

# Universalism Unravels

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Universalism will not work. That is cause for immediate concern because Congress has just enacted the UNCITRAL Model Law on Cross Border Insolvency.<sup>2</sup> The Model Law makes universalism the foundation of the United States’ international bankruptcy policy.

By “universalism” I mean the proposed international bankruptcy system in which a court of a multinational debtor’s “home country” would apply home country law to control the company’s bankruptcy worldwide. Multinational companies do not have home countries in any meaningful sense, and no one has yet figured out a way to assign them. In a universalist system, the indeterminacy of the home country standard would lead to forum shopping and ultimately to a strain of court competition even more virulent than the strain that today is corrupting the U.S. bankruptcy courts.<sup>3</sup> In a universalist system, credit extenders often would not know what country’s law would govern collection until their debtors filed bankruptcy and the courts ruled on venue. From the credit extenders’ perspective, a universalist system would be entirely

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<sup>2</sup> Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8 §§ 801-02 (2005).

<sup>3</sup> LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* (2005).

unpredictable.

Universalists claim to have solved the forum shopping problem by defining “home country” as the country where the debtor has “the centre of the debtor’s main interests” (hereafter “COMI”). That standard is intentionally vague and practically meaningless. It obscures conflicting views among the universalists as to the appropriate court for any given case. To make the point, in some of my earlier writings I challenged the universalists to answer three basic questions as to the identity of the home country:

First, when the principal assets, operations, headquarters, and place of incorporation are in different countries, which is the “home country?” Second, does “home country” refer to the home country of a corporate group or does each corporation in the group have its own “home country?” Third, what rules will govern the inevitable changes in the “home country” that will occur after credit has been extended?<sup>4</sup>

The leading universalists offer no answers. Instead, they claim that in the vast majority of cases, the home country will be obvious. The remaining cases, they say, will be so few that the problem of definition can safely be ignored.<sup>5</sup>

Recent events demonstrate the absurdity of this universalist claim. The European Union adopted a universalist bankruptcy scheme internally in 2000 and the regulation became effective in 2002. Court competition for big cases erupted almost immediately. In several of those cases, courts of European Union countries have claimed their countries to be the COMIs of corporations whose assets, operations, and places of incorporation were entirely elsewhere.<sup>6</sup>

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<sup>4</sup> Lynn M. LoPucki, *The Case for Cooperative Territoriality In International Bankruptcy*, 98 MICH. L. REV. 2216, 2217 (2000).

<sup>5</sup> Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177, 2207 (2000) (“There is widespread agreement among those interested in transnational insolvency that, in the vast majority of cases, the home country will be easy to identify – making the issue a minor question.”); Ulrik Rammeskov Bang-Pedersen, *Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests*, 73 AM. BANKR. L.J. 385, 418 (1999) (“In most cases determination of the home country will be obvious regardless of which standard is used. . . .”); Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2317 (2000) (“Any law professor can then devise the marginal hypothetical where the plant is in Chicago, while the CEO, one secretary, and a fax machine actually reside on the sun-drenched isle, but the marginal cases will be few. Resolved in a single court, they would present little practical difficulty across the run of cases.”).

<sup>6</sup> LOPUCKI, *COURTING FAILURE*, *supra* note 3, at 223-25 (discussing Enron Directo, Eurofoods, and DaisyTek).

Answering my three questions would expose universalism as an idealist fantasy. Perhaps sensing this, the leading universalists are cautious. Two – Professors Jay Westbrook and Andrew Guzman – ruled out place of incorporation as the answer to my first question<sup>7</sup> and spoke approvingly of “principal place of business.”<sup>8</sup> That phrase, however, is sufficiently vague to straddle all three other possibilities listed in my question.<sup>9</sup> Even so, neither universalist was ultimately willing to endorse principal place of business as the test. Westbrook dissembled further, claiming that “[I]t is not necessary to assume a raw, unsophisticated choice between place of incorporation and principal place of business in choosing a choice-of-law rule for an international convention in a globalizing world. For one thing, the choice may be multidimensional.”<sup>10</sup> Westbrook did not say what the dimensions of his multidimensional test might be, nor did he attempt to explain how credit extenders in a universalist world could predict the application of a rule he could not even specify. He deferred the corporate group question to some future time that apparently has not yet arrived.<sup>11</sup> The only universalist to brave an answer to any of my questions thus far, has been NYU law student Liza Perkins.<sup>12</sup> (She proposed place

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<sup>7</sup> Guzman, *supra* note 5, at 2207 (“[A] test based on the place of incorporation would be inappropriate.”); Westbrook, *supra* note 5, at 2316 (“I agree that the law of the place of incorporation is unsatisfactory because of the risk of sham incorporation – a company organized under a flag of convenience unrelated to the location of its business, management, and assets.”).

<sup>8</sup> Guzman, *supra* note 5, at 2207 (“A test such as the principal place of business, on the other hand, is much more difficult for the debtor to manipulate.”); Westbrook, *supra* note 5, at 2316 (“Yet the principal place of business standard in one formulation or another is commonplace throughout American law . . .”).

<sup>9</sup> Under U.S. law, the principal place of business of an entity is at its headquarters, even if the great bulk of its assets and operations are elsewhere. But probably most understand the phrase “principal place of business” to refer not to some isolated headquarters, but to the place where the company conducts the most business or has its most valuable assets. *See, e.g.*, Westbrook, *supra* note 5, at 2317 (mocking the idea of “the CEO, one secretary, and a fax machine actually [resident] on the sun-drenched isle” as the COMI).

<sup>10</sup> *Id.* The obvious shortcoming of a multidimensional test is the same as the shortcoming of a vague one: no one can predict the outcome until the court rules. Applied to venue in international cases, that is unacceptable. Credit extenders need to predict what country’s laws will apply to their extensions at the time they make them.

<sup>11</sup> *See, e.g., id.* at 2311-12 (“It goes without saying that I cannot seriously address the multitude of issues presented by corporate groups within the confines of this Article nor can the bankruptcy aspects of those issues be easily isolated for analysis.”). Having written this in 2002, Westbrook never returned to my question regarding the location of a corporate group.

<sup>12</sup> Liza Perkins, *A Defense of Pure Universalism in Cross-Border Corporate Insolvencies*, 32 N.Y.U. J. INT’L. L. & POL. 787, 815 (2000) (advocating a treaty or convention providing that

of incorporation, the only factor Westbrook and Guzman were able to reject.).

The universalists are dissembling over these questions for good reason. Long before the universalists assured us that nations would easily agree on “home countries” of corporations for bankruptcy purposes, nations had battled to a stalemate on the home countries of corporations for corporate law purposes:

With the expansion of corporate activities across national frontiers and the separation between management (center of administration) and assets and operations (center of exploitation), the question of which of these is the better connecting factor had to be addressed. Continental practice continued to prefer "administration" based on the perception that the nation where the corporate "brain" or "nerve center" is located, where the key corporate decisions are made, and where "control" is exercised, has the greater concern about and power over internal corporate affairs. Yet there still remains a lack of consensus as to where this "administration" is actually located. The majority view equates "administration" with the directors while alternative theories advocate the place where shareholders meet and act. The uncertainty is compounded by the fact that different nations at various times, while using the same standard, arrive at differing conclusions as to where a particular seat is located.<sup>13</sup>

These corporate law battles focused on geographical links not even included in my list of alternative possibilities.

Despite their inability to explain what a “home country” is, the universalists prevailed in Congress.<sup>14</sup> “Home country” is now the foundation of U.S. international bankruptcy law and policy. Other countries seem likely to follow. The Model Law contains sufficient hedges that its promoters have been able to present it as territorialist when politically expedient.<sup>15</sup> But as a

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“a company’s place of incorporation shall determine its home country.”).

<sup>13</sup> P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 52 (1985).

<sup>14</sup> See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, *supra* note 2, at §§ 801-02.

