

## GREATER USE OF INTERNATIONAL ARBITRATION IN CROSS-BORDER INSOLVENCY CASES

An Address Given By Zack A. Clement to the UNCITRAL Congress  
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### PUBLIC POLICY

The International Insolvency Institute (“III”) recommends that UNCITRAL take its largest success, the New York Convention<sup>1</sup> concerning enforcement of arbitral awards and make clear its application to international insolvency disputes. The New York Convention has been ratified by over 140 countries, each of which promises to enforce international arbitral awards in its national courts without reexamining those awards for substantive correctness, subject to a public policy exception.

It is a central fact of insolvency practice that debtor companies are generally worth more as a reorganized going concern than they are liquidated. As with people, companies are generally worth more alive than dead. To achieve reorganization, it is important that the primary (main case) bankruptcy court have adequate power to enforce its orders. The New York Convention can help supply that power.

### PRIOR UNCITRAL ACTIONS

UNCITRAL has already twice addressed the international insolvency process in: (1) the UNCITRAL Model Law on Cross-Border Insolvency and (2) the UNCITRAL Legislative Guide on Insolvency Law. In the Model Law, UNCITRAL proposed that bankruptcy cases concerning companies with assets and operations in many countries have one “main case” in the country where the debtor has its “center of main interest,” with numerous ancillary (non main) cases in other countries to cooperate with the main case. The Model Bankruptcy Law acknowledges cultural and legal differences by providing that an ancillary case court need not send money to, or cooperate with, a main case if to do so would violate its public policy.

To reduce the chances that there would be public policy reasons not to cooperate with a main case, UNCITRAL also published its Legislative Guide for Insolvency Law to encourage a similar approach among the various nations in their public policy and laws concerning bankruptcy and insolvency.

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<sup>1</sup> The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958)

While the UNCITRAL Model Law has been adopted as a European Union Regulation and has been adopted as part of the national bankruptcy law in the United Kingdom and the United States, it has to date been adopted in fewer than fifteen countries. The UNCITRAL Legislative Guide has been the basis for legislation in fewer than ten countries. Until these two UNCITRAL Model Law initiatives spread further, the New York Convention stands as the best currently existing source of power to aid a main case bankruptcy court in the enforcement of its orders around the world.

Of course, arbitration is premised on the agreement of the parties to arbitrate disputes, as opposed to the coercive power of a court to assert and exercise jurisdiction over parties, adjudicate disputes, and enforce orders. However, it is easy to envision how parties might agree to arbitrate a wide array of insolvency disputes.

### **ARBITRATION OF CLAIMS ALLOWANCE DISPUTES**

The simplest and easiest to understand are claims allowance disputes. These are essentially disputes between the debtor and a claimant who wishes to share in a pro rata distribution of the debtor's assets. For instance, a claimant might assert a contractual right to payment of \$10 million, the debtor might contest saying it only owes \$1 million, and the bankruptcy court will decide what the amount of the allowed claim shall be.

If the main bankruptcy case is in Berlin and the debtor has substantial operations and creditors in Brazil, for example, it is easy to see why Brazilian creditors might prefer to arbitrate their claims allowance disputes in Brazil, rather than have to come to Berlin to fight about the size of their claims. By contrast, if the German debtor is concerned that a Brazilian creditor will not abide by the claims allowance decision of the main case bankruptcy court in Berlin, and may attempt to pursue collection on the contested \$9 million portion of the claim in Brazil, then the debtor will have ample reason to agree to arbitrate such claim allowance disputes in a location convenient enough to the foreign creditor to induce it to agree to arbitrate.

Arbitration of certain claims allowance disputes will not present a threatening intrusion on bankruptcy court jurisdiction. The debtor would not be able to agree to arbitrate claims allowance disputes without permission of its bankruptcy court, thus, the bankruptcy court will ultimately be able to decide whether to allow this portion of its jurisdiction to be exercised by an arbitral panel. As claims allowance issues present few issues of significant bankruptcy policy, bankruptcy courts have little reason not to grant a debtor's request to send certain claims allowance disputes to arbitration.

