions due to the flexibility advocated under the theory. Regarding the goals of predictability and efficiency, modified universality does not fit as well as universality. Flexibility generates unpredictability, despite the fact that this problem is not as severe as commonly perceived. Relative to universality, the degree of economic efficiency also drops slightly due to the need to file ancillary proceedings in other jurisdictions. This may result in delay and higher litigation expenses. Referring to the practicality issue, modified universality has already been incorporated into the domestic legislation of a few countries. Thus, the acceptability of the theory by states is unquestionable. Overall, modified universality fits in very well with the three-prong test with a slight defect in the second aspect. Adopting the presumption that no theory is perfect, this minor defect would not invalidate the theory.

Third, territoriality is the only system that advocates a non-international approach to international bankruptcy. As such, there will be multiple proceedings wherever the debtor's assets are, necessitating multiple filings of claims by creditors. On the issue of sovereignty, territoriality represents the most non-invasive solution among all. Since there is no cooperation among states, no proceeding will be denoted as primary, secondary or ancillary. As such, no court will be asked to accede to the decisions of another court. Regarding the goals of predictability and efficiency, territoriality satisfies the former but not the latter. Creditors simply refer to the domestic priority scheme to find out their recoveries in insolvency. Efficiency fares worst in territoriality than any other theory for obvious reasons. With multiple proceedings come duplicated costs.

Referring to the practicality issue, territoriality has been put into practice for a long time. This is not surprising since territoriality does not tamper with sovereignty. Thus, it will be acceptable to all states. Once again, there is a correlation between the first and the third prong to the test. Overall, territoriality fits in perfectly with the first and third prongs with a setback on the goals, resembling the situation depicted for modified universality.

Fourth, cooperative territoriality is the cooperative version of territoriality. While allowing states to behave territorially and sever the connection between the debtor and their assets on a nation's border, the theory involves a degree of cooperation at the international level in an attempt to avoid the pitfalls to territoriality. On the issue of sovereignty, cooperative territoriality does not coerce a court to accede to another court unless agreed to beforehand. All purported invasions on sovereignty, such as, treaties requiring the repatriation of illegally transferred assets, are minor. Regarding the goals of predictability and efficiency, cooperative territoriality provides marked improvements over territoriality. According to Professor LoPucki, efficiency will be enhanced as states enter into treaties or conventions dealing with the sharing of distribution and claims list notwithstanding the fact that multiple proceedings are still necessary. Though somewhat alleviating the efficiency problem, cooperative territoriality is no match to either universality or modified universality in terms of the efficiency goal. Referring to the practicality issue, since the powers of the states are still restricted through cooperative efforts, it suffers from the same pitfalls as universality. This is probably the only case where the first prong is not correlated to the third prong. The fact that cooperative territoriality offers a less invasive solution in terms of sovereignty to states does not make the theory more appealing. This is due to the fact that the theory will probably fail on a cost-benefit analysis and states will refuse to enter into treaties.

It must be obvious that the contest for the strongest link in cross-border insolvency is one between modified universality and territoriality. Both theories satisfy the first and third aspects to the test, especially sovereignty and practicality concerns. The only problem rests on the second prong or the predictability and efficiency goals. Modified universality is unpredictable but efficient while territoriality is predictable but inefficient. It is an established fact that territoriality is inefficient.¹⁵⁶ Yet, it is debatable if

¹⁵⁶ See 34, above, for more on this issue.

modified universality is truly unpredictable as commonly perceived.¹⁵⁷ It has already been presented earlier that theoretically, modified universality can be unpredictable. Practically speaking, however, the adverse is true. By this point, it goes without saying that modified universality is indeed the strongest link! However, giving modified universality the title of champion does not override the truth that there are still problems associated with the theory. It is merely that they are not as prevalent as the other theories.

3.5 A Theoretical Note

Four theories have been represented in Part I: Universality, Modified Universality, Territoriality and Cooperative Territoriality. Each theory has been critically analyzed in the context of the *ex ante* and *ex post* goals possessed by an ideal bankruptcy system. These goals have laid the foundation for a theoretical analysis of the four theories. From a theoretical standpoint, it is not difficult to observe that universality provides the best solution in regulating cross-border insolvencies. The administration of a debtor's entire body of assets in a single proceeding allows creditors to predict their respective claims if their debtors become insolvent, which is essential to setting correct prices in lending arrangements. Furthermore, the existence of only one set of proceedings generates considerable cost-savings to both the debtor and creditors who are domiciled in the home country. The only party that may be adversely affected is those creditors who do not reside in the home country of the debtor. As this group only represents a small portion in the body of creditors, the overall savings in terms of the entire bankruptcy administration should not be affected.

However, an assertion that universality represents the best model in governing cross-border insolvency must not be taken at face value. In other words, the theory must be examined in the context of developments in cross-border insolvency by means of treaties or other international instruments. It is safe to assume that nations will engage in best practices in realizing the benefits to their citizens to the maximum extent possible. Thus, if the assertion that universality is the optimal solution in regulating cross-border insolvency, the theory will have played out relatively well in the treaties and conventions. It has already been suggested that there is a gap between universality in theory and in practice. As demonstrated by the three-prong test, instead of universality, modified

¹⁵⁷ See 27, above, for more on this issue.

universality should be the best model in dealing with international insolvency because it works both in theory and practice. The next chapter will substantiate this proposition by studying the agreements negotiated by different states in governing cross-border insolvency. It is not a coincidence that all international instruments rely on modified universality.

4 Multilateral Efforts in the Regulation of International Insolvency

The first part of the paper has centered on a discussion of the bankruptcy theories proposed in the research community. This part will focus on the practical solutions entered into by nations in regulating international insolvencies. A practical analysis on multilateral efforts in this area is necessary to further the understanding of cross-border insolvencies and correct the widespread misconception that anything short of universality is second-best.

Ever since the eighteenth century, states have recognized the importance of regulating international insolvencies. Yet, the first few bankruptcy treaties were of a bilateral nature, limited to states which were geographical neighbours or trading partners.¹⁵⁸ Despite bearing some characteristics which today's scholars would associate with universality,¹⁵⁹ the practical values of bilateral agreements were limited. With the globalization of business and commerce and the increased mobility of assets, it is commonplace for multiple states that are neither geographical neighbours nor trading partners to find themselves entangled in cross-border insolvencies. This would prove bilateral treaties, which are by nature applicable between two states, to be defective. In view of the inherent limitation of bilateral treaties and the frustration of applying them in a multilateral context, the first multilateral bankruptcy convention, the Montevideo Treaties of 1889, was introduced in South America. Soon, the rest of the world would follow suit and enact similar agreements.

This chapter will examine three multilateral efforts in guiding international bankruptcies: the Nordic Bankruptcy Convention of 1933, the European Union Regulation on Insolvency Proceedings of 2002 and the United National Commission on International Trade Law ("UNCITRAL") Model Law on Cross-Border Insolvency. It is important to point out that these three documents are not the only solutions employed by states in regulating cross-border insolvency. For example, as already mentioned, there

¹⁵⁸ These include the 1715 Treaty of Alliance among France and the Catholic Swiss Cantons and Valais, the Franco-Swiss Treaty of 1869 entered into between Switzerland and France, the Franco-Belgian Treaty of 1899 between France and Belgium and Belgium and the Netherlands, a treaty in 1930 between France and Italy and other agreements. It is interesting to note that not all treaties referred to insolvency explicitly. Some merely referred to the recognition of foreign judgments. See K. Lipstein, "Early Treaties for the Recognition and Enforcement of Foreign Bankruptcies" in Ian F. Fletcher ed., *Cross-Border Insolvency: Comparative Dimensions: The Aberystwyth Insolvency Papers* (London: The United Kingdom National Committee of Comparative Law, 1990) 223.

¹⁵⁹ *Ibid.* at 224.

was the Montevideo Treaties of 1889 concluded among Argentina, Paraguay, Peru and Uruguay. However, the absence of data on the actual applications and effects of the Montevideo Treaties and the unwillingness of creditors in the region to seek assistance under the treaty dismissed the utility of the treaty as a model for study.¹⁶⁰ Similarly, the Bustamante Code of Havana Conference of 1928, which was entered into by fifteen Latin American states,¹⁶¹ has never been put to use. In sum, the Nordic Bankruptcy Convention, the E.U. Regulation on Insolvency Proceedings and the Model Law are selected for examination for their representative nature. A recurring theme among all agreements on cross-border insolvency is that the underlying premise to a successful regime must rest on modified universality.

4.1 The Nordic Bankruptcy Convention of 1933¹⁶²

The Nordic Bankruptcy Convention ("Convention") was concluded by Denmark, Finland, Iceland, Norway and Sweden on 7 November 1933. Though the Convention contains only seventeen articles, covering a wide array of matters that arise in a cross-border bankruptcy, the convention has often been quoted as the most successful multinational instrument in international insolvency.¹⁶³ To some, the Convention may be of historical interest since it was overridden by the E.U. Regulation on Insolvency Proceedings which entered into force on 31 May 2002.¹⁶⁴ However, a close examination on the Convention is desirable because of its unique application of *lex concursus* and *lex rei sitae* approaches, denoting the application of modified universality.

4.1.1 Jurisdiction

The primary question that must be addressed by any international bankruptcy convention is the circumstances under which a state will have jurisdiction over an insolvent individual or company. Surprisingly, the Convention does not answer this question explicitly. Rather than providing a list of situations granting a state jurisdiction

¹⁶⁰ Fletcher, *supra* note 27 at 231.

¹⁶¹ The sixteen states were Bolivia, Brazil, Chile, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Peru and Venezuela.

¹⁶² *Nordic Bankruptcy Convention*, 7 November 1933, 155 L.N.T.S.133.

¹⁶³ Fletcher, *supra* note 27 at 237; Michael Bodgan, "The Nordic Bankruptcy Convention" in Jacob S. Ziegel ed., *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford: Clarendon Press, 1994) 701.

¹⁶⁴ Please note that Denmark did not submit itself to the E.U. Regulation so the Nordic Convention continues to be in force in Denmark. For further discussion, see 56 below.

over the bankrupt subject, a “simple” or “indirect” approach is taken.¹⁶⁵ Article 13 states that the Convention will not apply to a bankruptcy judgment where a “court proposes to base its jurisdiction on a fact unconnected with the residence of a bankrupt individual or with the registered offices of a company, association or foundation which has been declared bankrupt”. The result of which is to divide an adjudication of bankruptcies based on domiciliary factors, where the Convention will apply, and non-domiciliary factors, where the Convention will not apply.

Two situations can be anticipated from the operation of Article 13. First, concurrent proceedings are made possible.¹⁶⁶ This will happen when a non-domiciliary proceeding is opened before a domiciliary proceeding where a decision reached in the latter will not be recognized in the former. While this is true, Article 13 does not prevent the court deciding in the non-domiciliary proceeding from cooperating with the domiciliary proceeding for the general interest of creditors.¹⁶⁷ Second, if the domicile of the bankrupt subject is in a third state who is not a contracting state, the states are free to open as many local proceedings as possible,¹⁶⁸ retreating to a territorial approach.

4.1.2 International Effect of Bankruptcy Decisions

Article 1 provides boldly that “a declaration of bankruptcy in any of the contracting states shall also apply to the bankrupt’s property in the territoriality of the other states”. Thus, the decisions made by one of the courts in the contracting states based on the domiciliary factors of the bankrupt will be given universal effect in other contracting states. There is no need for separate or *exequatur* proceedings.¹⁶⁹ As a complementary measure, Article 2 requires the bankruptcy officers, belonging to the court where a declaration of bankruptcy is made, to give notice of the bankruptcy by an announcement in the Official Journal of the said state and enter the declaration in the Land Register, Shipping Register or any other public register in accordance to the rules in force in that state. In addition, a notification of bankruptcy must be sent to all identified creditors in the other states as soon as possible. The notification should also point to any

¹⁶⁵ Fletcher, *supra* note 27 at 238.

¹⁶⁶ Bogdan, *supra* note 163 at 703.

¹⁶⁷ Fletcher, *supra* note 27 at 239.

¹⁶⁸ *Ibid.*

¹⁶⁹ Bogdan, *supra* note 163 at 702.

objections raised against the creditors' claims. On the other hand, it is curious that Article 2 does not provide a penalty for a failure to adhere to the publicity requirement. This helps to point to the amount of trust or confidence each of the contracting states possess towards the others.

To fortify the extraterritorial effect stipulated under Article 1, Article 3 vests the bankruptcy officer, belonging to the court where a declaration is made, with the power to request the courts of the contracting states to make a list of assets located in their territories and to take measures to conserve the property provisionally. In the eyes of Article 3, the bankruptcy officers in one of the states are seen as the bankruptcy officers of other states. Thus, the request for assistance can be made directly to the competent authority, suggesting a bypass of the courts is possible.

4.1.3 Choice of Law

The choice of law issue has always been the most exciting yet controversial area in cross-border insolvencies. The Nordic Convention has done a remarkable job in wrestling with the issue. It is renowned for its innovative approach in protecting the legitimate expectations of parties and ensuring a fair and equitable distribution of the proceeds through the use of a combination of *lex concursus* and *lex rei sitae* rules.

The general choice of law rule is laid out in the second paragraph of Article 1. Basically, the Article provides that the law of the contract state where the bankruptcy takes place (*lex concursus*) will rule on the following issues unless otherwise provided: the effect of the bankruptcy on the bankrupt's ability to deal with its assets, the composition of the bankrupt's estates, the bankrupt's rights and obligations, the administration of the bankrupt's property and transactions, the rights of creditors, the distribution of assets, the composition with creditors and other procedures for terminating the bankruptcy proceedings.

The exceptions to the general choice of law provision in Article 1 are found in Articles 4, 5, 6 and 7. Articles 4, 5 and 6 take on a *lex rei sitae* approach, using the bankruptcy legislation of the contracting state where the assets are, while Article 7 uses a combination of *lex concursus* and *lex rei sitae* approaches. Article 4 concerns interests created in immovable and movable properties prior to bankruptcy. Regarding immovable

properties, any dispute involving the perfection of interests through an entry in the Land Registry will be settled through the law of the state where the property is situated. For movable properties, such questions will be answered through the law of the state where the property is located at the beginning of the bankruptcy proceeding. Article 5 further provides protection to creditors whose interests are secured by a mortgage or pledge by allowing the rights of these creditors be governed by the law of the country where the property mortgaged or pledged is located. Article 6 simply authorizes the sale of the bankrupt's assets in accordance with the law of the state where the property is located. Together Articles 4, 5 and 6 highlight the importance of identifying the location of the property when the bankruptcy proceedings take place.

Article 7 is probably the most innovative and interesting section in the whole Convention. There are two paragraphs to the section. The first paragraph is relatively straightforward. It deals with the existence of preferential claims against particular assets and the question of priority between preferential claims, mortgages, pledges or other rights *in rem*. In addressing such issues, the law of the state where the property is situated when bankruptcy takes place will be applied. This paragraph cleverly protects the preferential status of some creditors whose status may be defeated by applying the laws of the state where the bankruptcy proceeding takes place.¹⁷⁰

Among other preferential treatments, such as, the treatment of a lessor, the second and third paragraphs discuss the treatment towards taxes and other public dues levied by a contracting state. A combination of *lex concursus* and *lex rei sitae* is used here. An example will help to illustrate the operation of Article 7:¹⁷¹

A domiciliary proceeding has opened in Denmark. The total value of the assets amount to Kr200,000, Kr50,000 of which belongs to assets located in Sweden, representing 1/4 of the total assets. On the debt side, a total of Kr180,000 is owed to the body of creditors, including a tax claim by the Swedish government amounting to Kr100,000. Before paying any money to satisfy the preferential claims of the Swedish government, since 1/4 of the assets are located in Sweden, Kr20,000 (1/4 of Kr180,000 – Kr100,000) will be deducted before the remaining

¹⁷⁰ Fletcher, *supra* note 27 at 242.

¹⁷¹ Bogdan, *supra* 163 at 705.

amount (Kr30,000) is applied to the tax claim. The unsatisfied portion of the tax claim (Kr70,000) will then be treated as an ordinary claim in the Danish court. Under the example, the percentage of recovery under preferential claims is 30% for the Swedish government. Simple arithmetic shows that the higher the value of the assets located in Sweden is, the higher the recovery rate will be for the Swedish government.¹⁷² One must question the logic of the formula contained in Article 7 and raise the question of why the deduction is necessary before any amount can be paid to satisfy the fiscal claim of a state? In the example, will it not be more equitable for the Swedish government to be afforded the same treatment as the Danish government through the application of Danish bankruptcy laws? Doing so will echo the principal universal priorities as advocated by Professor Westbrook in support of universality. Though not being able to fully appreciate the logic underlying the formula, paragraphs 2 and 3 satisfies the five states by approaching fiscal claims with this innovative approach.

4.1.4 Embracement of Modified Universality

The reason why the Nordic Bankruptcy Convention works remarkably well is often associated with the high degree of homogeneity in legal cultures and political climates among the five Nordic countries.¹⁷³ There is no doubt that homogeneity has contributed to the high level of mutual confidence and integrity among the states which may have provided a level of support to the functioning of the Nordic Convention. However, it does little justice to the Convention by simply associating its success with homogeneity while overlooking the substantive elements. After all, the legal systems in the Nordic region are far from identical.¹⁷⁴ The question remains as to what prompted the countries to enter into a relatively simple yet concise arrangement in regulating cross-border insolvencies? This calls for a theoretical analysis.

From a theoretical standpoint, the Nordic Convention is akin to both universality and modified universality. Referring back to the discussion in Chapter 4 that universality is merely a paper theory, if the Nordic Convention is classified under universality, the

¹⁷² If Kr50,000 is substituted with Kr100,000 (1/2 of the estate), the Swedish will be owed Kr100,000. So Kr40,000 [$.5 \times (180,000 - 100,000)$] will be deducted from the total value of assets in Sweden, leaving Kr60,000 to satisfy the claim. This will represent a recovery rate of 60% for the preferential claims before further recovery as a general creditor in Denmark.