<sup>15</sup> See, e.g., *Grassley Holds Hearing on UNCITRAL Model Law*, BANKRUPTCY COURT DECISIONS, Jan. 20, 1998, at A5 (hereafter “*Grassley Holds Hearing*”) (quoting Jay Westbrook that “[The Model Law “bows to the primacy of local proceedings wherever they may be opened and depends upon a willingness of local officials to cooperate.”). Westbrook’s report to the National Bankruptcy Review Commission on the Model Law deprecated territorialism, but never mentioned universalism. NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS, Appendix E-1 (1997) available at <http://govinfo.library.unt.edu/nbrcreport/01title.html> (Report by Professor Jay Westbrook on UNCITRAL Model Law on Cross-Border Insolvency).

practical matter, the Model Law, in conjunction with the ALI Principles<sup>16</sup> commit the U.S. to universalism. Even though they are not obligated to do so, some bankruptcy judges will immediately begin implementing universalism in particular cases, thus sacrificing the rights of some creditors for the benefit of others.<sup>17</sup> As I see it, the universalists have plunged the world's bankruptcy system off a cliff in the hope that they can solve the insoluble problems of universalism on the way down.

In his reply published in this issue,<sup>18</sup> United States Bankruptcy Judge Samuel L. Bufford breaks ranks with his fellow universalists. He takes the second and third of my questions seriously, and provides thoughtful, reasoned answers. His answer to the second is that the COMI of a corporate group should be at the joint COMI of the integrated members of the group.<sup>19</sup> His answer to the third question – regarding changes in a debtor's COMI – is that he would require that the debtor's COMI be in a country for six months or a year before that country would be the home country.<sup>20</sup> By offering these answers, Judge Bufford joins Liza Perkins in moving toward a genuine debate on the workability of universalism.

Although he argues for universalism, Judge Bufford acknowledges that “both [the EU Regulation] and [the UNCITRAL] Model Law need three important improvements to make them workable . . . .”<sup>21</sup> First, recognizing that the COMI decision “determines the country where the

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<sup>16</sup> AMERICAN LAW INSTITUTE, PRINCIPLES OF COOPERATION IN TRANSNATIONAL INSOLVENCY CASES AMONG THE MEMBERS OF THE NORTH AMERICAN FREE TRADE ASSOCIATION (2002).

<sup>17</sup> Indeed, some were doing it before adoption of the Model Law. *See, e.g.*, Westbrook, *supra* note 5, at 2323 n.97 (praising cases in which bankruptcy courts have surrendered assets for distribution under foreign law that differed from that of the forum). Creditors' sense of entitlement to application of the law of the country where the transaction took place will slowly give way to uncertainty and confusion regarding entitlements. Reform attempts are more likely to be directed at the creation of some new system than a return to territoriality.

<sup>18</sup> Samuel L. Bufford, *Global Venue Controls Are Coming: A Reply to Professor LoPucki*, \_\_ Am. Bankr. L.J. \_\_ (2005) (hereinafter “Bufford Reply”).

<sup>19</sup> *Id.* at [§ 5.2] (“The sensible solution . . . is to administer economically integrated group members in the home country of the integrated group, and to administer economically independent group members separately in their own home countries.”).

<sup>20</sup> *Id.* at [§5.3] (“I recommend a residency rule for both the Model Law and EU Regulation that would specify a minimum period of time during which the COMI must be located in a relevant venue to qualify to open a man insolvency case there.”).

<sup>21</sup> *Id.* at [42]. Later he refers to EU Regulation and the Model law as “more or less workable.” *Id.* at 24.

main case will proceed, and which country’s laws will for the most part govern the rights of creditors . . . ,” Judge Bufford concludes that venue is “too important an issue to . . . decide it at the outset before all of the parties in interest have had an opportunity to be heard.”<sup>22</sup> The second flaw Judge Bufford identifies is that each entity in a corporate group is deemed to have its own home country. That would split control of the reorganization or liquidation of the typical multinational company among numerous courts, thus defeating the very purpose of universalism in most cases.<sup>23</sup> The third is that neither the EU Regulation nor the UNCITRAL Model Law address the issue of a change in the company’s home country. In the universalist system about to be thrust on the world, multinational companies could change their home countries right before filing, thus thwarting their creditors’ expectations as to the law that will govern bankruptcy rights and priorities.<sup>24</sup> Each of the three flaws identified by Judge Bufford is, from a systems perspective, potentially devastating.

## I. Trying to Fix Universalism

Having identified the flaws, Judge Bufford proposes a fix for each. In this response, I explain why his fixes would not work and would instead multiply the number and seriousness of the flaws. Together, our two essays demonstrate the unraveling of universalism.

### A. Claiming Cases

Universalism is an all-or-nothing system. A single court gets the case, and runs it worldwide. Courts in other jurisdictions are required to follow the “home” court’s lead. Universalists have tried to ignore the uncomfortable fact that someone must be given the power to decide what country’s court – and thus what country’s law – will control. To the extent they do address the issue, however, universalists acknowledge that the only practical forum in which that decision can be made is the court in which the first case is filed.<sup>25</sup> Judge Bufford makes no

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<sup>22</sup> *Id.* at [44].

<sup>23</sup> *Id.* at [27] (“Further, under both the Model Law and EU Regulation, the COMI analysis must be made separately for each legal entity. . . . I disagree with this feature of both of these laws: in my view, if the related entities form a group that functions as an integrated economic unit, then venue for those related entities may be where the collective COMI is located.”).

<sup>24</sup> *Id.* at [56] (“Professor LoPucki can rightly charge that the lack of specificity in the Model [Law], and EU Regulation’s focus on the moment of opening of a case, give opportunity for manipulation of the COMI in some cases. I agree that a better rule is needed.”).

<sup>25</sup> Council Regulation (EC) No. 1346/2000, European Union Regulation on Insolvency Proceedings, 2000 O.J. (L. 160) preamble ¶22 (hereinafter “EU Regulation”) (“The decision of the first court to open proceedings should be recognised in the other Member States without those Member States having the power to scrutinize the court’s decision.”); United Nations Commission on International Trade Law, UNCITRAL Model Law on Cross-Border Insolvency

argument to the contrary.<sup>26</sup> That means the case placers – the debtor, its attorneys, and their contractual allies – will choose the court that makes the venue decision. In *Courting Failure*, I describe the problems that have already resulted in the European Union.<sup>27</sup> In essence, the case placers choose a court, make their arguments to that court *ex parte*, and that court generally responds by deciding that it is the home country court and keeping the case.

## 1. Judge Bufford’s Due Process Proposal

Judge Bufford recognizes that the decisions in *Daisytek* and *Parmalat* are problematic. He responds with the interesting observation that while the decision to open a proceeding must be made quickly upon the filing of the case, the determination whether the proceeding is a main proceeding need not be.<sup>28</sup> His observation is a potentially important advance in thinking about the problem. He proposes that the main proceeding determination be delayed until “approximately a month after notice of the filing is given to creditors” – presumably a period of about 40 days.<sup>29</sup> In his already lengthy reply, Judge Bufford does not consider precisely what ill effects might flow from his proposal.

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with Guide to Enactment, para. 124, *available at* <http://www.uncitral.org/english/texts/insolven/insolvency.htm> (last visited May 28, 2005) (“Apart from the public policy exception (see article 6), the conditions for recognition do not include those that would allow the court considering the application to evaluate the merits of the foreign court’s decision by which the proceeding has been commenced or the foreign representative appointed.”).

<sup>26</sup> Arguably, the Model Law permits every court to make its own determination regarding the home country of the debtor. Competing courts will be inclined to make conflicting claims to main case status to increase their bargaining power in relation to other competing courts. The consequence of those conflicting claims will not be merely to replicate territoriality. They will create multiple *extraterritorial* claims to the debtor’s assets. The Cenargo episode suggests that aggressive U.S. courts will try to use such claims to capture cases by intimidating foreign creditors. Courts that have no claim to main case status will be compelled to choose between the competing claims of courts that do.

<sup>27</sup> LOPUCKI, *COURTING FAILURE*, *supra* note 3, at 223-25.

<sup>28</sup> Bufford Reply, *supra* note 18, at [42] (“It is important that the decision to open a case . . . be made promptly. . . . In contrast, there is much less urgency in making a decision whether a case is main.”).

