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### INTERNATIONAL ADR 2.0 : BIG SOLUTIONS FOR BIG PROBLEMS

#### *The Arbitration of Cross-Border Business Insolvencies\**

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# The Arbitration of Cross-Border Business Insolvencies

by

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## I. SUMMARY

*The subject of cross-border insolvency—the recognition that a bankruptcy or insolvency proceeding brought in one jurisdiction is accorded in another—has received significant attention in recent years, commensurate with the growth of international trade. Efforts to meet the challenges created by cross-border business failure have included a Model Law on Cross-Border Insolvency, drafted by the United Nations Commission on International Trade Law (“UNCITRAL”) and adopted in many of the world’s leading commercial nations, in-*

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cluding the United States, where it is codified as chapter 15 of the Bankruptcy Code. The goal of the drafters has generally been to realize the universalist ideal of a single proceeding that will coordinate the insolvency of a multinational enterprise, providing for centralized control over its worldwide assets, the possibility of a reorganization, and a single, uniform distribution to creditors of the same priority.

Even for multinational enterprises administered and controlled from a central headquarters, however, cross-border insolvencies usually involve the opening of a proceeding in each jurisdiction in which assets are located. This creates conflicts, costs and inefficiencies, and substantial loss of value, by making it difficult and often impossible to sell or reorganize the assets of a global enterprise on a going concern basis. To promote coordination and centralization, the UNCITRAL Model Law posits an enterprise's "center of main interests" or "COMI," which will presumably have some form of primacy. However, it is not clear that the COMI principle can act as a force for simplification or unification. It has proven difficult to locate the COMI of an enterprise, and, even when ascertained, the COMI may be situated in one of the many countries that lack a functioning insolvency law or a court system in which creditors have confidence. Moreover, the COMI principle founders on the fact that multinational companies ordinarily form distinct legal entities in the jurisdictions in which they operate, each of which is considered a separate unit for insolvency purposes, leading to the likelihood that multiple courts will administer the assets of an enterprise based on their location, with little regard for the fact that they may be essential parts of an integrated enterprise.

This paper proposes international arbitration as a new approach to achieve the goals espoused by the Model Law in a world without an international court or another means to exercise authority over disparate national proceedings. Arbitration would be particularly useful in connection with two types of proceedings that have proven particularly difficult to resolve in cross-border insolvencies. The first involves disputes among estates of affiliated debtors in insolvency cases in different jurisdictions. In a world where proceedings are usually opened in multiple jurisdictions, there are few effective means to resolve disputes between affiliates, especially as the Model Law applies only to unitary entities and not to groups.

Second, arbitration could play a positive role in the reorganization of the debt of an insolvent or financially distressed enterprise that does not have access to an effective reorganization law. In present practice, the debtor and its principal creditors, who are ordinarily its lenders, attempt to "work out" the problem. Arbitration would complement the workout process by providing a neutral arbitrator or panel to attempt to effectuate a consensual restructuring while keeping in reserve a binding process that would provide an enforceable decision in a reasonable time frame. Arbitration would also provide the parties with the abil-

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ity to designate the applicable law, the forum, and prospective neutral decision-makers, whose awards would be *prima facie* enforceable.

Arbitration would thus benefit all the parties involved in the economic distress of a multi-national entity by consolidating and centralizing disputes relating to the debtor and its affiliates in a single proceeding, in an ascertainable neutral or acceptable venue, before expert arbitrators. Under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, an arbitration agreement and award is enforceable unless it is “null and void, inoperative, or incapable of being performed.” There is no reason to believe that the arbitration of issues relating to the financial distress of a business enterprise would be unenforceable.

As is the invariable rule in any arbitration, cross-border insolvency arbitration would be based on consent. In an arbitration among affiliates, the consent of the affiliates (and presumably the respective courts) would be required. An arbitration of a debt restructuring would also require consent and would ordinarily bind only the borrower (debtor) and its principal lenders, a limited group of entities whose consent could be obtained. However, the benefits of arbitration ought to be great enough for the lenders to consent to the process, even though creditors not participating in the arbitration would have to be paid in full or left unimpaired.

## II. BACKGROUND: THE DEVELOPMENT OF CROSS-BORDER INSOLVENCY LAW

At present, almost all large companies are part of a global economy. In 2009, for example, U.S. domestic corporations owned and operated foreign affiliates that collectively reported \$4.885 trillion in sales and employed 10.3 million workers.<sup>1</sup> During the same year, businesses in the European Union (“EU”) invested \$155 billion in companies located in other EU countries.<sup>2</sup> Foreign companies have engaged in transactions involving billions of dollars either in the United States or governed by U.S. law, with the result that U.S. creditors have a substantial involvement in foreign insolvencies. The financial distress or insolvency of a large business enterprise is certain to have cross-border ramifications, implicating the insolvency regimes of multiple nations.

A multinational business enterprise usually operates outside its home jurisdiction through one or more separately formed subsidiaries or affiliates.