¹⁷³ Fletcher, *supra* note 27 at 245.

¹⁷⁴ Bogdan, *supra* note 163 at 702.

earlier proposition is shaken. Fortunately, there are at least two reasons why the Convention should not fall under universality. First, the exit mechanism provided for under Article 13 makes multiple proceedings possible. Specifically, Article 13 divides a court taking on proceedings based on domiciliary factors from non-domiciliary factors. The instantaneous recognition of a declaration of bankruptcy as demanded under Article 1 without any requirement of *exequatur* proceedings will only apply to a court basing its jurisdiction on domiciliary factors. This is very different from universality as perceived by the universalists. For whatever reasons the court feels that it is in the state's best interest to act territorially, it can do so legitimately. The court simply has to set forth the facts to support its decision in basing jurisdiction on non-domiciliary factors and the other states will be bound by its findings.¹⁷⁵ Second, the Convention takes on a combination of *lex concurus* and *lex rei sitae* approach. Under clearly defined situations, the laws of the state where the assets are located play a crucial role in defining the rights of the respective parties. It is questionable whether universalists would accept such a profound application of laws which do not belong to the home country to a cross-border case.

Now the question remains as to why the Nordic Convention would be classified under modified universality in the absence of ancillary proceedings, which is often seen as an integral part to modified universality. Rather than putting an ancillary proceeding in place, the bankruptcy officer from a foreign state is vested with the power to request assistance from the competent authority directly, bypassing the court, under Article 4. On the surface, this arrangement seems be closer to universality than modified universality. But it must not be forgotten that both territoriality and multiple proceedings are still made possible under Article 3. It must also not be forgotten that ancillary proceeding is merely a creation under the U.S. Bankruptcy Code. The core characteristic to modified universality is the possibility of retreating to territoriality when things do not look favourable for states. Basically, modified universality is merely a concession to the limits within universality. Though it remains to be true that the Convention provides the exiting mechanism for the signatory states only if a state begins a non-domiciliary proceeding before a domiciliary proceeding takes place in another state and not the other way round,

¹⁷⁵ *Ibid.*

the exiting mechanism has created an avenue of retreat to territoriality. This exiting mechanism is very different from the exiting provisions found as a standard clause in any international agreements and conventions in cross-border insolvencies. Specifically, in those conventions, a court can only refuse to cooperate if doing so will be contrary to public policies.¹⁷⁶ Limiting cooperation to cases where jurisdictions are claimed through domiciliary factors is a characteristic that universalists oppose.

The fact that the Nordic countries regulate cross-border insolvency through modified universality shows that even with the existence of a high degree of homogeneity, states are not ready for a universal approach. It is also questionable if the states will be willing to give in and allow for an automatic recognition of a declaration of bankruptcy made by another state in the absence of the exiting mechanism under Article 13 or the fiscal claims arrangement under Article 7. Another observation that can be made from the Nordic Convention is that the Nordic region did not aspire to build bridges with the wider world or else more states would have been solicited to become a signatory.¹⁷⁷ This observation is a little disturbing. It seems to suggest that even with modified universality, a high degree of mutual trust and confidence in the integrity of another state's laws and procedures is necessary. The additional pre-requisite will present a strong barrier to the rest of the world in reaching a workable solution in cross-border insolvency. After all, not many countries share the exceptional degree of homogeneity as the five states in the Nordic region.

4.2 European Union Regulation on Insolvency Proceedings¹⁷⁸

With the entering into force of the European Union Regulation on Insolvency Proceedings (the "Regulation") on May 31st 2002,¹⁷⁹ the Nordic Convention is no longer applicable in the Nordic Region with the exception of Denmark.¹⁸⁰ Though the

¹⁷⁶ EC, *Council Regulation on Insolvency Proceedings 1346/2000*, [2000] O.J. L. 160/1 at Article 26; *UNCITRAL Model Law on Cross-Border Insolvency*, 30th Sess., UN Doc. A/52/17 (1997) at Article 6.

¹⁷⁷ Fletcher, *supra* note 27 at 245.

¹⁷⁸ Council Regulation on Insolvency Proceedings, *supra* note 176.

¹⁷⁹ *Ibid.* at Article 47.

¹⁸⁰ Under the Amsterdam Treaty, which is now incorporated into the Consolidated Version of the Treaty Establishing the European Community ("the E.C. Treaty"), the United Kingdom, the Irish Republic and Denmark enjoy the right to elect whether to opt in or opt out of any measures concluded under Title IV of the E.C. Treaty. Title IV provides the basis for the Regulation on Insolvency Proceedings and both the U.K. and Irish Republic have opted in but Denmark has not. See EC, *Consolidated Version of the Treaty Establishing the European Community*, [2002] O.J. C. 325 at Article 69; see E.C. *supra* note 176 at

Convention has been successful in its implementation, the scope and originality of the Regulation outrun it. Applicable to all member states of the E.U. other than Denmark, the Regulation has overcome the immensurable task of harmonizing the varied legal and political cultures among the member states. Thus, there is little surprise that the Regulation is dubbed as the most “radical achievement to date in terms of the creation of internationally enforceable rules with multi-national application”.¹⁸¹

4.2.1 Historical Background: Struggles to Enactment

Ever since the European Union came into existence in 1958 through the creation of the Treaty Establishing the European Community (“E.C. Treaty”),¹⁸² the European countries have envisioned a harmonization of commercial and financial laws to allow the free circulation of persons, services, goods and capital to create a unitary internal market.¹⁸³ Article 298 of the Consolidated E.C. Treaty provides that, “Member States shall, so far as is necessary, enter into negotiation with each other with a view to securing for the benefit of their nationals... the simplification of formalities governing the reciprocal recognition of judgments and enforcement of judgments of courts or tribunals and of arbitration awards”.

Article 220 had contributed to extensive discussions among the Member States in harmonizing commercial matters and fostering mutual recognition of the judgments of courts. The discussions bore fruit in 1968 through the enactment of the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, better

Preamble para. 32, 33. It has been suggested that Denmark’s reluctance to assent to the Regulation is due to public’s involvement by means of a referendum before an E.U. harmonizing measure can be accepted. Simply put, the government of Denmark probably does not want to be exposed to the pressure of a democratic rejection of the proposals. Denmark, however, has expressed its interest in enacting parallel legislation. See Ian Fletcher, “The European Union Regulation on Insolvency Proceedings,” online: The INSOL International <<http://www.insol.org>> at 17.

¹⁸¹ Fletcher, *Ibid.* at 15.

¹⁸² The Treaty Establishing the European Community was originally signed on March 25th 1957 among the original six member states which include Belgium, France, Germany, Holland, Italy and Luxembourg. On January 22nd 1972, the Treaty of Accession was introduced, inviting U.K, Denmark, Norway and the Republic of Ireland to accede to the European Community. The treaty was ratified by the Parliaments in the U.K., Denmark and the Republic of Ireland with a rejection from the Norwegian people in a referendum. Subsequent accession treaties brought Greece, Spain, Portugal, Austria, Finland and Sweden into the EC. The original EC Treaty along with amendments agreed under the Amsterdam Treaty have now been consolidated and renamed the Consolidated Version of the Treaty Establishing the European Community. See *Consolidated Version of the Treaty Establishing the European Community*, *supra* note 180.

¹⁸³ Manfred Balz, “International Law Symposium: The European Union Convention on Insolvency Proceedings” (1996) 70 Am. Bankr. L.J. 485 at 490.

known as the “Brussels Convention”. Article 1 of the Brussels Convention states that, “The Convention shall apply in civil and commercial matters whatever the nature of the court or tribunal... [but] the Convention shall not apply to bankruptcy, proceedings relating to the winding-up of insolvency companies or other legal persons, judicial arrangements, compositions and analogous proceedings”. Apparently, at an early stage, the Committee of Experts, which was formed by experts drawn from the original six Member States,¹⁸⁴ agreed that solvent and insolvent circumstances must be severed and contained in two separate pieces of Conventions. It was decided that the relative difficulty in negotiating an agreement regarding the bankruptcy of natural and legal persons could endanger the vitality of the entire project.¹⁸⁵ Following the passage of the Brussels Convention, the Committee of Experts was commissioned to develop a Bankruptcy Convention which would complement the Brussels Convention in bringing the entire Article 220 to life. It took almost 40 years and countless struggles before the Committee came up with the Regulation in its current form. The development of the Regulation can be divided into four phases.

Phase One – The Draft European Union Convention on Insolvency Proceedings

Being drafted by the same Committee of Experts, the Draft Convention borrowed heavily from the Brussels Convention, especially the innovative approach towards jurisdiction where superimposing rules of direct jurisdiction will be created.¹⁸⁶ This direct mode of jurisdiction sought to replace the individual rules previously applied by Member States regarding matters governed by the Convention. For example, rather than having Country B evaluating a judgment made by Country A who claims that her decision has a extraterritorial reach as authorized by the Convention, the decision made by Country A automatically applies. By imposing the rules of direct jurisdiction, the recognition and enforcement of judgments and orders will be an automatic process.¹⁸⁷ There will be little room for parties to challenge or appeal against a decision at the enforcement stage. The objective of implementing the direct jurisdiction approach is to integrate the differences

¹⁸⁴ These states were Belgium, France, Germany, Holland, Italy and Luxembourg.

¹⁸⁵ Harry Rajak, “The Harmonization of Insolvency Proceedings in the European Union”, online: The World Bank <<http://www.worldbank.org>> at 3

¹⁸⁶ Fletcher, *supra* note 27 at 251

¹⁸⁷ *Ibid.*

in the philosophies and structures of bankruptcy laws among the Member States which would help to realize the creation of a unitary internal market.

The effect of direct jurisdiction calls for a clear, unambiguous, logical and sensible approach in the Draft Convention. After all, Member States who are not deciding in a particular bankruptcy case will have limited power to rectify any misinterpretation or misuse made of the Convention. The Draft Convention fell far from the required standard and dug a grave for itself by incorporating absurd and illogical provisions, two of which will be examined here.

First, three levels of jurisdictional rules were contemplated by the Draft Convention. At the top level, the courts of the Member State where the debtor has its 'centre of administration' will have an exclusive jurisdiction in declaring the bankruptcy of the debtor.¹⁸⁸ At the middle level, if the debtor does not have a centre of administration in any of the Member States, any of the Member States where the debtor has an 'establishment' will have to the power to declare the bankruptcy of the debtor.¹⁸⁹ At the bottom level, if the debtor does not have a centre of administration or an establishment in any of the Member States, an 'open season' can be declared by the court of any of the Member States whose national bankruptcy laws allow for a declaration of bankruptcy of the debtor.¹⁹⁰

With the words, such as, the 'centre of administration' and 'establishment', inserted into the jurisdictional rules of the Draft Convention, one can reasonably expect the Committee of Experts would use clear and unambiguous language in defining the terms. However, the opposite is true. The 'centre of administration' is described as the 'place where the debtor usually administers his main interests'.¹⁹¹ Likewise, an 'establishment' is defined as 'a place where an activity of the debtor comprising a series of transactions is carried on by him or on his behalf'.¹⁹² The wording of both definitions does not lend any clue to the qualitative or quantitative factors that a court must look at in deciding where the centre of administration or an establishment of a debtor is located. For

¹⁸⁸ EC, *Preliminary Draft Convention*, [1970] E. Comm. Doc. 3.327/1/XIV/70-F at Article 3(1); EC, *Draft Convention*, [1980] E. Comm. Doc. III/D/72/80 at Article 3(1).

¹⁸⁹ *Preliminary Draft Convention*, *ibid.* at Article 4(1); *Draft Convention*, *ibid.* at Article 4(1).

¹⁹⁰ *Preliminary Draft Convention*, *ibid.* at Article 5; *Draft Convention*, *ibid.* at Article 5.

¹⁹¹ *Preliminary Draft Convention*, *ibid.* at Article 3(2); *Draft Convention*, *ibid.* at Articles 3(2) and (3).

¹⁹² *Draft Convention*, *ibid.* at Article 4(2).

example, does the timeframe referred to by the word 'usually' in the definition of the 'centre of administration' stand for a quarter of a year, half a year, three-quarters of a year or an entire year? With this in mind, how could a court of a Member State enforce the judgments of another Member State when the former doubts the validity of the jurisdiction of the latter?

Another disappointing rule contained in the Draft Convention is the one dealing with the priority of decisions made in concurrent proceedings where the debtors have multiple establishments among the Member States. Rather than developing a logical rule in deciding on the most appropriate forum for the opening of such proceedings, a mechanical rule was proposed. The Member State where the first proceeding is opened will be granted a Community-wide supremacy with her decisions binding in other Member States.¹⁹³ In anticipation of two Member States opening a proceeding based on the establishment factor on the same date, the Draft Convention proposed a rule whereby precedence would be determined by the alphabetical order of the name of the States concerned.¹⁹⁴ The operation of both rules may be convenient. Yet, it is hard to accept that a multilateral agreement on cross-border insolvency would be premised on convenience rather than fairness and efficiency.

Second, the Draft Convention introduced a combination of *lex concursus* and *lex situs* rules in dealing with the choice of law issues. As a general rule, for the proceedings and the administration and distribution of the estate, the applicable law will be the law of the Member State where the proceeding is opened.¹⁹⁵ As a concession to the substantive differences among the Member States towards the treatment of security and the perfection of interests, the law of the *situs* of the location of the secured property will dictate the fate of secured and preferential creditors.¹⁹⁶ This combined approach echoes the principle adopted by the renowned Nordic Convention and a series of sub-estates will be created in each Member State concerned. It has been identified that in the context of

¹⁹³ Articles 15(2) and 52(1) of the 1970 Draft Convention; Article 13(2) and 58(1) of the 1980 Draft Convention.

¹⁹⁴ Article 52(2) of the 1970 Draft Convention; Article 58(2) of the 1980 Draft Convention.

¹⁹⁵ Articles 17, 18, 19, 20-22, 28, 30 and 32 of the 1970 Draft Convention; Articles 15, 17, 18, 20-22, 29, 31 and 33 of the 1980 Draft Convention.

¹⁹⁶ Articles 40 – 46 of the 1970 Draft Convention; Article 43 – 52 of the 1980 Draft Convention.

the Draft Convention, the exercise of the combined approach would generate horrifying complexities and wasteful expenditure of administrative resources.¹⁹⁷

Despite the fact that the implementation of the dual approach has been relatively unproblematic in the Nordic Regions, this does not lend support to the proposition that the same principle would function well in the E.U.. As mentioned earlier, the five signatories to the Nordic Convention share a high degree of homogeneity. This degree of homogeneity is non-existent among the Member States in this situation. The fact that the Draft Convention involves many more states and the division among them in terms of legal cultures and political climates made the implementation of the dual approach impossible. Adopting the mechanisms contained in another agreement without fine-tuning the arrangements in the context of the E.U. was irrational. After all, the legal systems and traditions of the E.U. Member States were much more diverse than the five states in the Nordic Region. Coupled with the vague wordings of some of the sections to the Draft Convention, the Draft Convention came under heavy attack from the Member States. In sum, the failed embracement of unity and universality had contributed to the eventual death of the Draft Convention in 1984.

Phase Two: Council of Europe Convention of Istanbul of 1990¹⁹⁸

Following the failure of the Draft Convention, the Council of Europe concluded a European Convention on Certain International Aspects of Bankruptcy ("Istanbul Convention") which was opened for signature on June 5th 1990. Under Article 34 of the Istanbul Convention, a minimum of three ratifications is needed for the Convention to enter into force. Up to May 31 2002 when the E.U. Regulation came into force, which overrides the Istanbul Convention,¹⁹⁹ only eight of the Member States to the Council of Europe had signed the Istanbul Convention with only one ratification in Cyprus.²⁰⁰ The reason why the Istanbul Convention is a significant step in the development of the E.U. Regulation because its innovation, or improvements over the Draft Convention, was

¹⁹⁷ Fletcher, *supra* note 27 at 255; EC, *The Report on the Convention on Insolvency Proceedings* (the "Virgos-Schmit Report") (EC) 6500/96 DRS 8 (CFC) at para. 5.

¹⁹⁸ *European Convention on Certain International Aspects of Bankruptcy*, 5 June 1990, E.T.S. No. 136.

¹⁹⁹ Council Regulation on Insolvency Proceedings, *supra* note 176 at Article 44(1)(k).

²⁰⁰ These states were Belgium, Cyprus, France, Germany, Greece, Italy, Luxembourg and Turkey. The ratification in Cyprus took place on 17 March 1994.

brought into the E.U. Convention in 1995, which was used as a blueprint for the E.U. Regulation in 2002.

Learning from the failure of the Draft Convention, the Istanbul Convention is much less ambitious in scope. It dealt primarily with two innovations: the opening of secondary proceedings where the debtors have substantial assets and the powers of the foreign liquidators. Regarding the opening of secondary proceedings, Article 18 indicates that a secondary proceeding can be requested by the liquidator in the main proceeding or any other person granted the right to request the opening of a bankruptcy by the law of the Member State where the opening of the secondary bankruptcy is requested. Apparently, Chapter III of the Istanbul Convention, which contained the articles on secondary proceedings, is introduced to counterbalance the inequitable situation created under the head of unity and avoided the messy situation created by applying different rules of law in the same proceedings as purposed by the Draft Convention. Specifically, secondary proceeding is designed to safeguard the interests of the secured and preferential creditors, reserving locally-collected assets for the satisfaction of secured local claims. As will be seen, this measure is adopted into the E.U. Regulation. Regarding the powers of the liquidator, Chapter II authorizes the liquidator to take all provisional and protective measures legally possible under the other Member State.