<sup>29</sup> *Id.* at [44] (“My view is that a decision on whether a case is a main case should be delayed approximately a month after notice of the filing is given to creditors, to provide both notice of a hearing on this issue and an opportunity to be heard to all of the parties in interest.”). I have added ten days to Bufford’s 30 for the court to send notice of the filing to thousands of creditors and shareholders worldwide in each multinational case.

Under his proposal, every multinational bankruptcy case will begin with a 40-day period of official uncertainty about which court will have the case. The due process rationale on which Judge Bufford relies would seem to prevent any of the courts involved from exercising worldwide jurisdiction during that period. During that period, the system would necessarily be territorial; that is, the courts of each country would have jurisdiction over the assets and operations of the debtor within its borders, but none would have jurisdiction over foreign assets and operations. If the debtor sought DIP financing, for example, the court could grant the DIP lender a priority only with respect to assets located in the country. If the debtor sought to sell the company as a going concern, it could do so only if proceedings were filed in every country concerned and the administrators in those countries agreed to the sale. The same restrictions would apply to the confirmation of a plan in a prepackaged or prenegotiated case.<sup>30</sup>

Judge Bufford – a skeptic regarding the likelihood of agreement in a territorial system where bargaining endowments are known<sup>31</sup> – assumes the parties would reach these agreements in a universalist system where bargaining endowments would not be known.<sup>32</sup> I disagree. Knowing that the court would identify a home country in about 40 days and give the home country control, the parties would simply wait in most cases. Thus, the likely effect of Judge Bufford’s due process proposal would be a period at the beginning of every genuinely multinational case in which little could be accomplished – even if the survival of the business might depend on it.

That period is a crucial one for many debtors. Some desperately need to pay employees or suppliers. They might not be able to do so if the priorities of the proposed payees depended on the not-yet-determined identity of the home country. Other debtors need to borrow working capital to keep their businesses functioning. A debtor-in-possession might not be able to get the money because, depending on the venue decision, the debtor-in-possession might be displaced in a few days by an administrator and a different country’s laws might govern repayment. Some debtors need to resolve contractual relationships with landlords and suppliers; they could not do so during the 40-day delay because the identity of the country whose laws would govern acceptance or rejection of executory contracts would not be known.

Judge Bufford is right in thinking that in a universalist system, the venue decision is so important that it should not be made *ex parte* in the first few days of the case. But he has

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<sup>30</sup> See LOPUCKI, *COURTING FAILURE*, *supra* note 3, at 161, (listing 21 large, public company prepackaged cases that were concluded in less than 40 days). In a universalist system, prepackaged and prenegotiated cases in which the COMI was in doubt would be delayed.

<sup>31</sup> Bufford Reply, *supra* note 18, at [20] (“[E]xamples abound of the lack of cooperation by courts applying territorialist laws, and examples of cooperation are virtually unknown.”).

<sup>32</sup> *Id.* at [33] (claim by Judge Bufford that in a universalist system a territorial “secondary case” may be “used to implement cooperation and coordination with foreign courts and representatives”).



underestimated the difficulties that would flow from affording due process. Some bankrupt companies are like patients arriving in the emergency room of a hospital. They need immediate treatment. To require them to wait 40 days for the wheels of due process to turn is to sentence them to death. Thus, the correct conclusion to draw from the failure of *ex parte* fixing of venue in the European Union is not that U.S. notions of due process should apply. It is that universalism is inherently unworkable.

As Judge Bufford expressly recognizes, no corresponding problem arises in a territorial system.<sup>33</sup> Each court has jurisdiction over the people, assets, and operations within its territory, so the courts can turn immediately to the merits of the reorganization or liquidation.

## 2. Due Process Will Not Solve the Problem

Judge Bufford acknowledges that courts in the universalist European Union are already fighting over the cases of multinational debtors.<sup>34</sup> He sees this, however, as merely the product of hurried decisions made with less than all the evidence, so he addresses only problems of procedural due process. I see the fighting as the product of court competition and so think that adding due process protections will have little effect. The pattern of competition is already glaring in cases Judge Bufford and I have discussed. The British courts in *Daisytek* and *Enron Directo* both decided that Britain was the home country of companies whose assets and operations were entirely elsewhere. The courts of Ireland and Italy both claimed Eurofoods for themselves. In *Cirio Del Monte*, the Italian court claimed to be the home country of a Dutch subsidiary. These “mistakes” are not random. In each of these cases, the court erred in favor of its own jurisdiction; in none did the court err against its own jurisdiction.

Judge Bufford claims that because the hearings in *Eurofoods* and *DaisyTek* were *ex parte* that “much important evidence was likely not presented.”<sup>35</sup> That claim enables Judge Bufford to avoid the otherwise obvious fact that the courts were grabbing cases for their own countries. I find Judge Bufford’s claim hard to credit. Lawyers have an ethical duty to give courts the information courts need to make informed decisions.<sup>36</sup> They will certainly slant the presentation in their client’s favor, but it would be foolish for them to fundamentally mislead a court before

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<sup>33</sup> *Id.* at [50] (This issue admittedly arises only under a universalist approach to transnational insolvency cases. . . . For a territorialist approach there is no role for a decision to recognize a foreign case as either a main case or a foreign case . . .”).

<sup>34</sup> *Id.* at [§ 4.2 and § 4.3] (describing the conflicts among the courts of the countries involved).

<sup>35</sup> *Id.* at [50].

<sup>36</sup> MODEL RULES OF PROF’L CONDUCT, R. 3.3(d) (“In an *ex parte* proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer which will enable the tribunal to make an informed decision, whether or not the facts are adverse.”).

which they regularly appear. Judge Bufford notes that the court of appeals “found as a procedural matter that the Leeds court considered all of the proper factors in determining that the *Daisytek* case was a main case.”<sup>37</sup> The courts in *DaisyTek* and *Eurofoods* undoubtedly knew that all or substantially all of the assets and operations of the subsidiaries they claimed for themselves were located in foreign countries.

What enabled the courts to claim those cases anyway was the virtually complete lack of content in the “center of main interests” test. That is hardly surprising; the drafters who chose the phrase have deliberately and continually refused to define it. The courts that interpreted the phrase were merely exercising latitude deliberately given them. Each claimed an economically important case for its own country. I doubt that another 40 days devoted to discovery and argument would change the results in many of these cases.

When courts compete for cases internationally, the stakes are higher than when courts compete domestically. If the Delaware court takes a Texas case, Texas lawyers can still play major roles. The same law and procedure – that of the United States – continues to govern the remedies available and the priorities of creditors. But if an English court takes a French case, French lawyers can have virtually no role at all and English law displaces French law with respect to remedies and priorities. The country that gets the case gets the business for its own professionals and can honor its own priorities and so prefer its own creditors.

Professor Fred Tung recently made the interesting observation that universalism is simultaneously a bad deal for every country involved.<sup>38</sup> Courts and countries care more about what happens within their borders than what happens outside those borders. Yet, universalism asks each country to give up control over events within its borders in some cases in return for control over events outside its borders in other cases. Tung argues that the irrationality of making this choice in favor of universalism renders universalism “impossible.”<sup>39</sup> I believe Tung will be proven correct in the long run. But the adoption of the EU regulation and the Model Law in some countries suggests that universalism might be able to do a lot of damage before its ultimate, inevitable rejection.

The all-or-nothing nature of the universalist venue decision puts each court to a choice. The court must either claim worldwide control over the company’s operations or give up control of the company’s domestic operations. Such Hobson’s choices make universalism an unstable, and hence an unpredictable, system.

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<sup>37</sup> Bufford Reply, *supra* note 18, at [41].

<sup>38</sup> Frederick Tung, *Is International Bankruptcy Possible?* 23 MICH. J. INT’L L. 31, 56-59 (2001) (distinguishing the states’ preferences).

<sup>39</sup> *Id.* at 102 (concluding that “[i]nternational bankruptcy is possible, but universalism probably is not.”).