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<sup>1</sup>News Release, U.S. Dep’t of Commerce, Bureau of Econ. Analysis, Summary Estimates for Multinational Companies: Employment, Sales, and Capital Expenditures for 2009 (Apr. 18, 2011), available at <http://www.bea.gov/newsreleases/international/mnc/2011/mnc2009.htm>.

<sup>2</sup>LONDON ECONS., ANALYSIS OF DEVELOPMENTS IN THE FIELDS OF DIRECT INVESTMENT AND M&A—2010 REPORT PART I: RECENT DEVELOPMENTS (2010), available at [http://ec.europa.eu/internal\\_market/capital/docs/fdi-ma-study-part1-2010\\_en.pdf](http://ec.europa.eu/internal_market/capital/docs/fdi-ma-study-part1-2010_en.pdf).

Separate units are created for tax, corporate governance or limitation of liability reasons, as it is impractical for most enterprises to do business in multiple jurisdictions as a single entity.<sup>3</sup> Nevertheless, the enterprise is often administered on a highly centralized basis, with all major decisions made at the headquarters and all of its worldwide cash electronically swept into one central account each day and disbursed throughout the world, in the manner directed by headquarters, the next morning.

Notwithstanding centralized management, the courts in the headquarters nation do not have the ability to assume effective control over the enterprise's far-flung assets in the event of its failure. Because insolvency proceedings are generally predicated on a court's in rem jurisdiction over estate property, a separate insolvency proceeding is ordinarily opened in each country in which a debtor has property, regardless of whether the debtor has operated as a unitary entity or through multiple subsidiaries.<sup>4</sup> Separate insolvency proceedings lead to the appointment of multiple estate administrators, which creates significant additional costs and normally precludes the possibility of a reorganization given the difficulty of coordinating the administrators' separate responsibilities.<sup>5</sup> Conflicting decisions from the courts involved in a multinational enterprise's insolvency cannot be readily resolved, as there is no international court with jurisdiction over insolvency matters.<sup>6</sup> As a practical matter, a court's power is limited to its national territory and does not extend beyond its borders.

A first step toward facilitating procedural coordination and a degree of cooperation in cross-border insolvency cases was introduced into the U.S. bankruptcy laws in 1978.<sup>7</sup> The Bankruptcy Code<sup>8</sup> adopted in that year pro-

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<sup>3</sup>See Edward S. Adams & Jason Fincke, *Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism*, 15 COLUM. J. EUR. L. 43, 83 (2008); Lesley Salafia, Note, *Cross-Border Insolvency Law in the United States and Its Application to Multinational Corporate Groups*, 21 CONN. J. INT'L L. 297, 324 (2006).

<sup>4</sup>For a discussion of the traditional in rem basis of bankruptcy jurisdiction, see *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006), and *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004). The most common predicate for the filing of a bankruptcy petition in the United States is the presence of property in the United States. See 11 U.S.C. § 109 (2006).

<sup>5</sup>See Adams & Finke, *supra* note 3, at 59. In addition, until recently, few countries other than the United States had insolvency regimes that gave serious attention to the reorganization, as opposed to the liquidation, of an enterprise. See *id.* at 45–47.

<sup>6</sup>Compare, e.g., *Lehman Bros. Special Fin. Inc. v. BNY Corp. Tr. Servs. Ltd. (In re Lehman Bros. Holding, Inc.)*, 422 B.R. 407 (Bankr. S.D.N.Y. 2010), with *Perpetual Tr. Co. Ltd. v. BNY Corp. Tr. Servs. Ltd.*, [2011] UKSC 38, 2011 WL 2747853.

<sup>7</sup>In the United States, Congress had earlier provided estate administrators with the authority to exercise some control over non-domestic assets. In the United States, the courts purport to exercise "exclusive jurisdiction . . . of all of the property, wherever located, of the debtor . . ." 28 U.S.C. § 1334(e) (2006) (emphasis added). The words "wherever located" were added to § 70 of the Bankruptcy Act, one of the predecessors to 28 U.S.C. § 1334, in 1952 for the purpose of clarifying the right of an American trustee to recover and administer assets abroad. See Kurt Nademann, *Revision of Conflicts Provisions in the Ameri-*

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vided in § 304 for an “ancillary” proceeding in which a foreign estate administrator could seek an order from the U.S. bankruptcy court that would recognize and give support to the foreign case.<sup>9</sup> Section 304 was based on the proposition that there was a principal insolvency proceeding in the foreign jurisdiction and that the U.S. proceedings would be “ancillary” and provide assistance to the foreign representative, in effect allocating authority between the foreign and American courts.<sup>10</sup> More recently, the principle in § 304 of a special proceeding in aid of a foreign insolvency case was adopted in the UNCITRAL Model Law on Cross Border Insolvency (the “Model Law”), which has been largely codified in the United States as a new chapter 15 of the Bankruptcy Code. The Model Law is the most significant effort to introduce principles of cooperation and coordination into the field of cross-border insolvencies.