While it is beyond the scope of this paper to elaborate on the mechanisms contained in the Istanbul Convention, it is important to highlight the fact that many of its provisions were later adopted into the E.U. Regulation. For example, the Istanbul Convention provided a two-tier approach towards jurisdictional issues. At the first tier, the court of the Member State where the debtor has a 'centre of main interest' will be authorized to commence a primary proceeding.²⁰¹ For companies and legal persons, the centre of main interest is presumed to be the place of their registered offices. This presumption is refutable if it can be proved that the entity's business decisions are made outside the place of incorporation.²⁰² At the second tier, secondary proceedings may be opened in Member States where the debtor has an 'establishment' on two conditions: the centre of the debtor's main interest is not located in any of the Member States and where

²⁰¹ *European Convention on Certain International Aspects of Bankruptcy*, *supra* note 198 at Article 4.1.

²⁰² Fletcher, *supra* note 27 at 307.

a primary proceeding cannot be opened where the debtor has its centre of main interests.²⁰³ Both articles were subsequently incorporated into the E.U. Conventions, albeit with modest changes.

Phase Three: The Convention on Insolvency Proceedings of 1995²⁰⁴

When the Istanbul Convention was opened for signatures on 1990, rather than signing it, a renewed enthusiasm for the E.U. Convention was fostered among the European Countries. This might be attributable to the non-ambitious nature or absurd arrangement contained in the Istanbul Convention where Member States are allowed to opt out of applying the entire Convention.²⁰⁵ This '*a la carte*' arrangement may lead to complicating and confusing situations if some Member States acted on the opt-out facilities.

Since the E.U. Convention is similar to the E.U. Regulation in substance which will be observed in depth in the subsequent section, a discussion on the mechanisms contained in the E.U. Convention is unwarranted. At this point, one might raise the question as to why the E.U. Convention failed while its parallel, the E.U. Regulation, survived. The answer rests on the political situation and relationship in 1996 between the United Kingdom, the state who refused to sign the E.U. Convention, and the rest of the signatory states. This helps to bring home a peculiar aspect of cross-border insolvency. Specifically, developments in international bankruptcies are intertwined with international politics and relationships.

The finalized version of the E.U. Convention was tabled for signature on 25 September 1995 by the Council of Ministers. Under Article 49, the Convention would be opened for signature for a limited period of six months until 23 May 1996. It further provided that the Convention would not be in force unless it was accepted, ratified or approved by all the Member States of the E.U.. Twelve states signed the Convention on 23 November 1995 in a meeting held in Madrid with Ireland and Netherlands adding

²⁰³ *European Convention on Certain International Aspects of Bankruptcy*, *supra* note 198 at Article 4(2).

²⁰⁴ *European Union Convention on Insolvency Proceedings*, 23 November 1995, 17 ZIP 976, 35 I.L.M. 1223.

²⁰⁵ *Ibid.* at Article 40.

their signatures in the following months.²⁰⁶ During this period, an Explanatory Report to the Convention, better known as the Virgos-Schmit Report, was put into circulation. The Report addressed some of the uncertainties or technical obstacles to implementing the Convention that were raised by the Member States. At the end of the six-month period, the U.K. shocked the world by announcing that it would not sign the E.U. Convention despite the fact that the House of Lords Select Committee on the European Communities advocated a favourable yet cautious approach.²⁰⁷ Inevitably, the Convention lapsed and fell apart.

In understanding why the U.K. withheld its signature, one must look beyond the substance of the E.U. Convention and focus on the political contingencies around the timeframe where the Convention was opened for approval. After all, the House of Lords did turn a green light to the Convention. Two theories have been advanced in capturing the reasons behind the U.K.'s refusal.

First, immediately before the expiry of the six-month limitation period, the relations between the U.K. and the rest of the E.U. were strained due to the eruption of "mad cow disease" (*bovine spongiform encephalopathy*) threatening the livelihood of the beef and dairy farmers in the U.K..²⁰⁸ In protesting against the E.U.'s refusal to lift the trade embargo, John Major, then the Prime Minister of the U.K., held the Convention hostage and refused to cooperate with the other Member States.²⁰⁹

Second, the U.K. was not comfortable with the situation in Gibraltar. Under the Treaty of Utrecht signed between Spain and England in 1713, the latter was granted sovereignty over Gibraltar in perpetuity. This rock formation located at the mouth of the Mediterranean had been daunting the relations between U.K. and Spain for over 300 years. While the Spanish is desperate to restore her sovereignty over Gibraltar, the British has been working hard to avoid any situation where the Spanish laws would be applied to

²⁰⁶ These states were Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Portugal, Spain and Sweden.

²⁰⁷ U.K., H.L., "Report: Convention on Insolvency Proceedings", in *Sessional Papers*, vol. 59 (1995-1996).

²⁰⁸ On 27 March 1996, the E.U. Commission passed a series of provisional measures geared at containing the spread of the BSE. One of the measures included an export on the U.K. preventing the nation from exporting meat and other products of bovine animals to the other Member States or third countries. On 21 May 1996, U.K. began a policy of non-cooperation with the E.U. partners until they would agree to lift the ban. See BSE Timeline, online: BBC News Online <<http://news.bbc.co.uk/1/low/uk/218676.stm>>.

²⁰⁹ Fletcher, *supra* note 27 at 298.

the rock. It is believed that such circumstances would cause erosion of British sovereignty and influence in the area.

Under the Brussels Convention, care was taken in drafting a clause excluding “any European territory situated outside the U.K. for the international relations of which the U.K. is responsible unless the U.K. makes a declaration to the contrary in respect of any such territory”.²¹⁰ This measure allowed the U.K. to bring the Isle of Man, the Channel Islands, the British Sovereign Bases in Cyprus and Gibraltar outside the Brussels Convention. However, such a territorial limitation clause was not available in the E.U. Convention. Relying on the general rules of international law or Article 29 of the 1969 Vienna Convention on the Law of the Treaties, the Report stated that the E.U. Convention would not apply to “those territories whose international relations are assumed by the Contracting State, but which are not an integral part of their territory, being a separate entity”.²¹¹ The fact that the issue was tackled separately outside the E.U. Convention and retrospectively after the E.U. Convention was tabled for signatures did not provide enough security to the British Government that her sovereignty would be adequately protected under the E.U. Convention.²¹²

Although both the mad cow disease and the Gibraltar situation are unrelated to cross-border insolvencies on the surface, the events serve to highlight two issues. First, any agreement passed in the realm of international bankruptcy or other subjects involving multiple nations may be used as a leveraging tool or bargaining chip by politicians. A minimal disruption in international relations may lead to the demise of an international instrument. Second, states are wary of any erosion to their sovereignty resulting from the implementation of a treaty or a convention. Care must be taken at the drafting stage to reduce any embarrassment and avoid any sensitive issues among different states. These two points will be significant in the next Chapter on the North American situation.

²¹⁰ EC, *Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters* [1989] O. J. L. 285 at Article 60.

²¹¹ Virgos-Schmit Report, *supra* 197 at para. 300 – 302.

²¹² Fletcher, *supra* 27 at 300.

Phase Four: The E.U. Regulation on Insolvency Proceedings of 2000

Miraculously, the European nations are not discouraged after three failed attempts in regulating cross-border insolvencies. Thanks to the enthusiasm displayed by the German and Finnish Republics, which successively held the Presidency of the E.U. Council of Ministers in 1999, the soul of the E.U. Convention was brought back to life, albeit in the body of the E.U. Regulation.²¹³ The difference between the E.U. Convention and the E.U. Regulation as well as the rules embodied by the latter will be examined.

As mentioned before, the difference between the E.U. Convention and the E.U. Regulation does not lie in substance but in form. Under Article 249 of the Consolidated E.C. Treaty, a regulation “shall have general application [and] shall be binding in its entirety and directly applicable in all Member States”.²¹⁴ This is contrasted with a convention which relies on the willingness of Member States in completing the internal processes, such as, ratification necessary for implementation of the instrument. In other words, a regulation is self-executing and binding on all Member States under the twin principles of direct effect and supremacy of E.U. law.

The principle of direct effect allows any E.C. legislation, which is clear and unambiguous, unconditional and whose operation does not rely on further action by the Member States, to confer on individuals in any of the Member States enforceable rights.²¹⁵ Thus, no separate domestic ratification of such legislations will be necessary for domestic parties to enjoy the full benefits. The supremacy doctrine simply states that any aspects of national law or practice that are incompatible with the E.U. legislations will be overridden by the latter. The objective of this is to create a uniform body of law which is binding and applicable throughout the E.U..²¹⁶ Fitting it in the context of the E.U. Regulation, the effect brought by the principle of direct effect and the supremacy doctrine is to allow domestic parties to make use of the provisions under the Regulation in a uniform manner, while harmonizing the differences in bankruptcy legislation among the

²¹³ Fletcher, *supra* 180 at 18.

²¹⁴ *Consolidated Version of the Treaty Establishing the European Community*, *supra* note 180 at Article 189.

²¹⁵ *Van Gend en Loos v. Nederlandse Administratie der Belastingen* Case 26/62 [1963] ECR I.

²¹⁶ *Flaminio Costa v ENEL* Case 6/65 [1964] ECR 585 at 593.

Member States. This goal is further guided by the interpretative power given to the European Court of Justice (E.C.J) regarding the Regulation.²¹⁷

4.2.2 Structure of the E.U. Regulation

There are three parts to the E.U Regulation: a preamble, forty-seven articles and three annexes. Preambles are standard features to any E.U legislation. They serve to point out the legal justification behind the legislation as well as the policies and considerations adopted throughout the drafting process. However, the Preamble to the E.U. Regulation is unusually long, standing at 33 paragraphs. Basically, it summarizes the information contained in the earlier Virgos-Schmit Report, including the justification behind adopting a combined model of existing theories to international bankruptcies as well as other subject matter which can be used as an interpretative guide by the Member States.²¹⁸ The articles contain rules governing the choice of forum, the choice of law and other administrative issues. These rules are supplemented by the three annexes, which contain information on the types of insolvency, winding up and liquidation proceedings in different Member States that fall under the Regulation.

4.2.3 Jurisdiction

The scope of the E.U. Regulation is clearly stated in Article 1(1). All “collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointing of a liquidator” falls under its ambit. However, the Regulation does not apply to insurance undertakings, credit institutions, investment undertakings and collective investment undertakings.²¹⁹ The reason why these sectors are excluded stems from the fact that the insurance and banking industries are subject to specific E.U. Regulations in

²¹⁷ See *Consolidated Version of the Treaty Establishing the European Community*, *supra* note 180 at Article 234. Normally, the E.C.J. has jurisdiction to consider the validity and interpretation of Regulation, directives or decisions at the request of any national court or tribunal regardless of where the court who requests assistance is standing in the national legal hierarchy. However, since the E.U. Regulation belongs to a special category, a reference to the E.C.J. can only be made by the final appellate court of a Member State who has a case pending. Thus, a request for interpretation will likely be rare. Due to money and time concerns, not many insolvency cases will make it to the final appellate court. With this in mind, the role played by the E.C.J. will likely be limited. However, the symbolic value brought by the availability of a dispute resolution mechanism plays a significant role in completing the E.U. Regulation. See Fletcher, *supra* note 180 at 22.

²¹⁸ The Preamble has been criticized as being unstructured, overlong and unnecessarily complex. The degree to which the Preamble can be consulted in interpreting the provisions to the E.U. Regulation is also uncertain. See Rajak, *supra* note 185 at 10.

²¹⁹ *Council Regulation on Insolvency Proceedings 1346/2000*, *supra* note 176 at Article 1(2).

the exercise of freedom to establishment and freedom to provide services. Therefore, these industries will be covered by a set of separate regulatory standards.²²⁰ The type of insolvency proceedings as well as the kind of liquidators Article 1(1) refer to are further listed under Annexes A and C respectively. For example, a creditors' voluntary winding up proceeding that results in a court appointment of a liquidator in the U.K. falls within the scope of the Regulation. For proceedings that are not mentioned in the Annexes, such as, administrative receivership in the U.K., the Regulation will not apply.

Having established the scope of the Regulation, it is important to look at the rules that govern the opening of a proceeding. Under Article 3, two types of proceedings are provided for: main proceedings and secondary bankruptcies. Main proceedings are opened in Member States where the debtor has a centre of main interests ("COMI"). In the case of a company or legal person, the COMI is presumed to be the place of the registered office of the company in the absence of proof to the contrary.²²¹ In other words, this is a refutable assumption with the onus of proving the contrary resting on the party asserting that the COMI is located elsewhere. To aid the determination of the COMI, paragraph 13 of the Preamble states that the "centre of main interests should correspond to the place where the debtor conducts the administration of its interests on a regular basis and is therefore ascertainable by third parties".²²²

As a complement to the main proceedings, secondary proceedings are allowed under Article 3(3). If the debtor has a COMI in a particular Member State, the court of another Member State can open secondary proceedings of a winding-up nature if the debtor possesses an establishment within that Member State. Establishment is defined under Article 2(h) as "any place of operations where the debtor carries out a non-

²²⁰ Virgos-Schmit Report, *supra* note 197 at para. 54.

²²¹ Council Regulation on Insolvency Proceedings 1346/2000, *supra* note 176 at Article 3(1). It is interesting to note that the E.U. Regulation answers the choice of forum issue through a combination of common and civil law approach. Specifically, a preliminary judgment is made based on the place of incorporation theory. The real seat theory is used to do justice in cases where a party can prove to that the state of incorporation is not where the debtor's COMI is.

²²² It is beyond the scope of this paper to comment on the guidance on the COMI provided in the E.U. Regulation. However, it is interesting to note the Regulation made no attempt to further define the "centre of administration", thus, repeating an error committed by the Working Group in the Draft Convention. Rather than providing a qualitative or quantitative test on the degree of administration needed to deem a debtor having a COMI in a particular state, the question is left open. See Ann-Christine Halen, "Centre of Main Interests" – a New Concept in European Insolvency Law (Master Degree in European Affairs Program, Lund University, 2002) [unpublished].

transitory economic activity with human means and goods”. Secondary proceedings can be opened prior to or after the commencement of a main proceeding in another Member State. If a secondary proceeding is opened prior to a main proceeding, either one of the following conditions have to be satisfied.²²³ First, an insolvency proceeding cannot be opened where the debtor has a COMI because of the bankruptcy laws of the Member State where jurisdiction for a main proceeding properly belongs. Second, the opening of a secondary proceeding is requested by a creditor who has its domicile, habitual residence or registered office in the Member State where the request is made. The purpose of incorporating the two conditions into the Regulation is to offset any grab-law effect brought upon the debtor’s estate by pre-emptive actions of creditors.²²⁴

Chapter III of the Regulation contains a list of rules regulating secondary bankruptcy proceedings. The basic principle is enunciated in Article 27 where it says that the decisions reached in a secondary proceeding are only applicable towards the debtor’s assets which are situated within the territory of that Member State. The rest of the Chapter goes on to discuss the right to request the opening of proceedings, advance payment of costs and expenses, duty to cooperate and communicate information and the exercise of creditors’ rights. Of significance, Article 31 stipulates that liquidators in both the main and secondary proceedings are duty bound to communicate information and cooperate with each other. This measure would bring down the ring-fences around the secondary proceedings and allow a free flow of information which may reduce administrative costs and enhance efficiency.

4.2.4 International Effect of Bankruptcy Decisions

Chapter II of the E.U. Regulation deals with recognition of insolvency proceedings. It covers rules governing the recognition of decisions, powers of a liquidator, hotchpot rule and other administrative procedures. The overriding rule on recognition is stated in Article 16 where it says that any judgment made by a court which has jurisdiction to open a main or secondary proceeding shall be given recognition by all other Member States once the decision becomes effective in the former. However, the recognition of a decision made in the main proceeding will not serve to preclude the

²²³ *Council Regulation on Insolvency Proceedings 1346/2000, supra* note 176 at Article 3(4).

²²⁴ Fletcher, *supra* note 181 at 31.

opening of a secondary proceeding.²²⁵ This recognition is universal and automatic and no further formalities are required.²²⁶

In regards of the enforcement of a decision, a liquidator appointed by a court in a main proceeding can exercise all the powers conferred on him by the law of the main proceeding in another Member State in the absence of a secondary proceeding in the latter. No separate appointment is necessary as his status merely needs to be evidenced by a certified copy of the original decision appointing him as a liquidator.²²⁷ The Regulation goes as far as allowing the liquidator to remove debtors' assets from any Member State. However, this power is not without limitation though. In the process, the liquidator has to be wary of the rights of third parties under Article 5, the operation of the set-off rule under Article 6, the reservation of title under Article 7, and the law of the Member State where he intends to take action. Subject to the limitations, the absence of the need for an executive judgment and the extensive power granted to a liquidator enhance administrative convenience and efficiency, both of which are desirable in cross-border insolvency.

Another important rule in Chapter II concerns return and imputations to ensure equality among creditors. Article 20(1) provides for the situation where a creditor receives part or a full satisfaction of its claims with the debtor's assets situated in another Member State after the commencement of a main proceeding. In this scenario, the creditor will have to return whatever it received to the liquidator. Article 20(2) further provides that a creditor can only receive a dividend on its claim if other creditors of the same class obtain an equivalent dividend. This arrangement is not an innovation created by the E.U. Regulation. It is simply a codification of a long-existing 'hotchpot' rule in the common law family.²²⁸ The rationale behind the rule concerns the maintenance of equality among creditors and the prevention of double recovery by any parties.

Among all the other Articles in Chapter II, another Article that is worth mentioning is Article 26. The Article serves to provide an exiting mechanism for the Member States. Specifically, a refusal to recognize a foreign proceeding or enforce a

²²⁵ *Council Regulation on Insolvency Proceedings 1346/2000*, *supra* note 176 at Article 16(2).

²²⁶ *Ibid.* at Article 17.

²²⁷ *Ibid.* at Article 19.