In short, Judge Bufford bases his solution on his assumption that judges will be disinterested and unbiased – an assumption he makes little attempt to justify or explain. I base my concerns on the pattern of decision making, both in the U.S. and abroad, that shows bankruptcy courts to be biased in favor of their own jurisdiction in big bankruptcy cases. That bias frequently will provide case placers with alternative courts in different countries, each ready and willing to claim the same case. The case placers will have a choice of courts, and that choice will provide them with leverage over the courts even greater than they have in U.S. bankruptcies today.

## B. Locating Corporate Groups

Universalists claim as the main benefit of their regime that it will put each business reorganization or liquidation under the control of a single court. That court can reorganize the entire company worldwide, or sell the company as a single unit. Westbrook, for example, concedes that the argument for universalism

depends equally on a second assertion, that a universalist rule would so increase values available for all local claimants in all general defaults as to offset by far the losses that particular local claimants might suffer in some cases. That assertion is persuasive because the preservation of going concern values and the maximizing of liquidation values by integrated sales will likely increase returns to creditors greatly.<sup>40</sup>

The trouble is that neither the EU Regulation nor the UNCITRAL Model Law provide for company-wide reorganizations or sales. Most multinational companies are groups consisting of many legal entities based in several countries. Under either the EU Regulation or the UNCITRAL Model Law, the main proceeding for each of those entities will be at the COMI of the entity. Thus a different court potentially will control the bankruptcy of each entity in a corporate group. That would occur in nearly every multinational bankruptcy, and each time it did, no single court would have the power to order a worldwide reorganization or liquidation. The benefits of universalism would go unrealized.

Judge Bufford grasps the problem and concludes that the approach taken by the EU Regulation and the UNCITRAL Model Law are “unsatisfactory, because a corporate group that is an integrated economic unit can only be reorganized or liquidated efficiently if it is done collectively for the entire group.”<sup>41</sup> The sensible solution, he says, is to administer economically integrated group members in the home country of the integrated group, and to administer economically independent group members separately in their own home countries.”<sup>42</sup> Judge

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<sup>40</sup> Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 465 (1991).

<sup>41</sup> Bufford Reply, *supra* note 18, at [46].

<sup>42</sup> *Id.*

Bufford recognizes that this solution complicates the venue decision. The court making that decision must first divide the worldwide firm into groups of entities based on which are integrated with which.<sup>43</sup> Then it must determine the COMI of each integrated subgroup.<sup>44</sup>

### 1. The Subjectivity of “Economic Integration”

“Economic integration” as it is used here has no generally accepted definition.<sup>45</sup> Judge Bufford appears to propose as his test whether the entities in question are “able to operate separately.”<sup>46</sup> Judge Bufford claims that “this kind of decision will not likely arise often.”<sup>47</sup>

Under his test, venue would depend on which assets should be reorganized or liquidated together.<sup>48</sup> One need only examine a few cases to see that, contrary to his assertion, the issue would arise in virtually every big case. Did Eastern Airlines need its shuttle to survive? Should the more than one thousand funeral homes in the Loewen Group be kept together or liquidated separately? Was MCI so integrated into Worldcom’s finances and operations that it was

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<sup>43</sup> *Id.* at [53] (“It will be necessary first to define which legal entities form a part of the integrated economic unit for which the COMI decision is to be made.”).

<sup>44</sup> *Id.* (“The solution is to modify the COMI definition to provide that the corporate group venue decision be based on the collective COMI of all of the legal entities that operate together as an integrated economic unit.”).

<sup>45</sup> Use of the term “integration” in the international bankruptcy context apparently arises out of an unreported Canadian case, *Bramalea, Ltd.* The history is reported in Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 718-20 (1999).

<sup>46</sup> Bufford Reply, *supra* note 18 at [48]. (“This proposed rule would also not provide an easy solution for a company that is only partially integrated into the corporate group, and may or may not be able to operate separately.”).

<sup>47</sup> *Id.* Judge Bufford does not explain why he thinks this kind of decision would not arise often. It might be because he thinks few multinationals are economically integrated or because he thinks that when multinationals are economically integrated, the integration will be obvious. Based on my twenty-five years of studying the bankruptcies of large public companies, I think that most are economically integrated with at least some of their subsidiaries and that the integrations are subtle.

<sup>48</sup> Judge Bufford does not explain what he means by “economic integration.” The only clue he gives is a single reference to the ability to “operate separately.” *Id.* at [48]. The purposes of the integration test is to permit worldwide reorganization or liquidation when necessary to maximize values. That suggests courts should look to the necessity for such reorganizations or liquidations as the test.

impractical for the court to separate them? Should the pipelines of Enron have been reorganized together as a network, or sold off one by one? Each of these issues was core to a bankruptcy case. The issues were resolved by the companies' managers and professionals, in interactions with representatives of creditors and shareholders over periods of months or years. Often, the parties resolved them by taking a wait-and-see approach. Judge Bufford would have the bankruptcy court resolve them in 40 days at the beginning of the case – as a prerequisite to determining which court should have the case.

## 2. Bias in the Decision Making Process

Judge Bufford does not attempt to explain how judges would solve these problems in 40 days. He acknowledges that their decisions would be highly subjective.<sup>49</sup> But he argues that the venue decision the judge would have to make in such a system “is no different in kind from many others that judges are routinely required to make.”<sup>50</sup> If judges can implement vague standards such as “due process” or “equal protection,” he argues, they can implement “economic integration.”<sup>51</sup>

Here again, Judge Bufford assumes that judges will be unbiased in face of overwhelming evidence they will not be. In a universalist world, judges would be under pressure from their own governments to keep control of multinational companies whose reorganizations or liquidations have substantial domestic impact. In havens, such as Bermuda, the Cayman Islands, or Delaware, it would be policy to claim as many big cases as possible. Using an “economic integration” test, imaginative, biased judges could retain control over substantial portions of the companies whose cases were filed with them.<sup>52</sup> In the period before filing, the courts of more

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<sup>49</sup> *Id.* at [52] (“This proposed rule would also not provide an easy solution for a company that is only partially integrated into the corporate group, and may or may not be able to operate separately. This decision would turn on the facts of the particular case, which may call for a difficult judgment by the trial judge.”).

<sup>50</sup> *Id.* at [52].

<sup>51</sup> Westbrook makes a similar argument. *See* Westbrook, *supra* note 5, at 2316 (arguing that “principal place of business” and “center of main interests” are similarly vague, but that he is “unaware of any widely held view that [principal place of business] is so imprecise as to be impractical or to maim any important legal objectives.”). The simple answer to Westbrook’s argument is that in nonbankruptcy contexts, courts were quickly forced to answer the equivalent of my first question with respect to principal place of business. They decided that it was at the headquarters, not the place of incorporation or center of operations: the very answer Westbrook refuses to give in the bankruptcy context. That answer did make forum shopping possible, but in the context in which principal place of business was used, that forum shopping was not the system-debilitating problem that it would be in international bankruptcy.

<sup>52</sup> That is, countries that could not plausibly claim to be the debtor’s home country could decide the integration issue in such a manner that they could claim to be the home country of an

than one country would stand ready to take overlapping portions of any given case, again giving the case placers choices among courts. To attract cases, the courts – and in the case of international bankruptcy, the governments<sup>53</sup> – would have to offer the case placers a better deal than was offered by competing courts and governments. The bankruptcy courts and governments of the world would be locked in a race to the bottom. With venue the subject of what amounts to an auction at the time of bankruptcy, lenders would have no way of knowing what law would apply to their loans until the case placers announced the winning bid.<sup>54</sup>

### C. Changing COMIs to Manipulate Venue

Regardless which characteristics of a company determine a multinational’s COMI, the multinational can easily change them. In *Courting Failure*, I provide several examples, including Dreco Energy, which moved both its headquarters and center of operations from Canada to the United States in contemplation of bankruptcy,<sup>55</sup> Singer N.V., which moved its headquarters from Hong Kong to the United States in order to file bankruptcy here,<sup>56</sup> Commodore, which moved its headquarters and place of incorporation from the United States to the Bahamas for tax reasons before filing bankruptcy there,<sup>57</sup> and BCCI, which moved its headquarters from London to Abu Dhabi before filing bankruptcy at its place of incorporation in Luxembourg.<sup>58</sup>

Neither the EU Regulation nor the UNCITRAL Model law has provisions to deal with this threat. Both permit a debtor to file in the debtor’s new home country immediately after effecting a change. Judge Bufford recognizes that deficiency and proposes a “rule of residency”

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integrated subunit.