### **ARBITRATION OF DISPUTES ABOUT VIOLATIONS OF BANKRUPTCY COURT ORDERS**

Arbitration could also be useful to resolution of disputes concerning alleged violation of main case bankruptcy court orders concerning debtor financing, such as court orders authorizing

loans to debtors (giving the lender liens senior to existing liens) or authorizing sale of assets (with liens to be taken off the assets sold and applied to the sale proceeds). Such orders involve substantial questions of bankruptcy policy. They enhance a debtor's ability to obtain loans and to sell assets for a higher price. They must often be entered quickly if a debtor is to receive financing necessary to survive as a going concern. We do not suggest that entry of such orders be referred to the arbitral process. However, it is of significant concern to the debtor and the court (as protector of the bankruptcy process) that these orders be respected and enforced.

Here again, there are ample reasons for both the debtor and a party alleged to have asserted a lien in violation of such an order to agree to arbitrate the dispute about whether such a breach has occurred and how it shall be remedied. The alleged breaching party will probably not wish to appear in front of the court whose order it is alleged to have violated. The debtor may have concern about the enforceability of a bankruptcy court order finding that a lien is being enforced in violation of a prior court order, requiring that the breach cease, and ordering money damages for the breach. Thus, there are good reasons for both the debtor and the alleged breacher of a main case financing order to agree to arbitrate disputes about such breaches.

Here again, with arbitration of certain issues about violation of these types of bankruptcy court orders, there is no threatening intrusion on bankruptcy court jurisdiction. These disputes are essentially two party disputes between the debtor and the alleged breacher and do not themselves involve questions of bankruptcy policy. Again, a debtor will only be able to agree to arbitrate such disputes if its bankruptcy court gives it permission to do so. Thus, ultimately the bankruptcy court will remain in charge of how much of its jurisdiction over these issues it permits to be referred to an arbitral panel.

A very interesting sub-question is presented concerning consent to arbitration. Generally, when a creditor files a claim in a bankruptcy case it submits to bankruptcy court jurisdiction to decide that claim and to decide any counterclaims the debtor has against the claiming creditor. This submission to jurisdiction is a well recognized part of bankruptcy law, jurisdiction and practice. Many creditors take it so seriously that they refrain from filing claims to avoid submitting to bankruptcy court jurisdiction concerning fraudulent conveyance counter-claims back against them. Given the gravity already attached to forcing a creditor to file a claim and submit to bankruptcy court jurisdiction (including jurisdiction over counterclaims), I think it appropriate for a bankruptcy court to order that, if a party files a claim, it agrees to arbitrate any disputes that would have been within the bankruptcy court's jurisdiction to decide, and that the bankruptcy court decides to refer to arbitration.

## ARBITRATION OF DISPUTES BETWEEN ESTATES

Next, there are already developing a number of disputes under the UNCITRAL Model Law between various bankruptcy cases of the same multi-national debtor that are under the jurisdiction of bankruptcy courts in numerous countries. Not surprisingly, a number of disputes have arisen about which country is actually the center of main interest; which court is really in

charge. These disputes are often surrogates for the question of what public policy in which country's bankruptcy law will determine reorganization versus liquidation and the priority of creditor claims.

The UNCITRAL Model Law encourages bankruptcy courts presiding over the numerous cases in different countries for the same debtor to coordinate through any methods they find appropriate. Various organizations are pursuing model protocols for inter-court cooperation, such as for example, the American Law Institute/International Insolvency Institute Project on Inter Court Communications. If a multinational debtor and its creditors find themselves embroiled in a difficult dispute about which court ought to have the main case (the debtor having chosen to file its main case in one country and its creditors thinking the main case should go forward in another country), these two parties might ask the two courts to establish a protocol that would refer this dispute to an arbitral panel. Indeed, the courts themselves might propose this as they confer as contemplated by the UNCITRAL Model Law.

Similarly, disputes may arise where a main case court orders that assets be sent to it for distribution from an ancillary case court and the ancillary case court refuses to do so because of public policy concerns about how the assets will be distributed. Here again, either at the suggestion of the debtor and creditor parties, or on the initiative of the courts involved, the courts may agree upon a protocol to refer these issues to arbitration. In each of these examples, the bankruptcy courts will plainly remain in control of what part of their decision making authority will be referred to an arbitral panel.