²²⁸ Fletcher, *supra* note 27 at 289.

judgment is allowed if doing so would be manifestly contrary to the public policy of a Member State, in particular the fundamental principles or constitutional rights and liberties of an individual. It is believed that this exiting mechanism is included in international agreements as “safeguard clauses” which are common to most international agreements that assert an extraterritorial effect on the other states’ judiciary processes. With the degree of mutual trust and confidence that the E.U. Member States possesses towards each other, such clause will unlikely be invoked.²²⁹ Setting this aside, Article 26 also contains another indirect yet significant result. Other than for reasons contrary to public policies, Member States are not allowed to review or object to the decisions made by the courts in another Member State.²³⁰ This is the case even if the former believes the latter is not vested with the proper jurisdiction as laid down by Article 3 of the Regulation. If the parties want to launch a disagreement or rebut the assumption made relating to COMI, they would have to do so in the original proceedings. In essence, the non-objectivity aspect of Article 26 counts on the judiciaries of the Member States in monitoring the exercise of their jurisdictions as well as honouring the full spirit of the Regulations.

4.2.5 Choice of Law

In light of the absence of a uniform system of security rights in Europe and the existence of a diversity of national bankruptcy laws and procedures within the E.U., the Regulation does not seek to harmonize the system and create a uniform code of bankruptcy rules.²³¹ Rather than imposing a set of rigid rules, a flexible approach is introduced through a combination of *lex concursus* and *lex sitae* principles.

Article 4 states that the applicable law in an insolvency proceeding is that of the Member State where a proceeding is opened (“the State of the opening of proceedings”). The Article does not distinguish main from secondary bankruptcies. Thus, in either proceeding, the law of the State of the opening of proceedings shall govern the procedural and substantive aspects to a proceeding. Article 4 goes on to provide a list of areas where those laws would apply.²³² However, the list is not exhaustive. The *lex*

²²⁹ Fletcher, *supra* 180 at 40.

²³⁰ *Ibid.*; Virgos-Schmit Report, *supra* note 197 at para. 40.

²³¹ Virgos-Schmit Report, *Ibid.* at para. 12.

²³² *Ibid.* at para 91.

concurus approach enunciated in Article 4 is not without limitations. Articles 5 to 14 provide the exceptions where the approach would be overridden.

Article 5 states that the rights *in rem* of creditors or third parties in respect of tangible or intangible, movable or immovable assets will not be affected by the laws belonging to the State of the opening of proceedings. Rather, these rights will be governed by the laws where the assets are situated at the opening of the proceedings. With the divergent treatments towards perfection of security interests, a rule favouring the application of the laws of the Member States where the interests arise is desirable. This measure will serve to protect the legitimate expectations of creditors by making sure their rights will not be discarded through an application of a rigid *lex concurus* approach. This concession will be of particular significance in the E.U. where the nations are divided into the common law and civil law families. For example, the common law creation of a floating charge over a collection of debtor's assets does not have a counterpart in the civil law family. By applying a *lex situs* approach, the rights of a creditor who holds a floating charge over the debtors' assets in the U.K. will not be compromised even if the State of the opening of proceedings is France.²³³

Article 6 concerns the set-off of creditors' claims against the debtors'. In such a situation, the right of a creditor to claim a set-off against the debtor will not be affected by the rules of the State of the opening of proceedings as long as the set-off is permitted under the law applicable to the debtor's claim. Therefore, even if a set-off is denied under the *lex concurus*, it will nevertheless be allowed if the law applicable to the debtor's claim allows it.²³⁴ However, if the laws of both Member States deny set-offs, it will not be available. Alike Article 5, this Article serves to reconcile the different philosophical premises between the common law and civil law families. Under the civil law traditions, set-offs are restricted to cases where the debts and credits arise between two parties based on a single transaction. Any further set-offs are regarded to be a breach of the *pari passu* principle among creditors. On the other hand, set-offs in the common law system are tolerated as long as there are mutual dealings between the same parties in the same

²³³ Fletcher, *supra* 180 at 34.

²³⁴ Virgos-Schmit Report, *supra* note 197 at para. 198.

capacity.²³⁵ By including set-offs as an exception to the general rule under Article 4, creditors can predict the availability of set-offs at the moment of contracting or incurring a claim.²³⁶

Other than the two exceptions examined in the above, the Regulation goes on to provide for eight different types of exceptions. These include the reservation of title, contracts relating to immoveable property, payment systems and financial markets, contracts of employment, rights subject to registration, community patents and trade marks, third-party purchasers and lawsuits pending. Basically, the relevant laws of the *lex concursus* are tossed aside in the aforementioned situations in favour of the laws of the Member State where the asset is located or the contract is entered into or the case is pending at the opening of the proceedings. In sum, these exceptions are incorporated into the Regulation to protect the legitimate expectations and the certainty of transactions in Member States other than the one where the main proceeding is opened. They also serve as a guideline allowing parties to predict what their respective rights will be if the debtor goes into bankruptcy.

4.2.6 Secondary Proceedings and Modified Universality

It is suggested earlier that one of the many reasons why the Nordic Convention is successful is due to its adoption of modified universality, albeit not in the widely accepted notion of the theory involving ancillary proceedings. Compared to the Nordic Convention, the E.U. Regulation is relatively new. It is still too early to judge whether the E.U. Regulation will be as successful as its predecessor. However, if the E.U. Regulation shares the same theoretical premise as the Nordic Convention, the likelihood of success will increase. In light of this, it is important to study the theoretical underpinning of the Regulation.

As expressed in the Virgos-Schmit Report, the Convention follows a combined model of the existing theories on the regulation of cross-border insolvencies. The Report specifically refers to universality, territoriality and the unity of plurality of proceedings.²³⁷ With this somewhat convoluted assertion in mind, the question that must

²³⁵ *Ibid.* at para. 35.

²³⁶ *Ibid.* at para 109.

²³⁷ *Ibid.* at para. 12.

be addressed is: precisely, what theory best captures the essence of the Regulation? As with any international instrument which is geared at regulating international insolvency, territoriality is out of the question. Unity is also out of the picture despite the fact that it was the original principle endorsed in the Draft Convention. So what remains are universality and modified universality.

Alike the Nordic Convention, the E.U. Regulation is akin to both universality and modified universality. Universality is preserved in the main proceedings whose law will rule on all aspects of cross-border insolvencies outside the Member States where secondary proceedings are opened and whose decisions will be given automatic recognition across the E.U.. However, the provision of secondary proceedings is in direct contravention of universality. In any given case, as long as a debtor has a centre of main interest in one of the Member State and multiple establishments in other Member States, there will be one main and multiple bankruptcy proceedings. Rather than having a set of laws applicable to every issue arising, there will be multiple sets of rules applying in different proceedings. In sum, the combined effect brought forth by main and secondary proceedings has made it difficult to fit the Regulation under universality.

The next question draws on whether the operation of secondary bankruptcies falls within the ambit of modified universality. As discussed earlier, one of the examples to modified universality is the incorporation of ancillary proceedings in a nation's bankruptcy laws, resembling those of the U.S. Bankruptcy Code. However, ancillary proceeding is not the only means to achieve modified universality. A secondary proceeding is another way to approach the theory. Redefining modified universality in a more general manner, three characteristics can be associated with the theory. First, a retreat to a territorial proceeding is always available. Second, more than one set of bankruptcy laws may apply. Third, the system is geared towards protecting the interests of local creditors.

In the context of ancillary proceeding, territoriality is made possible by affording a court with the discretion in deciding whether to cooperate with a foreign proceeding or not. If the court decides against a foreign proceeding, a territorial proceeding may commence. In this situation, more than one set of rules will be applied towards the debtors depending on where the proceeding commences. As discussed earlier, one of the

many considerations a court applies in deciding whether to accede to a foreign jurisdiction is the protection of local creditors.

Similarly, all three aspects to modified universality are addressed by secondary bankruptcies. Territoriality is made possible by the opening of secondary bankruptcy outside the Member State where the main proceeding is opened. Within a secondary proceeding, the law of the Member State where such proceeding is opened is applied. In other words, the law belonging to the main proceeding will be applied to all Member States where no secondary proceeding exists. The result will be multiple sets of rules governing problems arising from the bankruptcy of one debtor. As stated in the Virgos-Schmit Report, secondary bankruptcies are geared at reconciling the advantages of universality and the necessary protection of local interests.²³⁸ Specifically, they are used to ameliorate the defeat of the legitimate expectations of creditors through the application of the law of the main proceeding. This is a desirable mechanism in the E.U. where a harmonization of the Member States' bankruptcy legislations is not possible.

It has been suggested that the operation of secondary proceedings works to defeat the universal progress in the E.U. Regulation by providing an avenue for evading the main proceedings and curbing automatic recognition.²³⁹ There is nothing to prevent the secondary proceedings from non-cooperation with the main proceeding despite the fact that the Regulation has imposed a positive duty on Member States to cooperate.²⁴⁰ As such, rather than promulgating a universal administration of assets, the Regulation is limited to realizing territorial administration. This argument is brought further by stating that the U.S. mode of modified universality through ancillary proceedings is preferable to secondary proceedings due to the element of reciprocity found in the former.

It is curious why ancillary proceedings would be preferred over secondary bankruptcies. After all, if the two modes of modified universality are placed side by side, it is not difficult to see that secondary bankruptcy is even more universal than ancillary proceedings. Thus, there are three reasons why secondary bankruptcies represent a better fit to the *ex ante* and *ex post* goals.

²³⁸ *Ibid.* at para. 13.

²³⁹ Jilly Pae, "The E.U. Regulation on Insolvency Proceedings: The Need for a Modified Universality" (2004) 27 *Hastings Int'l & Comp. L. Rev.* 555 at 576-578.

²⁴⁰ *Council Regulation on Insolvency Proceedings 1346/2000*, *supra* note 176 at Article 31.

First, automatic recognition of a universal effect is always afforded towards the decisions handed down in a main proceeding. It does not matter whether a secondary proceeding is opened or not. While it is true that the decisions reached in a main proceeding do not have any effect in a secondary proceeding, the universal effect of the decisions reached in the former is not entirely compromised. There are adequate safeguards contained in Article 3 guarding against the strategic use of secondary bankruptcies. For example, a secondary proceeding can only commence if the debtor owns an establishment in that Member State. Therefore, if there is merely a presence of assets in another Member State, a secondary bankruptcy is not allowed. The assets in that particular Member State will be under the control of the main proceeding subject to the exceptions listed in Articles 5 to 15. This is a considerable advantage, in terms of costs and time, over ancillary proceeding where a foreign representative must plea for cooperation no matter how weak or strong the connection between the debtor and that territory is.

Second, while it is true that reciprocity is not expressly provided for in the E.U. Regulation, it is implied by the fact the E.U. provides for automatic recognition of insolvency proceedings. There is also a heavy emphasis on coordination between main and secondary proceedings in the Preamble.²⁴¹ Coupled with the fact that one of the many goals of the E.U. is the creation of an unified internal market, the E.U. Regulation is pointing in the direction of reciprocity through mandatory cooperation. In fact, reciprocity is an understatement of the ongoing efforts in the E.U.. Member States are not coordinating their proceedings with the belief that they will receive equal treatments in the future. They are cooperating because the E.U. Regulation demands it. While it is true that the meaning to some of the terms in the Regulation, such as 'centre of main interest' or "establishment", could be subject to manipulation by the Member States, the courts should be given the benefit of the doubt that they will honour the spirit of the E.U. Regulation. Reliance on judicial willingness is not unique to secondary bankruptcies. They also exist in ancillary proceedings.

Third, the *ex ante* goal of predictability is better captured by secondary proceedings. Creditors can always rely on the law of the Member State where they enter

²⁴¹ *Ibid.* at Preamble para. 20.

into a transaction with a debtor. This proposition is substantiated by Articles 5 to 15 where there is a clear list of exceptions overriding the *lex concursus* rules and Article 29 where the creditors are given the right to request for the opening of secondary bankruptcies.²⁴² Regarding the *ex post* goals, there are specially designed provisions in the Regulation catered to the enhancement of efficiency, equity and finality. These include the sharing of information between the main and secondary proceedings, the hotchpot rule and the role played by the European Court of Justice.

At this point, it becomes apparent that the mode of modified universality contained in the E.U. Regulation is even better than the US version involving ancillary proceedings. However, it is important to point out that the above discussion does not serve to deny the logic and validity of ancillary proceedings. In most cases, ancillary proceeding is a preferred vehicle in approaching modified universality because of legislative convenience. Specifically, states do not need to negotiate for a separate international instrument. Unilateral efforts in incorporating provisions for ancillary proceedings into domestic bankruptcy laws suffice. All the discussion above regarding the desirability of secondary bankruptcies only serves to bring forth the logic and wisdom contained in the E.U. Regulation. Putting it differently, the embracement of modified universality will likely lift the Regulation to success in the foreseeable future.

4.3 The UNCITRAL Model Law on Cross-Border Insolvency²⁴³

One of the restrictions to the E.U. Regulation is that it only addresses a bankrupt debtor who has a COMI or an establishment in the E.U.. It does not tackle any problems that may arise in an international bankruptcy which involves non-signatory states. This is a significant shortcoming to the Regulation. After all, debtors and their legal advisers may take advantage of this loophole and transfer their assets and contract their transactions in non-participating jurisdictions. The only method to alleviate these strategic movements rests on a global effort in the harmonizing different bankruptcy systems.

To this end, on 31 May 1997, the United Nations Commission on International Trade Law ("UNCITRAL" or the "Commission") adopted a Model Law on Cross-Border

²⁴² *Ibid.* at Article 29.

²⁴³ *UNCITRAL Model Law on Cross-Border Insolvency*, *supra* note 176..

Insolvency ("Model Law" or the "Law"). There is little doubt that the best way to conquer the many problems inherent in a cross-border insolvency is to promote a universal bankruptcy code where all creditors and debtors will be treated alike no matter where they are. Yet, in view of the fact that insolvency laws are deeply embedded in the legal traditions and cultures of a nation, negotiation in promulgating an identical set of rules will likely be futile. As phrased by Professor Fletcher, "the greater the degree of practical utility that is pursued by means of a treaty, the greater the difficulty in bringing it to fruition, and hence the greater the risk of ultimate failure".²⁴⁴ In light of this, the Model Law addresses only the cross-border provisions in a nation's bankruptcy legislation. This part of the paper discusses the historical background, character, objectives and the substantive provisions of the Model Law.

4.3.1 Historical Background: From MIICA to the Model Law

The concept of using a model law to overcome the immense difficulties in concluding a global treaty in transnational bankruptcies did not come from within the UNCITRAL. It was the creation of Committee J of the International Bar Association during the 1980s through the drafting of the Model International Insolvency Co-operation Act ("MIICA").²⁴⁵ Essentially, MIICA endorses the principle of universality. It envisions a single administration of a debtor's asset with an equal distribution to both local and foreign creditors and equitable administration in reorganization efforts.²⁴⁶ However, the MIICA did not gain universal support among nations. This failure has been associated with the unequal contributions to the MIICA by practitioners from various states.²⁴⁷ The fact that the insolvency practitioners from the U.S. played a huge role in developing the provisions to MIICA had increased nation's awareness that most of the provisions to the MIICA which was based heavily on the U.S. Bankruptcy Code. Specifically, many nations felt that the U.S. Code was culturally incompatible with their own bankruptcy

²⁴⁴ Fletcher, *supra* note 27 at 323.

²⁴⁵ Committee J of the International Bar Association, *Model International Insolvency Cooperation Act* (Third Draft, Nov. 1, 1988).

²⁴⁶ John A. Barrett, "Various Legislative Attempts with Respect to Bankruptcies Involving More than One Country" (1998) 33 Tex. Int'l L. J. 557 at 576.

²⁴⁷ Fletcher, *supra* note 27 at 325.

procedures.²⁴⁸ This is exemplified through the universal application of debtor-in-possession financing in the US where most nations felt it was inappropriate.²⁴⁹

Against this background, the UNCITRAL and INSOL International formed a Working Group to contemplate the plausibility of a set of harmonized rules on cross-border insolvencies. From November 1995 to January 1997, four meetings were held alternatively in Vienna and New York where substantive provisions were drafted.²⁵⁰ At the end of the last meeting, the Working Group decided to table a Draft Model Law to the Second UNCITRAL-INSOL Multinational Judicial Colloquium on Cross-Border Insolvency held in New Orleans. The draft version was well received in New Orleans. At the thirtieth session of the Commission held in Vienna on 30 May 1997, the Draft Model Law was submitted where further amendments were made. A formal resolution was subsequently passed adopting the Model Law.²⁵¹ In the resolution, the General Assembly of the Commission requested that the Model Law and the Guide to Enactment²⁵² be made known to governments and other interested bodies. A recommendation was also made towards all states asking them to review their legislation on cross-border insolvencies and give favourable consideration to the Model Law while bearing in mind the need for an internationally harmonized legislation on transnational bankruptcies.²⁵³

4.3.2 Nature of the Model Law

At this point, it may be appropriate to address the question as to why the Model Law took its present form. Specifically, why would a Model Law be preferable over a treaty or convention? The answer is simple. Learning from the Istanbul Convention where only one state ratified the instrument, the consensus among the members to the

²⁴⁸ Canada expressed the concern that the MICA contained terms imported directly from the US Code which did not have a parallel in the Canadian legislations. Canada also felt that the MICA did not sufficiently address the difficulties with reorganization, treatment and priority for local creditors, treatment of foreign revenue or penal claims, degree of discretion allowed to local courts, dichotomy between common law and civil law concepts, bilateral treaty alternatives and the effect of local adaptations and variations of the MICA. See David C. Cook, "Prospects for a North American Bankruptcy Agreement" (1995) 2 Sw. J. of L. & Trade Am. 81 at 94, 95.

²⁴⁹ Fletcher, *supra* note 27 at 326.