<sup>53</sup> Because federal law applies to domestic bankruptcy cases, state governments cannot participate in the domestic competition for bankruptcy cases. Under universalism, national laws would apply to multinational cases. Countries could compete for cases by enacting laws favorable to case placers.

<sup>54</sup> The most powerful lenders might contract for control of the venue decision. But they would use that control for their own benefit, not to guide cases to appropriate venues. See LOPUCKI, *COURTING FAILURE*, *supra* note 3, at 210 (“When billions of dollars are at stake, there are no free riders.”).

<sup>55</sup> *Id.* at 34 (describing Dreco Energy).

<sup>56</sup> *Id.* at 227-28 (describing Singer, N.V.).

<sup>57</sup> *Id.* at 199-200 (describing Commodore).

<sup>58</sup> *Id.* at 219-20 (describing BCCI).

to deal with it.<sup>59</sup> Rather than select a particular period, he proposes six months and one year as alternatives.<sup>60</sup> His ambivalence is understandable given the tendency for any period selected to be too long for some cases and too short for others. That is, some debtors are positioned such that they will be able to move their COMIs and wait out any residency period before filing. Even with a rule of residency in effect, they will be able to select the legal system most disadvantageous to their opponents. Other debtors will find themselves desperately in need of immediate relief in the months after moving their COMIs by acquisition, divestiture, integration, or disintegration. A rule of residency will drag them back into a forum that was appropriate six months or a year ago, but which now lacks any relevance at all.

For example, consider the circumstances of Derby Cycle as it faced bankruptcy in 2001.<sup>61</sup> Derby's COMI was probably at its headquarters in England or the location of its Gazelle subsidiary in the Netherlands (based on ultimate sale prices, the Gazelle assets were four times as valuable as Derby's other assets). Derby separated Gazelle, sold it, moved Derby's headquarters to the U.S., and filed bankruptcy in the U.S. a few months later. Assuming Derby's integration prior to the Gazelle sale, under Judge Bufford's rule of residency, the proper place for Derby's bankruptcy would have been in the Netherlands, even though at the time of bankruptcy Derby no longer had any connection with the Netherlands. Derby could not have waited out the six month residency requirement to file in the U.S. because the company needed immediate relief.<sup>62</sup> Had Judge Bufford's rule of residency been in effect, Dutch law would have governed the Dutch bankruptcy of a company with no Dutch connections.

Derby Cycle is an extreme example. But the problem illustrated in Derby would be present in every case in which a rule of residency applied. Every time the rule applied it would be to require that the bankruptcy take place in a country that was not the debtor's home country at the time of the bankruptcy.

Seeking to minimize the threat from COMI moves, Judge Bufford claims that “[m]oving the COMI of a corporate group such as General Motors, IBM, or General Electric out of the

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<sup>59</sup> Bufford Reply, *supra* note 18, at [55-57].

<sup>60</sup> *Id.* at [57] (“Six months is not a magic term: it could be any duration of time long enough to make it unlikely that a potential debtor would change its COMI on the eve of bankruptcy . . . . Indeed, a year may be a more appropriate duration.”).

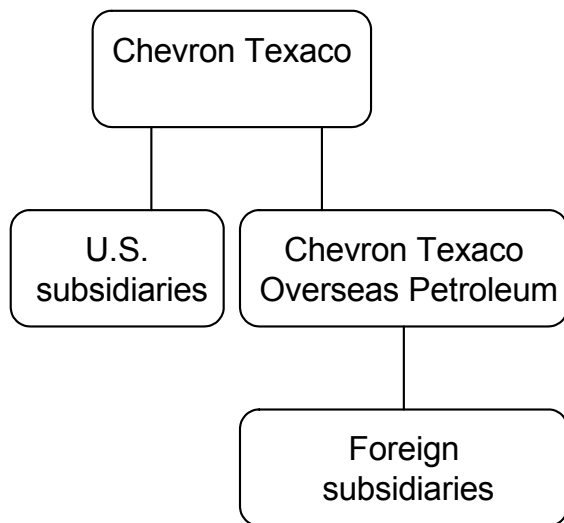
<sup>61</sup> LOPUCKI, COURTING FAILURE, *supra* note 3, at 229-30.

<sup>62</sup> Derby Cycle filed for bankruptcy on August 20, 2001. “The following day, the debtor’s attorneys filed a statement with the court stating that ‘debtor needs to consummate this sale no later than September 28, 2001’ and that ‘unless there is a sale by September 28, there is not likely to be a business to sell.’” LOPUCKI, COURTING FAILURE, *supra* note 3, at 172.

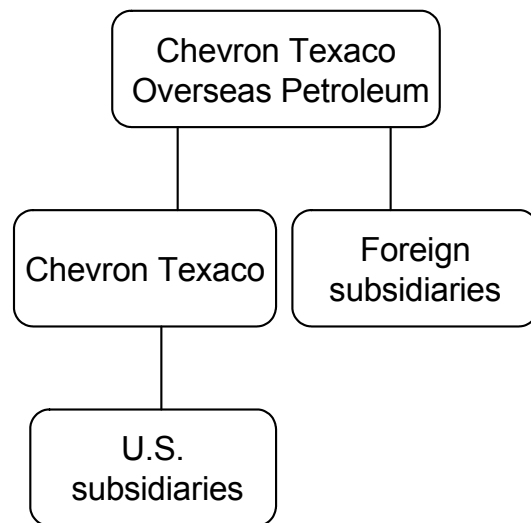
United States, or the COMI of Fiat out of Italy would be a formidable task.”<sup>63</sup> I disagree. Today each of these companies has a domestic parent company and numerous foreign subsidiaries. The foreign subsidiaries produce a substantial portion, if not most, of the group’s revenues. Each could easily become a putatively foreign company (putatively is sufficient with a biased judiciary) through an internal share exchange – without changing its operations in any way. In fact, many large U.S. companies have already done such transactions in order to “move” offshore for tax purposes. They include Tyco, Ingersoll-Rand, Global Crossing, and Fruit of the Loom.<sup>64</sup>

The figure shows a hypothetical restructuring by which Chevron Texaco could move offshore. Before the move, a first level subsidiary, Chevron Texaco Overseas Petroleum, holds the stock in the “foreign” subsidiaries. The restructuring makes that corporation the parent of the entire group. If it is not yet a foreign corporation, it reincorporates offshore. The former parent becomes the new parent’s “foreign” U.S. subsidiary. All assets, people, and operations remain exactly where they were. Such “moves” are effective to defeat U.S. taxation. Why would they not be effective to defeat U.S. bankruptcy?

### Before moving offshore



### After moving offshore



The rule of residency causes no great problems in domestic U.S. bankruptcy cases. That

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<sup>63</sup> Bufford Reply, *supra* note 18, at [52].

<sup>64</sup> See, e.g., DAVID CAY JOHNSTON, PERFECTLY LEGAL: THE COVERT CAMPAIGN TO RIG OUR TAX SYSTEM TO BENEFIT THE SUPER RICH- AND CHEAT EVERYBODY ELSE 229-33 (2003) (describing the restructurings and referring to them as “corporate inversions”).



does not, however, mean that the rule of residency would not wreak havoc in international cases. The difference is that a domestic bankruptcy proceeds according to essentially the same law regardless of the state in which it is adjudicated. The same would not be true of an international case. A change of COMI would mean a change of legal systems and perhaps even language.

When the rule of residency is combined with the integration doctrine – as Judge Bufford proposes<sup>65</sup> – another bizarre system characteristic emerges. One of the ways a company could forum shop in a universalist system with an integration rule would be integrate or disintegrate in contemplation of bankruptcy. Integration, for example, could be accomplished simply by commingling the assets of separate entities in such a manner that substantive consolidation would be appropriate. (Worldcom did precisely that shortly after acquiring MCI.)