## ARBITRATION OF BREACHES OF BANKRUPTCY LAW CAUSED BY ASSET EXPROPRIATION

Another issue that might be appropriate for arbitration is presented by asset expropriations which have occurred with greater frequency in recent years. In many cases, these expropriations may violate local foreign investment laws and bilateral investment treaties ("BIT's") and, therefore, give rise to arbitrations about whether and how much compensation is owed that may occur in many possible for an including ICC, LCIA, AAA and ICSID.

If these expropriations occur after the owner of the asset has filed a bankruptcy case, they might also violate applicable bankruptcy law. A significant issue will be presented about whether claims for breach of the bankruptcy law, which might be very straightforward, clear and easy to prove, should be decided in the bankruptcy court or referred to an arbitral panel to be decided along with the claim for violation of the appreciable foreign investment law or BIT.

## ARBITRATION OF CENTRAL BANKRUPTCY ISSUES

Finally, it is entirely possible that one of the most fundamental bankruptcy questions could be submitted to arbitration, the question of the proper re-allocation of the enterprise value of an insolvent large public company between its secured bank lenders, unsecured bond debt

(represented by an indenture trustee) and shareholders (represented either by the company, which owes them fiduciary duties, or by a committee with powers to bind them). General unsecured creditors would be left unaffected. While this is the most significant core function of a bankruptcy case, there is no reason why these three groups could not agree to submit their restructuring dispute to one or more arbitrators with many years of experience in the insolvency field. This would not be much different from what currently happens in many pre-packaged plans of reorganization where the major parties pre-negotiate a plan of reorganization, then file a bankruptcy case asking the bankruptcy court to approve it. Here the parties could litigate before an arbitral panel their various legal and fact arguments about how a restructuring plan should come out, presumably negotiating simultaneously how these issues might be settled. The arbitral process would result in either an order from the arbitral panel telling the parties the answer to their dispute or an agreed arbitral award resulting from settlement.

## REQUEST FOR ESTABLISHMENT OF A UNCITRAL INSOLVENCY ARBITRATION COMMISSION

III asserts that it would be good public policy to use arbitration for many, and possibly all, of the insolvency issues described above. III encourages UNCITRAL to establish a Commission made up of insolvency and arbitration experts to study this suggestion and propose any changes that are necessary in either insolvency or arbitration law to facilitate greater use of international arbitration in cross border bankruptcy matters.

There is some lore in the arbitration field that insolvency matters should not be submitted to arbitration. We do not think this should be an impediment to our proposal. First, the notion of non-arbitrability of insolvency matters appears to have been designed to protect bankruptcy jurisdiction over the core matters of a bankruptcy case which often reflects public policy. As described above, many of the matters proposed to be sent to arbitration are straightforward two party disputes over non-policy laden issues (how big should a claim be, who has violated an order, should that violation be stopped and compensation awarded for it).

Next, as shown above, the bankruptcy courts will have control over what bankruptcy related disputes they do and do not permit to be referred to arbitration. There is no need for concern about intruding on their jurisdiction over matters they think best to refer to arbitration. This would be particularly true of disputes between bankruptcy courts presiding over cases concerning the same debtor in multiple countries. These kinds of disputes did not exist in the 1950's when the concept of the non-arbitrability of insolvency claims originated. Moreover, UNCITRAL has tried to address these kinds of inter-case disputes in its more recent UNCITRAL Model Law which encourages bankruptcy courts to be creative in finding ways to cooperate. There is no reason to deny bankruptcy courts the right they have under the UNCITRAL Model Law to select arbitration (which might involve mediation) as a method to break deadlocks in disputes between estates.

Whether the proposed UNCITRAL Insolvency Arbitration Commission proposes new or amended insolvency and arbitration laws and treaties, or merely issues commentary on how existing laws and treaties should be interpreted in the current age of large cross-border bankruptcy cases and in the context of the UNCITRAL Model Law, we believe such a Commission could improve public policy by explaining how the New York Convention can be used to benefit the insolvency process. We hope UNCITRAL will establish such a Commission.