²⁵⁰ Andre J. Berends, "UNCITRAL Model Law on Cross-Border Insolvency: The UNCITRAL Model Law on Cross Border Insolvency: A Comprehensive Overview" (1998) 6 Tul. J. Int'l & Comp. L. 309 at 319.

²⁵¹ *Report of the UNCITRAL on the Works of its Thirtieth Session*, UN GAOR, 52d Sess., Annex No. 1, U.N. Doc. A/52/17 (1997) at 68 – 78.

²⁵² *Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency*, XXVIII UNCITRAL Y.B., U.N. Doc. A/CN.9/442 (1999).

²⁵³ *Ibid.* at 221 – 222.

Working Group was that a convention could be too ambitious.²⁵⁴ The process of organization global cooperation in insolvency proceedings, including the drafting of the instrument as well as the negotiating for ratification, can be both time-consuming and daunting. The nature of a convention, being an ‘all or nothing’ instrument, makes it prohibitive to draft. After all, a convention that has been drafted and signed but never ratified is of no practical value.

In contrast, a Model Law, as its name suggests, is a piece of model legislation for states to follow. It is drafted as if it is part of a state’s provision in dealing with cross-border insolvencies. Therefore, throughout the Model Law, many blanks are left in the articles where states can fill in the appropriate terms and incorporate the section into their own laws. The Model Law is merely a list of recommendations that states are free to decide how much or how little of the Model Law are they going to follow and adopt into their own bankruptcy legislation. The flexibility is desirable in cases where states wish to modify the provisions before they enact it into their domestic legislation.²⁵⁵ This flexibility, however, could lead to potential conflicts among states where a state decides to enact a few articles to the Model Law other than endorsing it on its whole or modify the Model Law to fit her own circumstances. To this end, a convention is preferable to a model law because there is a certainty to the contents. Yet a model law that is endorsed in parts is still better than a convention that is ratified by a few countries. Besides, the Model Law is constructed in a way that most states will adopt it in its entirety. Coupled with the global desire in promulgating an efficient and effective cross-border insolvency mechanism, most states will probably prefer adopting the Model Law with little or no modification.²⁵⁶

4.3.3 Structure and Objective of the Model Law

The Model Law is composed of 32 Articles preceded by a Preamble discussing the objectives to the Model Law. A separate Guide to Enactment, which is now incorporated into the Legislative Guide adopted by consensus in the thirty-seventh session of the Commission in New York on 25 June 2004, was written to complement the

²⁵⁴ Berends, *supra* note 250 at 319.

²⁵⁵ *Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency*, *supra* note 252 at 12.

²⁵⁶ M. Cameron Gilreath, “Overview and Analysis of How the United Nations Model Law on Insolvency Would Affect United States Corporations Doing Business Abroad” (2000) 16 Bank. Dev. J. 399 at 415.

Model Law. According to the Guide, its purpose is to act as a commentary discussing and analyzing the solutions posted in the Model Law in order to guide legislators and other interested parties.²⁵⁷

Before discussing the substantive provisions, it is important to observe the objectives served by the Model Law. Under the Preamble, five objectives are identified: cooperation between foreign courts and authorities, greater legal certainty for trade and investment, fair and efficient administration of cross-border insolvencies, protection and maximization of the value of the debtor's assets and the facilitation of restructuring or reorganization of the debtor's business. In addition to these objectives, specific emphasis is made towards speed and efficiency.

Nothing unique has been introduced by these objectives as stated in the Preamble. They are the traditional goals that an ideal cross-border bankruptcy system should address. One subject that is worth mentioning is that not all states will agree to the five objectives listed. For example, some states are unlikely to give any merit to reorganization efforts because rehabilitation has never had a prominent role in their legal cultures.

4.3.4 Jurisdiction

Article 1(1) provides four types of situation where the Model Law will apply. These include (a) foreign court or foreign representative requests assistance in connection to a foreign proceeding; (b) assistance is requested in a foreign state in connection to a local proceeding; (c) a foreign proceeding and a local proceeding are taking place concurrently; (d) foreign creditors and other interested parties have an interest in opening a proceeding under the local law. Article 1(2) goes on to provide that the law does not apply to proceedings concerning banks or insurance companies and any other types of entities the state feels appropriate. Article 2 further provides definition of terms, such as, foreign proceeding and foreign main proceedings, which are referred to under Article 1. It is interesting to note that the wordings of a few terms under Article 2 bears a close resemblance to those used in the E.U. Regulation.²⁵⁸

²⁵⁷ *Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency*, *supra* 252 at para. 2.

²⁵⁸ Article 2 of the Model Law referred to COMI and Establishment in defining foreign main and foreign non-main proceeding. In the context of the E.U. Regulation, the terms are used to address the question as to whether a secondary proceeding can be opened. In the context of the Model Law, the terms are used to

As apparent from Article 1, the Model Law is very limited in scope, keeping up with its intention to refrain from drafting a comprehensive code on cross-border insolvencies. In fact, the importance in Article 1 does not rest with what circumstances are covered by the Law. Rather, focus is placed on where the Law does not apply. Under Article 2, a foreign proceeding is defined as “collective judicial or administrative proceedings in a foreign state... pursuant to a law relating to insolvency”. Thus, the English foreign administrative receivership will not fall under the ambit of the Law for its non-collective character.²⁵⁹

Similar to other instruments, the Model Law has taken care in excluding credit institutions and insurance companies from its scope. It is felt that these entities are of a special nature that ordinary bankruptcy rules will not suffice in dealing with the complicated issues posted by these institutions. For example, a credit institution has many more creditors than a normal company which may post a lot of unique issues unseen in ordinary bankruptcies. In addition, credit institutions are usually tightly regulated by authorities who are vested with the ability to take action quickly before news of financial distresses reaches the public domain.²⁶⁰ Banks or insurance companies are examples of institutions given by the Model Law. States may designate “any types of entities” to be excluded from the scope of the Law. These may include essential service providers, such as, public utility companies. Though exclusions might be desirable, commentators are generally against blanket exclusions. After all, a state may wish to have judgments regarding a bank failure be recognized in other states and give the same effect to decisions handed down in a foreign proceeding regarding credit institutions.²⁶¹

4.3.5 Steps towards Recognition of Foreign Proceedings

Article 17 states the four criteria a foreign representative must meet before a court or other judiciary bodies in a similar capacity will decide on an application to recognize a foreign proceeding. First, the foreign proceeding has to meet the definition of such under Article 2(a). It does not matter whether the foreign proceeding is a main or a non-main

categorize a foreign proceeding as main or non-main and decide on the effects upon recognition under Articles 20 and 21 of the Law.

²⁵⁹ Fletcher, *supra* note 27 at 334.

²⁶⁰ Berends, *supra* note 250 at 325.

²⁶¹ *Ibid.*

proceeding. Second, the foreign representative applying for recognition must be within the definition of such under Article 2(d). Third, the application must meet the three requirements regarding documentation and evidence under Article 15(2). Fourth the application has to be submitted to a court that has a bankruptcy jurisdiction as stipulated under Article 4.

While the first, second and the fourth requirements are self-explanatory, Article 15 deserves some special attention. Article 15 concerns the evidence a court requires and may require on an application for recognition before her. Article 15(2) provides that an application has to be accompanied by (a) a certified copy of the decision commencing the foreign proceeding and appointing the foreign representative, or (b) a certificate from the foreign court affirming the existence of a proceeding, or (c) in the absence of the certificate of decision or affirmation, any other type of evidence acceptable to a court. Together with Article 18, Article 15(3) promotes full disclosure through imposing a duty on the foreign representative in keeping the court up to date with all foreign proceedings in respect of the debtor and any substantive changes to those proceedings. Article 15(4) further authorizes a court to ask for a translation of documents supplied under the Article. It is important to note that Article 15(4) is not a requirement. It simply allows the court to do so if it deems appropriate. Not requiring a translation upfront will save a foreign representative both time and money.

It may become apparent that Article 15(2) seems onerous in terms of both time and cost due to the certification requirement on the documents. However, Article 15 should not be read alone. In conjunction with Article 16, a simple structure for obtaining recognition is introduced.²⁶² Article 16(1) allows the court to presume that the foreign proceeding falls within the meaning of Article 2(a) and the foreign representative within the meaning of Article 2(d) if the certified decision presented to the court under Article 15(2) says so. Thus, courts are saved the time in deciding on questions of fact whether the definitions under Article 2(a) and (d) have been met. Another measure of convenience is introduced in Article 16(2) where it allows court to presume the documents submitted in support of an application are authentic whether or not they have been legalized. Authentication usually takes the form of a seal or signature by a court so it is relatively

²⁶² *Ibid.* at 350.

unproblematic. Legalization, however, requires a diplomatic or consular agent of the State where recognition is sought to legalize a document by means of a certification. It is a relatively time consuming process. In insolvency where time is always of essence, the requirement of legalization may thwart liquidation or reorganization efforts. By not requiring documents to be legalized, a considerable amount of time is saved. However, the wording of Article 16(2) has made it possible that in some instances, the court can still require a legalization of documents. The presumption is a refutable one.

An interesting question that was discussed in the Working Group to the Model Law was whether foreign creditors should also be given the right to apply for recognition of a foreign proceeding. Such a situation would only apply if a foreign representative decided not to apply for recognition. The Working Group quickly ruled out the possibility of granting such right to a foreign creditor. It was felt that since a foreign representative who is vested with much more information about a debtor than any creditor decides not to bring an application for recognition, there must be a sound reason supporting the decision. Therefore, it is not necessary to grant a foreign creditor the right to request recognition of a foreign proceeding.²⁶³

4.3.6 Effects of Recognition of Foreign Proceedings

The effects of recognition in foreign proceedings are different for foreign main proceedings and foreign non-main proceedings as defined under Article 2. In essence, a foreign main proceeding is a proceeding held in a jurisdiction where the debtor has a COMI.²⁶⁴ In contrast, a foreign non-main proceeding takes place in a jurisdiction where the debtor has an establishment. Flowing from this logic, a foreign proceeding that is opened in a jurisdiction where the debtor has neither a COMI nor an establishment will not be afforded recognition under the Model Law.

The effects of recognition towards foreign main proceedings are provided for under Article 20 of the Law. Article 20(1) contains three outcomes resulting from recognition. First, individual actions or proceedings against the debtor are stayed.

²⁶³ *Ibid.*

²⁶⁴ *UNCITRAL Model Law on Cross-Border Insolvency*, *supra* note 176 at Article 16(3). This presumption is rebuttable, alike the E.U. Regulation; See *Council Regulation on Insolvency Proceedings 1346/2000*, *supra* note 176 at Article 3(1).

Exception is made towards actions commenced to preserve claims against a debtor.²⁶⁵ However, once the claim has been established, all further actions, including the realization of claims, are stayed. Second, executions against the debtor's assets are stayed. Third, the debtor's right to transfer, encumber or dispose of his assets is suspended. It is important to highlight that these outcomes are automatic and do not require separate requests by the foreign representative. The Working Group felt that the automatic effects are necessary to organize an orderly and fair cross-border bankruptcy proceeding.²⁶⁶ Article 20(2) serves to integrate the three automatic results imposed by the Model Law with domestic legislations by subjecting them to local rules that apply to exceptions, limitations, modifications or terminations in respect of the orders. For example, if the local law grants the parties who are affected by the stay or suspension a right to be heard, this right will be upheld in face of the automatic results in Article 20(1).²⁶⁷ Other matters incidental to the stay orders, such as, the length of the stay and the penalty for contravention, are left to the local legislations where recognition is given.

The effects that may be granted upon recognition of foreign proceeding, whether it is a main or non-main proceeding are provided for under Article 21. Article 21(1) provides that a court can make any appropriate relief at the request of the foreign representatives. Article 21(1) goes on to provide a laundry list of seven orders a court may make. The list is not exhaustive, however. They are simply measures highlighted by the Law. The first three orders correspond to the items of automatic relief under Article 20. In other words, for non-main proceedings, orders staying actions against a debtor and the suspension of a debtor's right to transfer assets are subject to the discretion of the court. While the other measures of relief on the list are self-explanatory, attention must be directed towards Article 20(1)(e) which concerns the 'turnover' of assets to the foreign representative. However, the notion of "turnover" in the Model Law should not be confused with the conventional concept of turning over assets for foreign administration.²⁶⁸ A separate court order is necessary to empower a foreign representative to administer and distribute the assets. Article 21(2) further provides that if a court

²⁶⁵ *UNCITRAL Model Law on Cross-Border Insolvency*, *ibid.* at Article 20(4).

²⁶⁶ Berends, *supra* note 250 at 364.

²⁶⁷ *Ibid.* at 366.

²⁶⁸ *Ibid.* at 370.

decides to “turnover” the assets to a foreign representative, she must be satisfied that the interests of local creditors are adequately protected.

Out of the entire Article, Article 21(3) is tailored for the recognition of foreign non-main proceedings. It specifies that in granting a relief to a representative of a foreign non-main proceeding, the court must be satisfied that the assets related to the relief should be administrated in the foreign non-main proceeding. In other words, it serves to open up the possibility for a court to consider whether the foreign proceeding is an appropriate forum for handling the assets. Thus, the degree of connection between the assets and the foreign proceeding will be placed under scrutiny. This provision is not targeted at assets which are already situated within the territory of the foreign non-main proceeding at the time of the opening of the proceeding. Rather, it deals with those assets where a debtor deliberately transfers out of a particular state on the eve of bankruptcy. In such circumstances, a court may raise doubts about the asserted control declared in the foreign proceedings over the assets in question.²⁶⁹

In granting relief under Articles 20 and 21, a court has to ensure that the interests of creditors and other interested parties, including the debtor, are adequately protected as required under Article 22(1). The reason for incorporating this provision into the consideration process is to ensure that debtors will not be subjected to a jurisdiction that is known to be corrupted and act in blatant disregard of the rules of procedural justice. Another less obvious purpose served by the provision is to convince the states that the Model Law provides a satisfactory equilibrium where all parties’ interests will be balanced.²⁷⁰ Articles 22(2) and (3) allow a court to attach any condition to a relief or to modify or terminate any relief. However, Article 22(2) should not be interpreted to provide the court with the power to make recognition conditional.²⁷¹ A condition could range from a security to a guarantee where the preferential status of a particular local creditor will not be tossed aside in a foreign proceeding.

²⁶⁹ *Ibid.* at 346.

²⁷⁰ *Ibid.* at 374.

²⁷¹ *Ibid.* at 375.

4.3.7 Cooperation with Foreign Courts and Foreign Representatives

Together with Article 1, Chapter III of the Model Law serve to mandate for cooperation whenever one of the four situations listed under Article 1 occurs. Article 25(1) imposes a duty on courts to cooperate to the maximum extent possible with foreign courts or foreign representatives directly or through her appointee. It is important to note that cooperation as mandated under Article 25 does not require the foreign proceeding to be recognized. A local court has to cooperate with a foreign proceeding in cases even if recognition is denied. In such circumstances, however, the court may decide to give little or no cooperation to a foreign proceeding. The incorporation of the phrase, 'the maximum extent possible' has left courts with the discretion in deciding on the degree of cooperation. This flexibility is desirable especially in civil law countries where a court's action is limited to acts that are explicitly permitted by the law. In contrast, the common mode for cooperation for common law judges is to "pick up the phone" and contact foreign courts directly. Furthermore, the degree of cooperation permitted varies from case to case in light of restrictions posted by domestic legislation, such as, data protection and privacy acts. Therefore, it is impossible to articulate a common standard of cooperation for both the common and civil law courts. Only by permitting a degree of flexibility in the degree of cooperation can the Model Law address both the common and civil traditions as well as the differences among the substantive legislations of different countries.²⁷² Article 26 is similar to Article 25 in substance. The only difference lies in the fact that Article 26 deals with the cooperation between local liquidators or other personnel who are subject to the supervision of the court and foreign courts or foreign representatives. It is important to note that the substance to the nature of the relationship between the court and the liquidators is not mentioned in the Model Law. They are left to be decided by domestic legislations.²⁷³

Article 27 complements Articles 25 and 26 by providing the means of cooperation. It says that cooperation may be implemented by any appropriate means. Six examples of the types of cooperation are listed under the Article. They are, by no means, exhaustive and courts may engender other methods of cooperation as seen appropriate. The six methods are self-explanatory, making a detailed discussion unnecessary. However, it

²⁷² *Ibid.* at 379.

²⁷³ *Ibid.* at 381.

must be pointed out that again the Model Law has left courts with the flexibility in deciding the manner of cooperation. The only fetter on a court's discretion in deciding on the mode of cooperation rests in the domestic legislations of a state.

4.3.8 Other Features to the Model Law

The above discussion on the provisions of the Model Law merely represent a fraction of the many arrangements contained in the Law. In addition to the Articles discussed in the above, the Model Law also addresses issues, such as, the right of foreign creditors,²⁷⁴ interim relief²⁷⁵ and concurrent proceedings.²⁷⁶ Of special interests are Articles 3, 6 and 8 because they highlight the nature of the Model Law.

Article 3 states that if there is a conflict between the Model Law and an international treaty or agreement dealing with cross-border insolvencies where the state is a signatory, the latter shall prevail. This article serves to express the supremacy of international instruments over domestic legislation. Article 6 allows a court to refuse to take an action governed under the Law, if in doing so, will be in manifestly contrary to public policy. The public policy exception contained in Article 6 is typical to any international agreement. It is curious why the Model Law would choose to incorporate Article 6 into its body. After all, the Law is not an international instrument but part of the domestic legislations of a state. Even in the absence of Article 6, it is questionable whether the court will cooperate with a foreign proceeding if doing so will be against public policy.²⁷⁷ It is also curious why the Working Group to the Law would choose to incorporate a public policy exception which is not necessary rather than an international public policy, like those observed in the Netherlands.²⁷⁸ An international public policy is wider than domestic public policy where the focus is on international cooperation. The demand that the procedures and rules of a foreign proceeding be of the same kind as domestic law is alleviated. As such, if a policy exception is to be included into the text of the Model Law, an international public policy exception is much more desirable. Article 8 deals with the interpretation of the Model Law. It basically says that in interpreting the

²⁷⁴ *UNCITRAL Model Law on Cross-Border Insolvency*, *supra* note 176 at Article 13.