Judge Bufford's rule of residency would apply to forum shopping by integration or disintegration. That means courts would have to decide not what parts of the company are so integrated that they must be reorganized or liquidated together, but rather what parts were so integrated six months ago. That would lead to an absurdity: reorganizations could not take place where necessary at the time of reorganization, but only where they were necessary months before reorganization.

## II. Comparing Universalism and Territoriality

On one point, everyone in the universalism-territoriality debate agrees. The international bankruptcy system can be a success only if it is predictable. Credit extenders need to know, at the time of their extensions, what nation's laws and procedures will determine their recovery rights. As Judge Bufford put it:

Parties undertake economic transactions for their own benefit. In calculating the expected benefits, they are assumed to take into account the legal systems and rules that will likely govern how the transactions are carried out and the benefits are allocated. In addition, the parties must evaluate the risks incurred, including how these risks will be handled under the applicable legal system. If it is uncertain what legal system will govern the risks, it is difficult to quantify the risks. Where the distribution rules of legal systems are different, the ultimate beneficiaries of transactions may be different from what the parties anticipated *ex ante*. Thus the application of varying distribution rules may result in the parties having entered into sub-optimal transactions, and left them poorer than they would have been otherwise.<sup>66</sup>

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<sup>65</sup> Bufford Reply, *supra* note 18, at [54-55] (arguing that multinationals will not be able to forum shop by integration or disintegration solely because the transactions necessary would have “complex and subtle” undesirable consequences).

<sup>66</sup> Bufford Reply, *supra* note 18, at [13-14].

Judge Bufford echos other writers in claiming that universalism will provide this necessary predictability.<sup>67</sup> He does not, however, attempt to explain how.

#### A. Unpredictable Universalism

Professor Jay L. Westbrook, perhaps the world's leading universalist, is more modest regarding universalism's claim regarding predictability. Commenting on COMI as the test for international venue, Westbrook and his co-authors stated:

In those cases where the test does present difficulty, there may well be a "race of creditors" to have a proceeding opened in a favorable forum. Not too much has been lost, because *creditors have had in any event to assume that more than one possible forum exists*. At least the possible fora have been limited to those which can fairly assert jurisdiction on the basis that they are the center of the firm's main interests; that is to say, the test still imposes some limitation on the possible fora . . .<sup>68</sup> [emphasis added]

The picture Westbrook paints is still too rosy by several shades because Westbrook has not yet addressed the corporate group problem.<sup>69</sup> The universalist claim that the identity of the "home country" will be obvious in most cases rings particularly hollow with respect to corporate groups. Nearly every international company is a corporate group doing business in particular countries through subsidiaries specific to those countries.<sup>70</sup> As to this most basic multinational business form, the universalists are unable to say whether the subsidiary's home country is the country from which the parent operates the subsidiary or the country where the subsidiary is incorporated and has substantially all of its assets and operations. *DaisyTek*, *Eurofoods*, *Ciro del Monte*, and *Enron Directo* are examples.

When confronted with the horrible examples that would result from application of universalist principles, supporters of the Model Law are quick to point out provisions they assert would authorize an ad hoc return to territoriality for the particular case. Judge Bufford does this more than once. In *Courting Failure*, for example, I present the horrible of a Mercedes Benz bankruptcy with a German court applying German law to the claims of U.S. and Mexican customers and employees. Accepting the horror of it, Judge Bufford argues that it could not

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<sup>67</sup> *Id.* at [68] ("[T]he Model Law . . . embodies a version of modified universalism that will . . . lead to less distortion in investment decisions because it is more predictable ex ante.").

<sup>68</sup> Donald T. Trautman, Jay Lawrence Westbrook & Emmanuel Gaillard, *Four Models for International Bankruptcy*, 41 AM. BANKR. L.J. 573, 582 (1991).

<sup>69</sup> See *supra* note 11 (Westbrook declining to address the corporate group problem in universalism).

<sup>70</sup> Bufford Reply, *supra* note 18, at [49] ("Professor LoPucki correctly points out that virtually all multinational corporate empires are corporate groups . . .").

happen because “a secondary case . . . would surely be filed in the United States” and “would administer U.S. assets and deal with U.S. problems relating to employees and customers.” In other words, the system would return to territoriality. But a universalist who is unwilling to send U.S. customers, employees, and suppliers to file their claims in Germany and have them decided by a German court applying German law belongs on the other side in this debate. Giving a single court control worldwide – and thus overriding the law and languages of other countries – is the very essence of universalism.

Judge Bufford’s reversion to territoriality for my hypothetical Mercedes Benz case, provides the perfect illustration of the unpredictability of the Model Law. Anyone lending to Mercedes in the United States or Mexico under the Model Law could know what law would apply to their claim only by knowing what secondary proceedings would later be filed. If the drafters of the Model Law knew that, they could simply have deemed those cases filed. They did not do so because they didn’t know. Neither will future lenders.

The changes to universalism Judge Bufford proposes not only highlight that system’s unpredictability, they would increase it. His proposal to delay identification of the main proceeding pending actual notice and a hearing, will make the system territorial until the court rules after notice and a hearing.<sup>71</sup> The economic integration test he proposes will be complex and subjective in application, adding more uncertainty.<sup>72</sup> His proposed rule of residency recognizes that the COMIs of multinational companies change and his uncertainty as to the appropriate time period – he proposes both six months and one year – makes clear that the rule is only designed to make a rough separation between innocent and manipulative COMI changes.<sup>73</sup> Credit extenders, however, cannot live with a system in which one country’s laws govern worldwide and that country is selected only at or around the time of filing. Credit extenders need to know when they lend, at least in rough terms, whether their collection efforts will be governed by the laws of the United States, Bermuda, Britain, or Burundi.

## B. Predictable Territoriality

Cooperative territoriality can provide greater predictability. Under that system – essentially the system that is operating in the world today – bankruptcy administration of a multinational’s assets and operations within a given country is governed by the laws of that country. That is the law credit extenders expect at the time when they lend.

Assets and operations can move from one country to another. Those moves, however, are generally limited to a small portion of the debtor’s assets, they occur incrementally, and they are highly visible. In today’s territorial system, eve-of-bankruptcy transfers can alter creditor

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<sup>71</sup> *Supra* Part I.A.1.

<sup>72</sup> *Supra* Part I.B.1.

<sup>73</sup> *Supra* Part I.C.

priorities, but *only in the assets transferred*. In a universalist system the same transfers could alter creditor priorities *in all the debtor's assets* if it changed the debtor's home country.<sup>74</sup> In a territorial system, the creditors disadvantaged by a transfer are in the country from which the assets are removed, giving them a chance to anticipate the transfer and prevent it. In a universalist system, creditors in country A could lose their priority by transfer of assets from country B to country C. The disadvantaged creditors might have no way to discover, anticipate, or oppose the transfer.

Even when eve-of-bankruptcy transfers are made, those transfers seldom have any effect on ultimate creditor recoveries in the current, territorial system. Victims of the transfer can file claims in the country to which the transfer was made and reach the assets indirectly. That country will probably apply the "hotchpot" rule,<sup>75</sup> paying each general creditor, regardless of nationality, the amount necessary to effect a worldwide pro-rata distribution. Only in the case where the transfer is from a country where insufficient assets remain to pay local priority claims or to a country that before the transfer did not have sufficient assets to pay local priority claims is the transfer likely to affect creditor entitlements.<sup>76</sup>

Judge Bufford argues that universalism will reduce the costs of participation and administration of bankruptcy cases.<sup>77</sup> In a cooperative territorialist regime, he points out, it might be necessary to file a case in each country where the debtor had significant assets.<sup>78</sup> But

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<sup>74</sup> In a universalist system a debtor could change its home country without the transfer of any assets at all. For example a debtor with equal operations in each of two countries could move its COMI from one to the other simply by shifting its place of incorporation and its chief executive officer.

<sup>75</sup> Jay Lawrence Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles, and The EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1, 18 (2002) ("A creditor that receives a distribution in a foreign insolvency proceeding must stand aside in a local distribution until creditors of the same class (under local law) have gotten as much from the local proceeding as the first creditor got from the foreign one.").