²⁷⁵ *Ibid.* at Article 19.

²⁷⁶ *Ibid.* at Article 32.

²⁷⁷ Berends, *supra* note 250 at 336.

²⁷⁸ *Ibid.*

Law, the court must pay attention to the international origin and the need to promote uniformity in good faith.

At this point, a question may be raised as to why there is an absence of rules on choice of laws, choice of forum or other rules that are typical to any international instrument regulating international insolvencies in the Model Law? It must not be forgotten that the objective of the Law is not to promote a harmonization of the bankruptcy regimes among different states. The Model Law only addresses those aspects of domestic legislation that deals with cross-border bankruptcies. The nature of insolvency law draws on a wide variety of domestic legislations, such as, legislation governing the perfection of securities. If the Model Law attempts to address them all, it will literally have to re-write the insolvency regimes and other accompanying legislations of every state. The task will be prohibitive and the end product will unlikely be acceptable to states.

Probably the most unique feature of the Model Law is the bold attempt to integrate its text into the domestic legislations of enacting states. Rather than laying out the choice of law rules, the Law leaves the states free to deal with conflict of law rules using established rules and practices.²⁷⁹ Other instances where the Model Law defers to domestic law includes the incidents to a stay of proceedings, the degree of communication between courts and the relationship between a court and her appointed representative. In sum, the flexibility molded by the Model Law makes the Law non-invasive and thus, more appealing to states.²⁸⁰ As the ultimate fate of the Model Law in pushing for developments in the field of transnational insolvency depends so much on the number of states enacting it, it is important to make the text acceptable to the states by relying heavily on domestic laws and customs.

On the flip side of the coin, however, it can also be said that the lack of provisions in dealing with important questions, such as, the choice of law and forum issues, compromises the usefulness of the Law.²⁸¹ In light of the early success of the E.U. Regulation, notwithstanding the Regulation entered into force after the adoption of the

²⁷⁹ Fletcher, *supra* note 27 at 333.

²⁸⁰ The Model Law has already been accepted by Eritrea, Japan, Mexico, Poland, Romania, South Africa and Montenegro. See Status of Conventions and Enactments of UNCITRAL Model Laws, online: The UNCITRAL <<http://www.uncitral.org/en-index.htm>>.

²⁸¹ Gilreath, *supra* note 256 at 424.

Model Law, one must question whether there is a need for the Model Law to take such a conservative stance and not promote a stricter and more universal set of rules. If states have already recognized the importance of having certainty in international commerce and have decided to move forward, why should the Model Law pull them back into conservative territory? While it is true that Article 3 provides that should there be a conflict between the Law and an international instrument, the latter overrides, it does not serve to encourage states to move along and enter into more ambitious instruments which have a wider scope.²⁸² As a matter of fact, countries may be misled and feel all that needs to be done in addressing transnational insolvencies is to enact the Model Law.²⁸³

4.3.9 Theoretical Underpinning of the Model Law

It is obvious that the approach adopted by the Model Law is modified universality. The operation of the Model Law is akin to the type of “ancillary proceedings” as advocated in the U.S. Bankruptcy Code where a foreign representative appears before a court and asks for cooperation. The only main distinction between the Model Law and the Code rests in the effect after a court refuses to recognize a foreign proceeding and the more detailed provisions embodied in the Model Law.

Under the Bankruptcy Code, a court is not forced to grant relief under a proceeding. Based on the factors listed under section 304(c), a court can refuse to cooperate with a foreign representative. In contrast, Articles 25 and 26 of the Law stipulate cooperation with a foreign court or representative even in cases where recognition of foreign proceeding is rejected. Although the degree of cooperation is set at a level “to the maximum extent possible”, where it has the effect of allowing a court to reach a conclusion that cooperation is not possible, the court must consider Articles 25 and 26. This is a valuable provision when a court tries to evade the automatic relief brought upon by Article 20 while still wanting to cooperate, though at a lesser degree.

Another noticeable difference between the Bankruptcy Code and the Model Law is the detailed provisions entrenched in the Law. Though both instruments are premised

²⁸² The utility value of the Model Law is larger for the Member States of the E.U. relative to other nations who are not signatory states to any major multilateral agreement. In essence, the E.U. states can enact the Model Law to deal with nations who are not part of the E.U..

²⁸³ The Model Law is often viewed as a first based advance along a steep path of the journey towards an effective and efficient regulation of insolvency. However, no follow-up action has been recommended. See Fletcher, *supra* note 27 at 361.

on modified universality, the Model Law is much more comprehensive. Among other areas, it provides for the documents needed for recognition, the effects upon recognition of a foreign proceeding and interim orders. In other words, the Bankruptcy Code represents a more liberal approach which some may view as generating uncertain results. In contrast, the Model Law provides a set of more sophisticated and in-depth rules, which serve to increase predictability notwithstanding that discretion is still given to court in deciding on a wide array of issues. As mentioned earlier, unpredictability is the main objection raised by critics of modified universality, which the Model Law has circumvented. However, if compared to the Nordic Convention and the E.U. Regulation, the Model Law has not gone as close to universality as the other two instruments in regulating cross-border insolvencies. It is not difficult to understand why the Working Group adopted a conservative approach. If the Law is viewed as invading or damaging the sovereignty of a state, countries will unlikely pay any attention to the document and all the years of effort in drafting the Law will be frustrated. Yet, whether the Model Law is far too conservative is a different story. For now, it is trapped between the traditional U.S. model of ancillary proceedings and the more radical approach endorsed by the E.U. Regulations. If the Model Law is viewed as the first step in promoting an efficient and effective set of regulations for international bankruptcies, it is living up to its word. After all, it has opened up the doors of other nations, for example, Japan, who used to embrace territoriality completely.²⁸⁴ The greater challenge in the future is to move beyond its current text and endorse a more vigorous and universal approach.

4.4 A Practical Note

After touring through the Nordic Convention, E.U. Regulation and the Model Law, it becomes apparent that a comprehensive set of rules on the jurisdictional, choice of law and other administrative rules essential to the efficient administration of a debtor's estate is conducive to regulating cross-border insolvency. Out of the three international instruments, the Nordic Region bears the most significance. First, its success story lasted for more than a half century until the E.U. Regulation replaced it. Time has illustrated the smooth operation of the Convention. Second, some of the innovative ideas, such as, the combined *lex concursus* and *lex rei sitae* approach lent support to the drafting of

²⁸⁴ LoPucki, *supra* note 22 at 701.

subsequent instruments. Third, its embracement of modified universality had brought forth the important message that universality is not preferable even with the existence of a high degree of homogeneity among the signatory states. Relative to the Nordic Convention, both the E.U. Regulation and the Model Law are relatively young. It may still be too early to appraise or reject the utilities of both instruments. However, by analogy to the Nordic Convention, the fact that both instruments embraced modified universality will greatly enhance the chances of them being successful in regulating cross-border insolvencies.

5 Progress in Canada – U.S. Cross-Border Insolvency

The search for a solution in cross-border insolvencies on a global level has been encouraging so far, with the passage of the E.U. Regulations and the adoption of the Model Law by various states. However, it seems that North America has not caught up with this wave of development. This is different from saying that the U.S. and Canada have done little in dealing with transnational insolvency because both nations have enacted cross-border provisions into their domestic laws. Aside from these provisions, however, no treaty has been ratified and certainly no harmonization in cross-border provisions to bankruptcy legislation has been undertaken. This is a surprising outcome in light of both the enforcement of the North American Free Trade Agreement in 1991 and the common occurrence of cross-border bankruptcies between the U.S. and Canada. Despite the above facts, nothing substantive has happened in the past few decades. Recently, however, legislative activities in enacting the Model Law have taken place on either side of the border. It is hoped that these activities will lead to a uniform standard in handling cross-border insolvency between the two nations. This part of the paper will begin with a discussion on the insights provided by the two instruments presented in Chapter 4 and the unratified U.S. – Canada Bankruptcy Treaty of 1979. This will be followed by an analysis of the current statutory cross-border provisions in Canada and the U.S.. The chapter will end with a statement on the future outlook of cooperation between the two nations.

5.1 Insights from the Nordic Convention and the E.U. Regulation

As discussed in Chapter 4, not all efforts expended by the nations in searching for a solution to cross-border insolvency bore fruit. There are numerous accounts of failure, such as, the Draft E.U. Convention, the E.U. Convention, the Istanbul Convention and the MIICA. In fact, the unsuccessful attempts in regulating international bankruptcies far outnumber the successful ones.²⁸⁵ To avoid treading in the footsteps of those failed negotiations, it is important to look past the failures and focus on the essential features shared by the successful instruments. Upon a closer observation of the Nordic Convention and the E.U. Regulation, three characteristics core to the success in regulating cross-border insolvencies can be identified.

²⁸⁵ Berends, *supra* note 250 at 98.

First, states bound by bankruptcy conventions are usually geographical neighbours with regional homogeneity in legal tradition, culture, language and political institutions. In other words, there has to be a degree of integration in terms of economical and political interests before nations would submit to an instrument regulating international bankruptcies. Both the Nordic Convention and the E.U. Regulation fit into this proposition squarely. The five states in the Nordic region are acclaimed to share a high degree of homogeneity. Some commentators have even argued that the reason why the Nordic Convention was operative for more than half a century was due to the similarity of the bankruptcy legislations among the five states.²⁸⁶ Likewise, the Member States to the E.U. share a similar integration, in terms of economic interests, notwithstanding the fact that some Member States belong to the civil law camp while the others belong to the common law camp. The importance of homogeneity in a successful bankruptcy treaty is not difficult to understand. Since all bankruptcy treaties essentially request a court to accede its jurisdiction to a foreign court, there has to be a high degree of trust and confidence among signatory states. After all, a court will unlikely defer to a foreign jurisdiction unless it can be convinced that the foreign tribunal are at the same level of competency. By the same token, if two or more states do not share a common goal or interest, there will be no incentive luring the parties into negotiation for an international instrument.

Second, both the Nordic Convention and E.U. Regulation resolve issues arising in cross-border bankruptcies through a combination of *lex concursus* and *lex rei sitae* approach. In any typical case, different sets of legislation belonging to the various states where the debtors and creditors are associated with may apply. In the Nordic Convention, issues raised in a bankruptcy will be addressed by the law of the contracting state unless otherwise stated.²⁸⁷ Exceptions where the general principle is overridden, thereby, favouring the local laws of other contracting states are provided in Articles 4 to 7. These exceptions range from interests in immovable and movable properties to preferential treatment of fiscal agencies. Similarly, the E.U. Regulation provides the general rule that the law that ought to be applied in an insolvency proceeding is the law of the Member

²⁸⁶ *Ibid.* at 86.

²⁸⁷ Article 1 of the Nordic Convention.

State where the proceeding is opened.²⁸⁸ Again, this *lex concursus* approach is subject to exceptions as provided from Articles 5 to 14. The reason for preferring the domestic rules where the assets are located or the interests are registered is clear. It serves to protect the legitimate expectations of parties and the certainty of transactions. An international instrument is more agreeable if the interests of local secured creditors will not be affected by the application of foreign rules.

Third, both international instruments embrace modified universality over universality as the theoretical foundation. The Nordic Convention and the E.U. Regulation advocate modified universality through their choice of laws provision. The E.U. Regulation went a step further by allowing the commencement of secondary proceedings in Member States where the debtor has an establishment.²⁸⁹ As discussed earlier, universality represents the best fit with the *ex ante* and *ex poste* goals of a sound bankruptcy system. The fact that both the Nordic Convention and the E.U. Regulation prefer modified universality over universality helps to substantiate the proposition that universality cannot operate in practice. For example, the Draft E.U. Convention failed miserably due to its embracement of universality over modified universality. Simply stated, a single administration of all assets regardless of their location is unappealing to states. It does not matter whether the only court vested with the jurisdiction is required to apply foreign legislations as in the case of the E.U. Draft Convention.²⁹⁰ Nations are always wary of submitting their citizens to foreign proceedings. The enforcement of universality in an international instrument regulating cross-border insolvency is destined to fail. Modified universality should be the proper approach.

At this point, it is apparent that if the governments of Canada and the U.S. wish to negotiate a treaty regulating transnational insolvencies between the two countries, the chance of success would be greatly enhanced by satisfying the three criteria as laid down by the Nordic Convention and the E.U. Regulation. Towards this end, the U.S. and Canada had worked together in drafting a U.S. – Canada Bankruptcy Treaty (“Treaty”) in 1979. To date, the Treaty remains unratified for reasons that will be examined in the following section.

²⁸⁸ Article 4 of the E.U. Regulation.

²⁸⁹ Article 3(3) of the E.U. Regulation.

²⁹⁰ See 60, above.

5.2 The U.S. – Canada Bankruptcy Treaty of 1979²⁹¹

The benefit of a bankruptcy treaty between the U.S. and Canada was presented decades ago in 1944 by Professor Nadelmann.²⁹² In his article, Professor Nadelmann found that the absence of a bankruptcy treaty between the U.S. and Canada who are geographical neighbours with a similar bankruptcy law as strange. This comment echoes the first insight presented in the above. It is a fact that the geographical proximity between the U.S. and Canada and the commonalities in legal traditions, market systems, language and political systems resemble those in the Nordic region. Yet, both nations have not capitalized on this advantage in drafting an acceptable bankruptcy treaty. There are three main reasons why the Treaty failed.

First, the jurisdiction would belong to the state which has a greater portion in the value of the debtor's assets.²⁹³ The Treaty goes on to provide for rules setting the value of the assets. Using the value of the debtor's assets as a basis for determining jurisdiction is not justifiable.²⁹⁴ As the monetary value of assets can be volatile, creditors cannot reasonably predict whether the U.S. or Canada will have jurisdiction over the bankrupt. Second, the scope of the Treaty is limited to cases where the debtor's principal property is located in one or both of the countries. Principle property is defined as the "property fairly considered of greater value than in any other state".²⁹⁵ Again, value can be volatile and this could taint creditors' predictions as to the fate of their bankrupt debtors. The court may also question whether it has the appropriate jurisdiction to open a proceeding. This may lead to further enquiries or investigations that can contribute to undue delay in the bankruptcy proceeding. Third, the applicable law will be the local law belonging to the state that has jurisdiction over the bankrupt.²⁹⁶ Ancillary proceedings are permitted in the other state to the extent that it grants assistance to the main proceeding. However, courts could not apply local law in ancillary proceedings.²⁹⁷ In order words, the Treaty

²⁹¹ United States – Canada Bankruptcy Treaty 1979, reprinted in J.H. Dalhuisen, *Dalhuisen on International Insolvency and Bankruptcy* 6thed. 2.01[5] (New York: M. Bender, 1980) at 3-127.

²⁹² Kurt H. Nadelmann, "International Bankruptcy Law Its Present Status" (1943-44) 5 U. Toronto L.J. 324 at 351.

²⁹³ Kurt H. Nadelmann, "A Reflection on Bankruptcy Jurisdiction: News from the European Common Market, the United States and Canada" (1981-82) 27 McGill L.J. 541 at 550.

²⁹⁴ *Ibid.*

²⁹⁵ *Ibid.* at 551.

²⁹⁶ Berends, *supra* note 250 at 96.

²⁹⁷ *Ibid.*

imposes a blanket choice of law rules without providing for any exceptions for secured creditors or fiscal agencies.

Rather than promoting a workable solution, the Treaty had advanced an irrational set of rules. It has been dubbed as the negative model for regulating cross-border insolvencies.²⁹⁸ The drafters probably worked from a false assumption that the substance to the B.I.A., C.C.A.A. and the Bankruptcy Code were so similar that governments on both sides would have little problem accepting a universal approach with a single administration requirement. As demonstrated by the Nordic Convention and the E.U. Regulation, an international instrument should never take on a pure universal approach even if a high degree of homogeneity exists among the signatory states. While the drafters should be praised for their bold attempt in presenting a pure universal approach in cross-border insolvencies between U.S. and Canada, more attention should have been directed towards the sovereignty issue.

5.3 Prospects for a future North American Bankruptcy Agreement

It is beyond doubt that the Treaty failed miserably. However, the failure does not necessarily mean that both the U.S. and Canada had ruled out any form of cooperation in cross-border insolvency. The Treaty was negotiated well before Canada made its changes to the B.I.A. and the C.C.A.A. in 1997. The incorporation of Part XIII into the B.I.A. and Section 18.6 to the C.C.A.A. signaled Canada's recognition of the importance of regulating cross-border insolvencies. Despite the fact that Canadian cross-border provisions came into life almost two decades after its American counterpart, nonetheless, it has served to highlight the convergence of interests of both nations in regulating cross-border bankruptcies efficiently and effectively. Coupled with the courts' increased willingness to cooperate through the use of cross-border protocols, the atmosphere is right for both sides to renew their interests in negotiating a cross-border insolvency treaty.

If both the U.S. and Canada decide to enter into a full blown treaty with detailed provisions on the choice of forum, choice of law and other issues, the substantive provisions should bear a resemblance to the Nordic Convention or the E.U. Regulation. In other words, the theoretical approach that underpins any future negotiation has to be modified universality. A universal treaty that contains direct attacks on the laws of the

²⁹⁸ *Ibid.*

signatory states will invariably be defeated. Referring back to the failure of the Treaty in 1979, it is surprising that the drafters did not afford any attention to the provisions in the Nordic Convention and came up with an original yet irrational approach. This fundamental mistake should not be allowed to repeat. As with all negotiations for international instruments, the process of a cross-border bankruptcy treaty can be both expensive and time-consuming. Valuable resources should not be wasted in drafting an unacceptable bilateral agreement.

Rather than regulating cross-border insolvency by means of a treaty, it has been proposed that a modest three-step approach would be preferable in realizing the goals of clarity in the law and international cooperation.²⁹⁹ The approach provides for an automatic stay, encourages private negotiations and enforces multinational arbitral awards. The foundation behind the three-step model is that a comprehensive choice of law scheme will lead to the failure of a treaty or convention. Yet, this assumption is weakened by the insight generated from the Nordic Convention and the E.U. Regulation. As long as the choice of law rules stay within the bounds of modified universality, nations should not feel threatened by foreign jurisdictions.

It has already been established that the contents of a proposed cross-border insolvency treaty should not present a challenge to drafters as long as they tie themselves to modified universality. The next question draws on whether, from a political perspective, Canada and the U.S. would be willing to ratify a bankruptcy treaty? Based on the choice of forum model endorsed by both the Nordic Convention and the E.U. Regulation, it is very likely that a new U.S. – Canada treaty would decide on the jurisdictional question based on the principle of a debtor's centre of main interest. This possibility is strengthened by the fact that the Model Law also refers to the debtor's centre of main interest in defining whether a foreign proceeding is of a main or non-main nature. If this prediction is accurate, Canada must be wary of their comparative disadvantage in the greater volume and diversification of the assets of U.S. corporations relative to the holding assets of Canada. The numbers of American companies with assets in Canada will certainly exceed the number of Canadian companies with assets in the U.S.. Perhaps most of the cases that are caught within the ambit of a proposed treaty will

²⁹⁹ *Ibid.* at 119-121.

be decided in American bankruptcy courts. The situation between Canada and the U.S. cannot be compared to the signatory states to the Nordic Convention or the E.U. Regulation. In those regions, the balance of power, in terms of economic and political influence, does not favour a particular signatory over another. It is not news that Canada is constantly concerned about being overshadowed by its powerful neighbour. Recalling the failure of the E.U. Convention, the factor that dealt the final blow to the instrument emanated from a political issue. The substance of the E.U. Convention had little to do with its demise as demonstrated by the fact that the E.U. Regulation almost copied the entire E.U. Convention cover to cover. By analogy, Canada's awareness of its national identity could deal a fatal blow to a proposed bankruptcy treaty. However, this does not mean that cooperation by means of a treaty is impossible. As long as the working committees behind the new Canada – U.S. treaty develop a keen sense towards the sensitive relations between the nations and table the treaty for signature at the appropriate time, the chance of a ratification of will be greatly enhanced.

5.4 Canada: From Common Law to Statutory Provisions

In the absence of an effective bilateral treaty, the solution to Canada – U.S. cross-border bankruptcy rests on statutory provisions. The Canadian cross-border provisions are contained in Part XIII of the B.I.A. and section 18.6 of the C. C.A.A.. Unlike its American counterpart in Section 304, which was introduced in 1978, the Canadian cross-border provisions were introduced in 1997. Hence, the Canadian provisions are relatively new. This part of the paper will trace the evolution from common law to statutory provisions in regulating cross-border insolvency in Canada.

Before the 1997 round of amendments to the B.I.A. and the C.C.A.A., the Canadian courts resorted to the principles of the conflicts of law, also known as private international law, in recognizing foreign insolvency proceedings.³⁰⁰ In deciding whether to extend assistance or recognize a foreign order, the courts would focus on whether the foreign tribunal had proper jurisdiction over the debtor. Factors that courts would consider include the domicile of the debtor, international comity, existence of a real and

³⁰⁰ It is interesting to note that the *Winding-Up Act* contains limited provisions relating to international insolvencies at a time when neither the B.I.A. nor C.C.A.A. referred to the subject. See Latham, *supra* note 32 at 356.

substantial connection between the bankrupt and foreign country, and other proper jurisdictional grounds.³⁰¹

The place of incorporation of the corporate entity or the place where the centre of corporate affairs and functions were discharged was usually seen as the domicile of the debtor. Compared to the U.S., international comity was seldom used in the Canadian jurisdiction. However, in *William v. Rice*, Mr. Justice Dysart referred to the concept of comity in recognizing the extra-territorial effect of an order made under the U.S. Bankruptcy Code.³⁰² The existence of a real and substantial connection between the bankrupt and a foreign country could be seen as analogous to the domicile of the debtor. After all, a company will probably conduct a majority of its transactions in the jurisdiction where the company is domiciled. A real and substantial connection could also be taken as the jurisdiction where the bankrupt had submitted itself to by filing an involuntary bankruptcy petition. The proper jurisdiction ground was a catchall phrase under which a court would extend or decline recognition to a foreign proceeding.

If it was held that a foreign court was vested with the proper jurisdiction in handling a case, the courts would decide on the effect of the foreign order with respect to the assets of the debtor situated in Canada. If the assets were of an immoveable nature, such as, title in real estate, they would never be subjected to a foreign order.³⁰³ If the assets were of a moveable nature, courts would likely defer those assets to foreign administration.³⁰⁴ In sum, the distinction between immoveable and moveable property echoed the traditional approach entrenched in English common law.

With the application of private international law in the era before the 1997 round of amendments to the B.I.A. and C.C.A.A., the Canadian approach in regulating cross-border insolvency could be categorized under modified universality. Territoriality is not the proper classification of the approach in the pre-1997 era because the Canadian courts did not completely rule out the possibility of cooperation with a foreign jurisdiction.

³⁰¹ *Ibid.* at 357.

³⁰² [1926] 3 D.L.R. 225 (Man. K.B.); See *Re Sefel Geophysical Ltd.* (1988) 54 D.L.R. (4th) 117 (Alta. Q.B.) for a similar application of international comity.

³⁰³ *Macdonald v. Georgian Bay Lumber Co.* [1878] 2 S.C.R. 364.

³⁰⁴ *Marine Trust Company v. Weinig* [1935] 3 D.L.R. 282 (Ont. S.C.); *Re I.I.T.* (1975) 58 D.L.R. (3d) 55 (Ont. H.C.).

Overall, the application of private international law in the period before the 1997 amendments had generally resulted in cooperation with a foreign jurisdiction. However, reliance on judge-made rules gave rise to inconsistency and uncertainty.³⁰⁵ In light of this, considerable efforts were taken by the Study Committee on Bankruptcy and Insolvency in the 1970s in adding new cross-border provisions to the B.I.A.³⁰⁶ While there had been a number of attempts in drafting those provisions, the current provisions in Part XIII of the B.I.A. did not materialize until 1997. It is interesting to note that the Study Committee was not involved in the drafting of section 18.6 of the C.C.A.A..³⁰⁷ However, the two statutes share similar features while allowing for the differences in scope between the two.

Under Part XIII of the B.I.A., a foreign representative is given the right to commence a bankruptcy proceeding in the same fashion as Canadian creditors.³⁰⁸ On application by the foreign representative, a court may grant a variety of orders including a stay of proceedings, an appointment of interim receivers, and other actions as the court sees appropriate.³⁰⁹ In addition to the power of foreign representative, the B.I.A. also provides for the powers of the court to coordinate a proceeding under the B.I.A. with a foreign proceeding.³¹⁰ It must be emphasize that the powers of the court in making orders to facilitate a coordination of proceedings are unlimited. Section 268(3) reads that the court may make such orders and grant such relief as it considers appropriate. Section 271(1) goes on to grant the court with the power to seek aid and assistance from a foreign tribunal by order or written request otherwise as the court sees appropriate. This section reflects the reality that modern means of communication are constantly evolving. Courts are not tied to communicate in a certain manner. Rather, communications should be carried out effectively and efficiently.³¹¹ Another important section contained in Part XIII

³⁰⁵ Michael B. Rotsztain, "Cross-Border Issues: Managing the Canadian Side of an American Insolvency Application" IIC-ART 2003-2 (WL).

³⁰⁶ Jacob S. Ziegel, "Corporate Groups and Canada – US Crossborder Insolvencies: Contrasting Judicial Visions" (2001) 25 C.B.R. (4th) 161 (WL).

³⁰⁷ *Ibid.*

³⁰⁸ *Bankruptcy and Insolvency Act*, *supra* note 18 at s.270.

³⁰⁹ *Ibid.* at ss.271(2), (3).

³¹⁰ *Ibid.* at s.268(3).

³¹¹ E. Bruce Leonard, *Supplementary Submissions to the Senate of Banking, Trade and Commerce Committee: Reform Issues Relating to International Aspects of Reorganization and Insolvency* (Ottawa: International Insolvency Institute, 2003) at 8.

of the B.I.A. deals with multiple recoveries by a creditor in foreign jurisdictions. Section 274 is introduced to ensure that all creditors are treated fairly and equitably. Specifically, the section provides that the amount a creditor receives from a foreign decision shall be taken into account in determining the amount recoverable in Canada. This serves to ensure that a creditor who has participated in foreign jurisdictions will not recover more than a creditor of the same class who has only participated in the Canadian administration.

As mentioned earlier, amendments that are similar to those introduced to the B.I.A. were also brought into the C.C.A.A. in 1997. Section 18.6 of the C.C.A.A. provides for the powers of the court in granting such relief as it considers appropriate to facilitate a coordination of proceedings under the C.C.A.A. with foreign proceedings.³¹² A court is also given the right to seek aid and assistance from a foreign court in any manner it sees appropriate.³¹³ Relative to the detailed provisions in the B.I.A., section 18.6 of the C.C.A.A. is less comprehensive. For example, the section does not refer to the power of the court in appointing an interim receiver nor does it introduce a provision similar to section 274 of the B.I.A.. The brevity in section 18.6 of the C.C.A.A. reflects the nature of the C.C.A.A. being a less rigid statute.

There is little doubt that the theoretical justification behind the Canadian bankruptcy statutes is modified universality. By definition, modified universality is a system that vests a court with the power to either accept or reject cooperation with a foreign jurisdiction. This is the exact model followed in the B.I.A. and the C.C.A.A.. As mentioned earlier, there are two approaches to modified universality: primary and secondary proceedings and concurrent proceedings. Similar to the use of ancillary proceedings under section 304 of the U.S. Bankruptcy Code, both the B.I.A. and the C.C.A.A. have chosen to regulate cross-border insolvency through concurrent proceedings. This is not surprising as concurrent proceedings recognize the reality that a court may not wish to defer its jurisdiction in all circumstances. Under the E.U. model, which made use of primary/secondary proceedings, a secondary jurisdiction will automatically defer to a primary jurisdiction in all major decisions. As the 1997 round of amendments to both the B.I.A. and C.C.A.A was Canada's first attempt in enacting cross-

³¹² *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36, 18.6(2).

³¹³ *Ibid.* at s18.6(6).

border provisions into the bankruptcy statutes, it is understandable that the drafters would approach the matter conservatively. In fact, in the two decades preceding the 1997 round of amendments, numerous proposals were rejected by the Parliament and the Bankruptcy and Insolvency Act Advisory Committee as being too favourable to foreign jurisdictions.³¹⁴

After examining the statutory provisions, it is important to look at how the courts approached the sections in regulating cross-border insolvency. This is necessary to observe how far the court has advanced the goal of modified universality. After all, a law is only as good as the judges who apply them. Overall, the Canadian courts have been consistent in their approach towards the cross-border provisions in B.I.A. and the C.C.A.A.. There is a general tendency in cooperating with foreign proceedings. For example, in *Re Babcock & Wilox Canada Limited*,³¹⁵ Justice Farley relied on comity in recognizing a Chapter 11 proceeding under the U.S. Bankruptcy Code. A stay order was subsequently issued against the Canadian tort claimants. This is an interesting application of section 18.6 in the C.C.A.A. since the ancillary proceeding filed was for a solvent Canadian subsidiary of a U.S. company that was declared bankrupt in the U.S.. In Canada, insolvency is a pre-requisite to a company who seeks bankruptcy protection under either the B.I.A. or C.C.A.A.³¹⁶ Another interesting case that helps to substantiate the statement that Canadian courts are generally willing to cooperate with foreign proceedings involve the use of stalking horse bid in *PSINet Limited*.³¹⁷ PSINet Limited was the principal Canadian subsidiary of PSINet Inc. that filed voluntary petitions under Chapter 11 of the U.S. Bankruptcy Code. PSINet Limited soon followed suit and filed for protection under section 18.6 of the C.C.A.A.. In order to maximize the value of the assets owned by PSINet Limited, the Canadian and American courts cooperated and approved unique bidding procedures that involved a break-up fee payable to the Telus

³¹⁴ In 1984, Bill C-17 was introduced and rejected in the Parliament. The cross-border provisions were drafted by John D. Honsberger, Q.C., who borrowed heavily from section 304 of the U.S. Bankruptcy Code. It was felt that the proposed sections were too favourable towards the recognition of foreign orders and cooperation with foreign courts. In 1993, the new sections drafted by the Working Group of the Bankruptcy and Insolvency Act Advisory Committee were again rejected as being too favorably disposed towards foreign bankruptcy proceedings. See Ziegel, *supra* note 306.

³¹⁵ (2000) 18 C.B.R. (4th) 157 (Ont. S.C.J.).

³¹⁶ Michael A. Fitch, "Recent Canadian Transnational Insolvency Decisions," online: International Insolvency Institute < http://www.iiiglobal.org/country/canada/lrac_589732_1.pdf > at 1.

³¹⁷ (2001) 28 C.B.R. (4th) 95 (Ont. S.C.J.).

Corporation, who had initiated an offer to purchase the assets belonging to PSINet Limited. The bidding procedure involved setting the offer made by Telus as a stalking horse bidder or a benchmark against which other bidders would compete in the auction process. If Telus was out-bid by another bidder, it would be compensated by the payment of a break-up fee approved by the courts. Stalking horse bid is a procedure commonly employed in the U.S. in ensuring maximum recovery for stakeholders. Yet, the procedure is not generally used in Canada.³¹⁸ The application of a foreign procedure, namely, the stalking horse bid, to ensure maximum recovery for the creditors highlighted the willingness of a Canadian court to cooperate with a foreign jurisdiction.

Another important aspect of cross-border insolvency in Canada that points towards the inclination to facilitate cooperation with a foreign tribunal is the use of cross-border protocols. In essence, a protocol is a negotiated agreement between a debtor and its creditors that provides for substantive and procedural rights of all parties involved.³¹⁹ The use of protocols was first used in Canada in *Olympia & York* where Justice Blair extended the view that the courts of various jurisdictions should cooperate if it is in the interests of international cooperation and comity.³²⁰ It was a breakthrough in Canadian-American transnational insolvency in the sense that it was the first time a protocol was used to regulate an international insolvency between the two nations. Cases subsequent to *Olympia & York* that involved the implementation of cross-border protocols include *Everfresh Beverages Inc.*³²¹, *Livent Inc.*³²² and *Phillips Services Corp.*³²³.

As mentioned earlier, in general, the Canadian jurisdictions have consistently applied the B.I.A. and C.C.A.A. in a manner that favoured cooperation with foreign jurisdictions through concurrent proceedings. However, there are a few exceptions to the norm. For example, in *Re Singer Sewing Machine Co. of Canada Ltd.*³²⁴, Registrar Funduk refused to recognize a Chapter 11 proceeding that was initiated in New York

³¹⁸ Mark Laugesen, "Recent Developments in Cross-Border Transactions" (2001) 18 Nat'l Insolv. Rev. 57 at 60.

³¹⁹ Alex MacFarlane, Dave McKechnie & McMillan Binch, "US-Canada Cross-Border Insolvencies," (1 February 2004), online: Practical Law Company <<http://crossborder.practicallaw.com/9-102-7443?tab=1>>.

³²⁰ *Olympia & York Developments Ltd.* [1993] O.J. No. 1748 (Ont. Gen. Div.).

³²¹ *In re Everfresh Beverages*, Nos. 95 B45405-06 (Bankr. S.D.N.Y. 1995).

³²² *In re Livent Inc.* 98 B.R. 48312 (Bankr. S.D.N.Y. 1999), 98-CL-3162 (Ont. Sup. Ct. of Justice).

³²³ *Menegon v Philip Services Corp.* [1999] O.J. No. 4080 (Ont. Sup. Ct.).

³²⁴ (2000) 18 C.B.R. (4th) 127 (Alta. Q.B.).

against the Canadian subsidiary of the Singer Company. The Singer filing in New York covered the parent company and forty-six of its affiliates, including the Canadian subsidiary. A global stay order was subsequently issued by the Judge Liflin in New York. In justifying his decision, Registrar Funduk was of the opinion that comity did not require him to recognize a Chapter 11 proceeding over a Canadian company that carried on businesses and owned assets only in Canada.³²⁵ He distinguished the case with other cases where the Canadian courts cooperated with a foreign jurisdiction by stating that in those cases, the debtor was domiciled in the jurisdiction that made the bankruptcy order. Another case where a Canadian court refused to cooperate with a foreign proceeding involves *Re Antwerp Bulkcarriers*.³²⁶ The fact pattern behind the case is complicated involving both the Canadian maritime and bankruptcy laws. In essence, the case involved unpaid fees for services supplied to a ship by Holt Cargo System. Under Canadian maritime law, Holt had a lien against the ship, which subsequently led to its arrest in Canadian waters near Halifax. The owner of the ship ran into financial difficulties and made an assignment in bankruptcy in Antwerp, Belgium. Under Belgian law, the trustees were required to take possession of all of the bankrupt's assets, wherever located. A proceeding was brought in Canada requesting a release of the assets to the trustees. In refusing to cooperate with the Belgian court, the Supreme Court of Canada held that the plurality approach adopted by the Canadian bankruptcy law was geared towards coordination and not subordination. The recognition of foreign proceedings in Canada is not a "rubber stamping" process. In deciding whether to accede to a foreign jurisdiction, a court must consider the interests of the affected parties and the public policy of Canada.³²⁷ As such, the fact that the lien held by Holt would not be recognized in a foreign jurisdiction was a sufficient ground in refusing cooperation with the Belgian trustee.