<sup>76</sup> A creditor could also be adversely affected by a transfer if the transfer were to a country that discriminated against general creditors on the basis of nationality. Such countries are rare if they exist at all.

<sup>77</sup> Bufford Reply, *supra* note 18, at [12] (arguing that "multiple bankruptcy cases tend to defeat the benefits of collective action by multiplying the costs of participation and administration"); *id.* at [17] (claiming that "the bankruptcy costs are enormously multiplied by the necessity of parallel insolvency cases in each country").

<sup>78</sup> *Id.* at [16] ("Each jurisdiction requires a separate administration, separate filing and evaluation of claims, and separate prosecution of litigation.").

Judge Bufford also acknowledges that the same would be true in a universalist regime.<sup>79</sup> The administrator appointed in the home country court would need to initiate ancillary proceedings in each country where the debtor has assets and operations to obtain local recognition of the main proceeding and necessary cooperation.<sup>80</sup> Whether the ancillary proceedings required in a universalist system would be less costly and contentious than the plenary proceedings required in a territorial system is anybody's guess.

In a cooperative territorialist regime, each court would appoint an administrator. When international cooperation was needed, it would occur by agreement among the administrators. Judge Bufford complains that I “point[] to no inducements that would lead to . . . cooperation” among those administrators.<sup>81</sup> The inducements are obvious. If the assets of the multinational would bring a higher price if sold together, it will be in the interests of the administrators to sell them together and split the additional proceeds among them. Judge Bufford asserts that “none of this kind of cooperation has taken place in the past.”<sup>82</sup> In saying this he ignores dozens of cases in which the courts have agreed to “protocols” that provide international cooperation. They include Maxwell Communications, Commodore International, ICO Global Communications, Inverworld, Olympia & York, Everfresh, Solvex, and Loewen Group. As Professors Elizabeth Warren and Jay L. Westbrook put it, “Protocols have become enormously important in cross-border cases.”<sup>83</sup> In *Stonington Partners Inc. v. Lernout & Hauspie Products, N.V.* the Third Circuit Court of Appeals endorsed a “dialogue” between the Delaware and Belgian courts as the best means for resolving a conflict in priorities between U.S. and Belgian law.<sup>84</sup> In these protocols, representatives of involved countries agree to procedures or substantive moves that are mutually beneficial. In many other cases, protocols are unnecessary because the foreign administrator seeks and receives the cooperation of other countries in ancillary proceedings. For example, the practice has developed in U.S.-Canadian cases of obtaining U.S. cooperation –

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<sup>79</sup> *Id.* at [14] (“However, modified universalism recognizes that the main case may need support through secondary or ancillary cases in other countries where assets are located or local court support is otherwise needed.”).

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at [18].

<sup>82</sup> *Id.*

<sup>83</sup> Elizabeth Warren & Jay L. Westbrook, *Court-to-court Negotiation*, 22-9 A.B.I.-J. 28, Nov. 2003. A collection of these protocols is available on the International Insolvency Institute website at <http://www.iiiglobal.org/international/protocols.html>.

<sup>84</sup> *Stonington Partners, Inc. v. Lernout and Hauspie Speech Products, N.V.*, 310 F.3d 118 (3rd Cir. 2002). In its opinion, the Third Circuit cited Judge Bufford's book, SAMUEL L. BUFFORD, LOUISE DECARL ADLER, SIDNEY B. BROOKS, & MARCIA S. KRIEGER, *INTERNATIONAL INSOLVENCY* (2001).

including orders by which the U.S. court confirms the Canadian plan – under Bankruptcy Code §304.<sup>85</sup> Changes in the domestic laws of some countries are needed to maximize this kind of cooperation, but the territorial system is already functioning reasonably well. Neither Judge Bufford nor other writers present any examples of reorganizations or liquidations adversely affected by the failure to reach international agreements.

In a last-ditch effort prove universalism workable, Judge Bufford claims that the system operating in the world today is modified universalism. He then claims that the current system’s success proves universalism workable.<sup>86</sup> He is merely playing a word game. Universalism – defined as a system in which the court of the home country has worldwide control – has never been tested anywhere but in the European Union. If “modified universalism” does not require the identification of a home country and deference to the decisions made by the home country’s courts, I have no objection to it. But Judge Bufford is not arguing to keep the system that has been working reasonably well in recent years. He is arguing to change it by adoption of the Model Law.<sup>87</sup>

### C. Maruko

As his example of the failure of territoriality, Judge Bufford selects the Japanese role in the Maruko case.<sup>88</sup> As I discussed in *Courting Failure*, Maruko filed a bankruptcy case in Japan and then filed a parallel bankruptcy case in the United States.<sup>89</sup> The extraterritorial stay gained by the U.S. filing prevented Australian banks from foreclosing on Maruko’s hotel properties in

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<sup>85</sup> E-mail from Bruce Leonard, partner in the Canadian Law firm of Cassels and Brock, <http://www.casselsbrock.com/profiledetail.asp?sid=178> to Lynn M. LoPucki, March 6, 2005 (on file with the author); email from Bruce Leonard, partner in the Canadian Law firm of Cassels and Brock to Lynn M. LoPucki, March 17, 2005 (on file with the author) (“One imponderable with this type of Section 304 Order arises because virtually all of them have been consensual. Virtually none, if any, have been contested.”).

<sup>86</sup> Bufford Reply, *supra* note 18, at [34] (claiming that “[u]niversalism permitted the coordinated collection of assets, assessment of claims, sale of the business including its international subsidiaries, or whatever other procedures could lead to the successful reorganization (including liquidation) of these businesses.”). Some of the businesses Bufford lists as supposedly saved by universalism emerged from bankruptcy prior to the adoption of the first universalist law. The remainder are still in bankruptcy, making Bufford’s claim premature.

<sup>87</sup> *Id.* at [68] (“I heartily recommend the Model Law (again with the recommended revisions) as a solid basis for cooperation between countries . . .”).

<sup>88</sup> *Id.* at [17-18] (“Examples abound of the lack of cooperation by courts applying territorialist laws. The Japanese Maruko case is a good example.”).

<sup>89</sup> LOPUCKI, *COURTING FAILURE*, *supra* note 3, at 189-91.

Australia. Judge Bufford celebrates this outcome:

Under the territorial regime then in place in Japan, the Japanese administrator took no interest in preserving for creditors the substantial value residing in the uncompleted condominium project in Australia. This value was protected only by the United States creditors, acting through a United States chapter 11 case, under which they persuaded the international bank to honor in Australia the United States automatic stay. Thus the universalist solution provided by United States bankruptcy law achieved a much larger return for creditors than could be achieved through the territorial Japanese law.<sup>90</sup>

I see Maruko differently. What he refers to as persuasion was actually intimidation. The United States did not discover and rectify some fault in Australian law. Australian law – not unlike U.S. law today with respect to mortgages against principal residences<sup>91</sup> – deliberately favored the mortgage lender because Australian lawmakers believed that made more secured credit available. All the U.S. filing did in Maruko was to substitute a U.S. public policy for an Australian public policy. No value was created by the U.S. stay. What it did was change creditors' entitlements in a manner those creditors could not have anticipated.

The Maruko transaction was entirely domestic to Australia – a loan made in Australia by Australian banks secured by Australian condominiums. When the banks made their loan, they undoubtedly expected that Australian law would apply, and fixed the terms accordingly. When Maruko's lawyers hit on the brilliant strategy of filing a U.S. case to get an Australian stay that the Australian courts would not give, it came as a shock and surprise in international bankruptcy circles. That is why Maruko has received so much attention.<sup>92</sup>

Maruko demonstrates the unpredictability of universalism. In a world where nations feel free to impose their bankruptcy laws on foreign transactions retroactively, it becomes impossible to predict what law will be applied to an entirely domestic transaction. Knowing the nationality of the borrower does not solve the lender's problem, because the borrower can easily change its nationality after the lender disburses.

#### D. Advantages of Territoriality

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<sup>90</sup> Bufford Reply, *supra* note 18, at [17-18].