If compared to the numerous cases where the Canadian courts cooperated with foreign jurisdictions, instances where the courts refused to cooperate with foreign proceedings and retreated to territoriality are outnumbered. However, cases such as *Re Singer* and *Re Antwerp* should not be taken light-heartedly. They serve to indicate that

³²⁵ *Ibid.* at para. 26.

³²⁶ (2001) 30 C.B.R. (4th) 68 (S.C.C.).

³²⁷ Fitch, *supra* note 316 at 5.

the Canadian courts are not blindly approving ancillary proceedings under the head of comity and universality. The gist of modified universality implies that whenever a court wishes to protect domestic interest and policy, it is allowed to retreat to territoriality and decline cooperation with a foreign proceeding. Rather than stigmatizing the judges who refused to cooperate as practicing territoriality, they should be seen as protecting the plurality regime embraced in the B.I.A. and C.C.A.A.. After all, section 268(5) of the B.I.A. and section 18.6(5) of the C.C.A.A. specifically state that the court is not compelled to enforce foreign orders. Whether the courts have exercised their discretion in refusing to cooperate with a foreign proceeding in a justifiable manner is an entirely different matter. What is important is that modified universality is embraced in both the legislature and judiciary.

5.5 United States: From Section 304 to Chapter 15

After observing the Canadian legislative efforts in regulating cross-border insolvency, it is apparent that Part XIII of the B.I.A. and section 18.6(5) of the C.C.A.A. share the same philosophical underpinning as section 304 of the U.S. Bankruptcy Code. Namely, both systems adhere to modified universality through concurrent proceedings. This can be distinguished from the primary/secondary proceedings model applied under the E.U. Regulation. Since section 304 has been explored in great detail in Chapter 2, it will not be elaborated here again.³²⁸ As mentioned earlier, the cross-border provisions contained in the Canadian legislation came decades after its American counterpart. At the moment, it may seem that Canada has caught up with its neighbour. However, this landscape will change around October 2005. This is the case because the U.S. had already enacted and signed into law its own version of the Model Law on April 2005.³²⁹ The new cross-border provisions are contained in Chapter 15 entitled as “Ancillary and Other Cross-Border Cases”. The new provisions will govern the initiation and conduct of ancillary proceedings in substitution of section 304. Since the structure of Chapter 15 is modeled closely after the UNCITRAL Model Law on Cross-Border Insolvency, a

³²⁸ *Ibid.* at 22.

³²⁹ American Bankruptcy Law Institute, “President Signs Bankruptcy Overhaul,” online: American Bankruptcy Institute
<http://www.abiworld.org/Content/NavigationMenu/Online_Resources/Legislative_News/New_Bankruptcy_Law/New_Law.htm>.

throughout discussion on Chapter 15 is unnecessary. In general, the structure of the new Chapter 15 is identical to the Model Law. For example, there are five subchapters to Chapter 15 as there are five chapters to the Model Law. According to Daniel M. Glosband, one of the preliminary draftsmen of Chapter 15, the variations between Chapter 15 and the Model Law focused mostly on the language while changes to the statutory structure were few.³³⁰ The following discussion will focus on the six significant differences between the two instruments.

First, the set of terms defined under section 1502 of the U.S. Bankruptcy Code is different from those defined under Article 2 of the Model Law. In particular, “foreign proceeding” and “foreign representative” are not defined under Chapter 15. Rather, they are defined under the revised sections 101(23) and (24) of the Bankruptcy Code. The new definition of a foreign proceeding will include the phrase “under a law relating to insolvency” and the words “or debt adjustment”.³³¹ This modified definition of a foreign proceeding is probably a concession to the fact that insolvency is not a pre-requisite to a company seeking the protection under the Bankruptcy Code. Hence, the scope of foreign proceedings covered under Chapter 15 is wider than the one contemplated under the Model Law. While “foreign proceeding” and “foreign representation” are not defined in Chapter 15, “foreign main proceeding” and “foreign non-main proceeding” are defined under section 1502(4) and (5). It is curious why foreign main and foreign non-main proceedings are not included in the general provisions under section 101. For consistency purpose, the four terms should be defined together under either section 101 or section 1502. Another change that is made to the Model Law in allowing for a better adaptation to the U.S. context is the insertion of the definition of a “trustee”. Under section 1502(6), a “trustee” is defined to include a debtor in possession. Since debtor-in-possession financing is common only in the U.S., it makes sense for the drafters to include debtor in possession as a trustee to clear any confusion in the future regarding the power of such trustee in a foreign country that does not use debtor in possession financing.

Second, section 1505 introduces a new element to Article 5 of the Model Law. Under Article 5, the right of an estate representative to act in a foreign state is automatic.

³³⁰ Daniel M. Glosband, “Comparison of Chapter 15 to Model Law,” online: International Insolvency Institute <http://www.iiiglobal.org/international/cross_border/United_States_Daniel%20Glosband.pdf> at 1.

³³¹ *Ibid.* at 57

In contrast, section 1505 states that “a trustee may be authorized by the court to act in a foreign country on behalf of an estate” created under the Bankruptcy Code. Hence, the right of an estate to act abroad is not automatic. Introducing the court’s intervention to the formula may serve to impede the work of a trustee. It is uncertain why the drafters chose to modify Article 5 of the Model Law in such manner.

Third, section 1507 expands on Article 7 of the Model Law, which allows a court to provide additional assistance to a foreign representative. Article 7 is very brief and simply states that a court can render such assistance. Section 1507 adds to Article 7 by requiring a court to consider five factors before extending additional assistance to a foreign representative under the principles of comity. These factors are imported directly from section 304(c). The separate element of comity, previously listed as the fifth element under section 304 is deliberately excluded to avoid confusion as demonstrated by the mixed interpretation of comity issued by the courts.³³² However, the inclusion of the word “comity” as an overriding element under section 1507(b) has resuscitated the previous section 304 jurisprudence.³³³ It is unsure how the previous case law will interact with section 1507. In light of the fact that section 304 is frequently used by foreign representatives in obtaining a simplified and expeditious relief, it is hoped that the five factors included in section 1507 will not present a hurdle in a foreign representative’s request for additional assistance.

Fourth, under section 1509, a foreign representative can commence a case under Chapter 15 only by filing a petition for recognition in a bankruptcy court. This approach differs from Article 9 of the Model Law where a foreign representative is entitled to apply directly to a court in a country that enacted the Model Law. Under section 1509(b), a foreign representative can sue or be sued in another court in the U.S. only after the bankruptcy court recognizes a foreign proceeding under section 1515. It is hoped that the requirement under section 1509 will halt the development of inconsistent decisions under different courts and thwart forum shopping activity by foreign representatives.

Fifth, sections 1520 and 1521 of the Bankruptcy Code concerning interim relief upon filing of the petition for recognition and relief that may be granted upon recognition

³³² See 24, above, for more on this issue.

³³³ Glosband, *supra* note 330 at 6.

differ slightly from their counterpart in Articles 19 and 21 of the Model Law. Three limitations are introduced under section 1519 in a court's power in granting an interim relief. Section 1519(d) states that a court cannot enjoin a police or regulatory act of a governmental unit while section 1519(e) states the standards, procedures and limitations applicable to an injunction that are applicable to an interim relief. Furthermore, section 1519(f) states that certain financial contracts that are not bound by a stay under section 362 cannot be stayed. These three limitations can also be seen in sections 1521(d), (e) and (f) respectively.

Sixth, the Model Law and Chapter 15 differ greatly in the avoiding powers of a foreign representative. Under Article 23(1), upon recognition of a foreign main proceeding, a foreign representative is given the right to avoid acts that are detrimental to creditors. Under section 1523, however, a foreign representative can only bring an avoidance action in a case pending under another chapter of the Bankruptcy Code. For example, if a foreign representative commences a plenary bankruptcy case under section 1509, he can exercise his avoiding powers. Inevitably, in exercising such powers, a foreign representative risks losing administration of the case to a trustee or a debtor in possession.³³⁴ The restriction imposed in section 1523 is understandable as the U.S. delegation to the UNCITRAL opposed a foreign representative's right to avoid transactions in the Model Law.

Other than the six significant variances between Chapter 15 and the Model Law discussed in the above, the other differences between the two instruments are minute in nature. For example, under section 1501, railroads companies, in addition to regulated financial institutions as suggested under Article 1 of the Model Law, are added to the list of exceptions where Chapter 15 will not apply. In sum, all the modifications introduced in the U.S version of the Model Law are merely details that the drafters have filled in to fit the Model Law into the U.S. context. Overall, Chapter 15 has preserved the spirit of the Model Law in providing for cooperation and communication among courts and foreign representatives as well as encouraging coordination of concurrent proceedings. At this point, one may question whether the mechanism embodied in Chapter 15 will lend more assistance to a foreign representative than under section 304. It must be recalled

³³⁴ *Ibid.* at 9.

that under section 304, the judiciary was inclined towards cooperation with foreign proceedings.³³⁵ Sharing the same theoretical basis as section 304 under modified universality, it is questionable whether Chapter 15 will unleash magic and encourage an even higher degree of cooperation among the U.S. court and foreign courts. While it is too early to make a judgment regarding this issue, the enactment of Chapter 15 will help in unifying the cross-border provisions in the U.S. Bankruptcy Code with other countries, such as, Mexico and Japan, which have already enacted the Model Law. The U.S. enactment of Chapter 15 will also act as an example and encourage other nations to draft their own versions of the Model Law.

5.6 The Future Outlook of Cooperation between Canada and the U.S.

With the passage of Chapter 15, Canada is again lagging behind the U.S. in regulating cross-border insolvency. In the absence of a bilateral treaty, the future hope in dealing with a transnational insolvency between the two nations in an efficient and effective manner is by means of a uniform statutory standard. In other word, it will be in the best interest of Canada if it enacts new cross-border provisions that are based on the Model Law.

To this end, the Standing Committee on Banking, Trade and Commerce in Canada had released a Report in respect of its review of the Canadian bankruptcy legislation in November 2003.³³⁶ Paragraph 24 of the Report recommended that the B.I.A. be amended to incorporate the Model Law. The Report also recommended two modifications that should be made to the Model Law in the Canadian context. First, a requirement of reciprocity must be inserted. Second, a Canadian creditors' committee must be created.

The reciprocity requirement was perceived as necessary to protect the Canadian interests in restricting access to the remedies under the Model Law to nations that have adopted the Model Law. However, the reciprocity requirement came under attack in a Supplementary Submission made to the Senate Committee by the International

³³⁵ See 27, above, for more on this issue.

³³⁶ Canada, Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*, online: The Senate <http://www.parl.gc.ca/common/Committee_SenRep.asp?Language=E&Parl=37&Ses=2&comm_id=3>.

Insolvency Institute. The Institute found that the incorporation of a reciprocity requirement would put Canada at odds with other nations, which do not require reciprocity in their versions of the Model Law.³³⁷ The requirement is also inconsistent with the long-standing position in the B.I.A. as it does not require reciprocity. From a policy point of view, incorporating such provision will be a retrograde step. The Supplementary Submission did not comment on the creditors' committee provision. Indeed, it is desirable to involve Canadian creditors in a proceeding and protect their interests in respect of assets located in Canada. However, one must question whether the inclusion of such terms in the Canadian version of the Model Law is necessary. Article 22 of the Model Law already requires a court to consider the interests of the creditors and other interested parties when deciding whether to recognize a foreign main or non-main proceeding under Articles 19 and 21. In the consideration process, it is very likely that a court will hear from any parties whose rights are affected by an order. A specific reference to the creditors' committee may be desirable in protecting the rights of creditors but it can also be seen as redundant.

As noted above, the enactment of the Model Law via Chapter 15 in the U.S. will inspire other nations to look into the possibility of enacting their own versions of the Model Law. Since submissions had already been made to the Senate in enacting a Canadian version of Model Law, it is probable that Canada will follow the U.S. lead and revise its cross-border provisions. Hence, the future of cooperation between Canada and the U.S. in regulating cross-border insolvency will rely on a set of uniform standards promoted by the UNCITRAL Model Law. The benefits of having a uniform standard are twofold. First, the judiciary on either side of the border will approach cross-border insolvency on the same footing. This will encourage consistency among courts in deciding whether to recognize foreign proceedings. Furthermore, the skepticism that is particularly prevalent among Canadian judges that the U.S. courts are invading the sovereignty of Canada will be reduced.³³⁸ Sharing a uniform approach in regulating cross-border insolvency will reduce the alienation a Canadian judge may feel towards the American system and vice-versa. Second, the reliance on the Model Law will help to lift

³³⁷ Out of all the countries that have enacted the Model Law, only South Africa and Argentina have incorporated a reciprocity requirement. See Leonard, *supra* note 311 at 3.

³³⁸ *Re Singer Sewing Machine Co. of Canada Ltd.*, *supra* note 324.

the heavy burden placed on the cross-border protocols in regulating cross-border insolvency. While positive in merit, the protocols have constantly come under attack as being non-applicable to smaller companies with fewer assets across the borders. This criticism is substantiated by the fact that most companies, such as, Olympia & York and Everfresh Beverages, which resorted to the use of cross-border protocols were sizeable companies. Furthermore, the courts' ability to work out protocols on a case by case basis in a timely manner is doubted if the number of cross-border insolvency grows exponentially.³³⁹ Another doubt cast towards the protocols is whether it is possible to draft a cross-border protocols that cater for more than two nations if the operations of a debtor stretches beyond North America. Without solving these issues, it is unrealistic to assume that the *ad hoc* approach in regulating cross-border insolvency through protocols will be effective and efficient in the long run.

It is beyond doubt that the benefits offered under the Model Law will not as vigorous as those offered by a bilateral treaty that is modeled after the E.U. Regulation in Cross-Border Insolvency. In other word, the type of modified universality envisioned by the Model Law, namely, cooperation through concurrent proceedings, is not as universal as a system that is premised on primary and secondary proceedings. In such system, recognition of a foreign proceeding is automatic, which may lead to an expeditious disposal of a cross-border case. Hence, the value of a bilateral treaty cannot be replaced by the Model Law. However, realistically speaking, the Model Law may be as far as the two nations are willing to go in regulating cross-border insolvencies. This assumption is strengthened by the fact that the global economy has encouraged companies to expand beyond North America. Thus, a non-signatory state will very likely be involved in a Canada-U.S. cross-border insolvency proceeding. Bearing in mind that a bilateral bankruptcy treaty will only bind Canada and the U.S. and not a third party, the utility of such treaty will be restricted to companies that operate only within the two nations. If a debtor has a branch in the U.K., the treaty will not apply. Moreover, the drafting process of an international instrument can be both time consuming and expensive. Governments on both sides may find the negotiation for a bilateral agreement economically unfeasible.

³³⁹ Sean Dargan, "The Emergency of Mechanisms for Cross-Border Insolvencies in Canadian Law" (2001) 17 Conn. J. Int'l L. 107 at 124.

Therefore, it is logical to arrive at the conclusion that the future mode of cooperation between Canada and the U.S. will rest on the use of the Model Law while reserving cross-border protocols for sizeable companies.

6 Conclusion

After conducting a comprehensive overview of the approaches towards regulating cross-border bankruptcy, it is obvious that modified universality provides the best foundation for the construction of a regulatory scheme. The theory emerges at the top due to the absence of a perfect fit between the characteristics of an ideal bankruptcy system and the protectionist mentalities of states. An ideal insolvency system encourages a state to be as universal as possible. In contrast, protectionism draws states towards territoriality. Modified universality offers a workable compromise by staying somewhere between the two extremes.

The legacy of modified universality is demonstrated through the successful application of the theory in the Nordic Bankruptcy Convention, the E.U. Regulation on Insolvency Proceeding and the UNCITRAL Model Law on Cross-Border Insolvency. The Nordic Bankruptcy Convention adopts a combined choice of law rules. The E.U. Regulation provides for secondary proceedings. The Model Law provides recommendations for recognition of foreign proceedings. All three instruments have adopted modified universality into their texts, albeit in different degrees. Having established a strong case for modified universality, the next question draws on whether the nations have done enough in capitalizing the full advantages of modified universality.

If universality and territoriality are placed on two opposite ends of a line, modified universality will stand in the middle. As discussed in Chapter 4, there are two approaches to modified universality: ancillary proceeding and secondary bankruptcy. For reasons already presented in the context of the E.U. Regulation, secondary bankruptcy is more universal than an ancillary proceeding.³⁴⁰ If modified universality is removed from the line and replaced by an ancillary proceeding and secondary bankruptcy, the former will tilt closer to territoriality while the latter will lean towards universality. At this point, it becomes apparent that modified universality occupies more than one spot on the line. It actually represents the area between an ancillary proceeding and secondary bankruptcy. Within this area, states can choose to go forward and adopt a more universal approach or tread backward to a more territorial regime. However, any proposed changes that will bring nations beyond the area will fail. For example, both the E.U. Draft Convention and

³⁴⁰ See 73 – 77, above, for more on this topic.

the U.S. – Canada Bankruptcy Treaty failed miserably due to the embracement of universality.³⁴¹ Likewise, little utility can be attached to an approach that is too territorial.

The reason for conceptualizing modified universality as occupying an area on the line where different theories sit is to establish the proposition that an ancillary proceeding is an insufficient means to reap the full benefit of modified universality. As demonstrated in the discussion above between the U.S. and Canada, there is little doubt that an ancillary proceeding is a good starting point for countries that do not provide extensive cross-border provisions in their domestic legislation. However, the optimal solution in cross-border bankruptcy will only appear if states evolve beyond the *status quo* towards the type of secondary bankruptcies envisioned in the E.U. Regulation. Creativity, akin to those that created the cross-border protocols, is called for. For those countries that are already covered by the reach of the E.U. Regulation, their judiciaries should keep an open mind and respect the spirit of the instrument.

³⁴¹ See 58 – 61 and 96, 97, above, for more on this topic.

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