<sup>91</sup> See, e.g., *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993) (holding that a chapter 13 debtor cannot modify even the unsecured portion of a debt secured only by the debtor's principal residence).

<sup>92</sup> See, e.g., Kent Anderson, *The Cross-Border Insolvency Paradigm: A Defense of the Modified Universal Approach Considering the Japanese Experience*, 21 U. PA. J. INT'L ECON. L. 679 (2000); Arnold M. Quittner, *Cross-Border Insolvencies – Ancillary and Full Cases: The Concurrent Japanese and United States Cases of Maruko Inc.*, 4 INT'L INSOLVENCY REV. 171 (1995).

Judge Bufford strains to make my proposal for a cooperative territorial regime dependent on treaties and conventions.<sup>93</sup> I repeat here that it is not. The great advantage of territoriality over universalism is that territoriality requires no cooperation beyond that which already occurs. Territoriality also provides a stable platform for treaties and conventions dealing with specific opportunities for mutual benefit, such as the return of fleeing assets.<sup>94</sup>

Judge Bufford argues that opening the necessary proceedings would be faster in a universalist system than in a territorial one.<sup>95</sup> He correctly notes that under the EU Regulation, “the opening of a main insolvency case is automatically effective throughout the EU immediately.”<sup>96</sup> Here, he seems to have forgotten that in the same article, he proposes to eliminate that immediate effect in order to provide due process with respect to the location of the COMI.<sup>97</sup> In this respect, territoriality offers the best of both worlds. Each country is free to open proceedings as quickly or as slowly as the country chooses.

### III. Conclusions

Although Judge Bufford addressed the second and third of my questions in his reply, he did not address the first: “When the principal assets, operations, headquarters, and place of incorporation are in different countries, which is the “home country?”<sup>98</sup> Universalists ignore this question because they cannot provide a coherent answer. The world’s economy is globalizing. The links between multinational companies and countries are becoming increasingly tenuous. Because universalism depends upon the existence of a dominant link to a single country for every multinational company, globalization has already rendered universalism obsolete and unworkable.

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<sup>93</sup> Bufford Reply, *supra* note 18, at [17] (“Professor LoPucki states that there are two ways to achieve cooperation. First, countries will need to cooperate on a variety of matters through treaty or convention.”).

<sup>94</sup> LoPucki, *supra* note 45, at 758-59 (arguing that in a territorial system countries would find it in their common interests to enter into treaties requiring the return of assets fleeing imminent bankruptcy cases).

<sup>95</sup> Bufford Reply, *supra* note 18, at [20-21] (“The substantial delays in opening a case (which would be required in a territorial system), as well as the other delays inherent in a territorial system, are avoided altogether.”).

<sup>96</sup> Bufford Reply, *supra* note 18, at [20].

<sup>97</sup> Bufford Reply, *supra* note 18, at [42] (“The timing of [the decision on the location of the COMI] need to be delayed to a certain extent, so that the quality of the evidence for the decision can be improved and the parties in interest can be heard.”).

<sup>98</sup> *Supra* note 4 and accompanying text.



The problem is not merely that companies will forum shop in close cases. Even under the current system, companies that *do* have strong ties to particular countries nevertheless choose to file in other countries.<sup>99</sup> Universalism will accelerate this trend because the incentives for forum shopping would be greater. As it becomes apparent that the COMI standard is inadequate to control forum shopping, the incidence of forum shopping will increase. Such a progression occurred with respect to forum shopping in the United States. As case placers slowly came to the realization that courts would not transfer their cases back to their local courts,<sup>100</sup> domestic forum shopping increased from 20-30% in the early 1980s to an astonishing 60-70% in recent years<sup>101</sup> – without any change in the law.

Universalist are trying to bring their system in through the back door.<sup>102</sup> The UNCITRAL Model Law was negotiated by a delegation led by universalist Jay L. Westbrook, and then sold to Congress as not really universalist.<sup>103</sup> At the Congressional hearing, only supporters of the Model Law were permitted to testify.<sup>104</sup> Sensing imminent victory, the universalists have sought to avoid debate. I commend Judge Bufford for breaking ranks with the

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<sup>99</sup> They include Yukos (company with substantially all assets in Russia obtains injunction from a U.S. court), Cenargo (foreign creditor had to violate the U.S. automatic stay to prevent debtor with no U.S. assets or operations from reorganizing in the U.S.), Avianca (Columbian national airline reorganizes in U.S. court), National Warranty Insurance (entirely U.S. company transfers all assets to the Bahamas to liquidate there), ICO Communications (England-based company reorganizes in U.S. and offshore havens), Global Ocean Carriers (shipping company with no assets or operations in the U.S. reorganizes in the U.S.), and Divi Hotels (Caribbean hotel company reorganizes in the U.S.), TV Filme (Brazil’s largest cable company reorganizes in the U.S.), and Seven Seas Petroleum (company with substantially all assets in South America reorganizes in the U.S.).

<sup>100</sup> See 28 U.S.C. § 1412.

<sup>101</sup> For the five years ending in 2004, 221 of 342 large public companies (64.6%) filed away from the company’s headquarters. Lynn M. LoPucki, Bankruptcy Research Database, available at <http://lopucki.law.ucla.edu> (select 2000-04 under “A. Filing Years” in Step 1 and “G. Forum Shopping” in Step 3.).

<sup>102</sup> LOPUCKI, *COURTING FAILURE*, *supra* note 3, at 214 (“Universalism Comes in the Back Door”).

<sup>103</sup> See, e.g., Jay Lawrence Westbrook, *Fearful Future Far Off*, *BANKRUPTCY COURT DECISIONS*, March 30, 1999, at 5 (“The Model Law does not make the terrible changes that [LoPucki] suggests. He would be closer to right if the Model Law really did embody “universalism,” which I regard as our ultimate ideal.”).

<sup>104</sup> See *Grassley Holds Hearing*, *supra* note 15 (identifying the four witnesses who testified in favor of the law and describing their testimony).

other universalists and engaging with the issues.

I am puzzled, however, by Judge Bufford's support for the adoption of the Model Law in its current form.<sup>105</sup> He is not alone in seeking to adopt universalism first and figure out how to make it work later. In *Courting Failure*, I speculate that some universalists are endorsing universalism with full knowledge of the havoc it will wreak in international bankruptcy. Their goal is to use that havoc as leverage to force the rapid harmonization of the world's bankruptcy systems. The assumption seems to be that harmonization will be on American terms, with the U.S. getting the bulk of the cases. I do not think Judge Bufford so Machiavellian that could be his motive. But I do wonder why he approves the adoption of a law whose serious flaws he so clearly perceives.

Judge Bufford's reply, together with this response, demonstrates the unworkability of universalism. The vagueness of the COMI test, combined with the pressures on courts to claim big cases, will generate a competition more destructive than the competition that is corrupting the U.S. bankruptcy courts. As in the U.S., the beneficiaries will be the case placers – the companies' executives, professional advisers, and post-petition lenders. As in the U.S., the case placers will use their leverage not for the benefit of their companies, but for the benefit of themselves. Courts will be powerless to impose restrictions. If some courts try, the cases will go elsewhere. The losers will be the creditors, suppliers, employees, investors, the companies themselves, and perhaps most of all, the bankruptcy judges. They will lose their ability to enforce any restriction on case placers that another country is willing to waive.

A vibrant, territorially-based system for international cooperation is already in place. When international cooperation is required, the parties either file parallel bankruptcy cases in the countries involved and agree on protocols for joint administration or file ancillary proceeding and receive the cooperation needed by consent. Universalists have provided no examples of cases in which reorganization or liquidation efforts failed for lack of cooperation. Nor can they explain how the universalist system they propose will work. Don't let the universalists drag us over the edge of the cliff.

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<sup>105</sup> Bufford Reply, *supra* note 18, at [6] (“I support the adoption of the domestic version of the Model Law as chapter 15 of the U.S. bankruptcy code.”); *but see id.* at [69] (“Absent an EU Regulation type of regime, I heartily recommend the Model Law (again with the recommended revisions) as a solid basis for cooperation between countries . . .”).