## A. THE MODEL LAW

UNCITRAL completed drafting the Model Law on Cross-Border Insol-

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*can Bankruptcy Act*, 1 INT'L & COMP. L.Q. 484, 486 (1952). This grant of arguably “extraterritorial” jurisdiction was premised on the principle that there would be benefits from a single administration and a single court with control over all estate assets, even if they were situated in another jurisdiction. See 11 U.S.C. § 541(a) (2006); *Underwood v. Hilliard (In re Rimsat, Ltd.)*, 98 F.3d 956 (7th Cir. 1996). However, this form of universalism has often produced conflict among jurisdictions, each of which purported to have universal control over the assets of the same entity. See, e.g., *Fotochrome, Inc. v. Copal Co., Ltd.*, 517 F.2d 512 (2d Cir. 1975); *In re Travelstead*, 227 B.R. 638, 654—55 (D. Md. 1998); *In re Nakash*, 190 B.R. 763, 770—71 (Bankr. S.D.N.Y. 1996); see also David P. Stromes, *The Extraterritorial Reach of the Bankruptcy Code's Automatic Stay: Theory vs. Practice*, 33 BROOK. J. INT'L L. 277, 283–94 (2007) (discussing the practical difficulties of extraterritorial enforcement of an automatic stay). Later cases have tried to avoid conflict by requiring cooperation and coordination of parallel cases, sometimes to no avail. See *Stonington Partners, Inc. v. Lernout & Hauspie Speech Prods. N.V. (In re Lernout & Hauspie Speech Prods. N.V.)*, 310 F.3d 118 (3d Cir. 2002), *remanded to* 301 B.R. 651 (Bankr. D. Del. 2003), *aff'd*, 308 B.R. 672 (D. Del. 2004).

<sup>8</sup>Act of Nov. 6, 1978, Pub. L. No. 95-598, 92 Stat. 2549 (establishing a uniform law on the subject of bankruptcies). The prior U.S. insolvency law was known as the “Bankruptcy Act.”

<sup>9</sup>11 U.S.C. § 304 (repealed 2005). The statute specified the relief that the court could grant, including an injunction staying an action or the enforcement of a judgment or lien against the debtor or its property, and the “turnover of the property of such estate, or the proceeds of such property, to such foreign representative.” *Id.* § 304(b). The U.S. court was explicitly directed, “[i]n determining whether to grant relief,” to be

guided by what will best assure an economical and expeditious administration of such [foreign] estate, consistent with . . . (1) just treatment of all holders of claims against or interests in such estate; (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding; (3) prevention of preferential or fraudulent dispositions of property of such estate; (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title; (5) comity; and (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns. *Id.*

<sup>10</sup>See *id. passim*.

veny in 1997.<sup>11</sup> To date, the Model Law has been adopted by 18 nations in addition to the United States.<sup>12</sup> Like § 304, it embodies the concept of an ancillary proceeding that is designed to be of assistance to a foreign case, providing for the recognition of foreign insolvency proceedings and directing cooperation among the representatives of insolvency estates. The Model Law also distinguishes between a “main” and “nonmain” foreign proceeding. Under the Model Law, a main proceeding takes place in the debtor’s “center of main interests” or COMI, and a nonmain proceeding takes place anywhere else the debtor has an “establishment,” defined as a place of operations where the debtor carries out non-transitory economic activity.<sup>13</sup> The insolvent debtor’s COMI is presumed to provide the primary law that should govern the proceeding, so as to facilitate the goal of a single distribution of the worldwide assets of the enterprise, rather than separate distributions in multiple jurisdictions.<sup>14</sup> Centralized control would also presumably facilitate reorganization or sale of the enterprise as a whole, with its worldwide assets intact, rather than piecemeal dismemberment and the likelihood of liquidation at a significantly reduced value.<sup>15</sup> The Model Law also codifies a general principle of cooperation and communication when plenary insolvency cases are opened in more than one nation.<sup>16</sup>

The drafting of the Model Law and its eventual adoption in some of the world’s principal commercial centers was only one of several similar developments. In 2000, after 40 years of debate and study, the countries of the European Union (with the exception of Denmark) adopted the European Union Insolvency Regulation (the “EU Regulation”).<sup>17</sup> Like the Model Law,

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<sup>11</sup>UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment, U.N. Sales No. E.99.V.3 (1997), available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html) [hereinafter UNCITRAL Model Law].

<sup>12</sup>Legislation based on the UNCITRAL Model Law on Cross-Border Insolvency has been adopted in: Australia (2008), Canada (2009), Colombia (2006), Eritrea (1998), Greece (2010), Japan (2000), Mauritius (2009), Mexico (2000), Montenegro (2002), New Zealand (2006), Poland (2003), Republic of Korea (2006), Romania (2003), Serbia (2004), Slovenia (2007), South Africa (2000), United Kingdom (2006), and the United States of America (2005). *Status: 1997—UNCITRAL Model Law on Cross-Border Insolvency*, UNCITRAL, [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html) (last visited Apr. 18, 2012). UNCITRAL, the World Bank and the International Monetary Fund have also adopted “best practice” guidelines for the liquidation or reorganization of failed business enterprises.

<sup>13</sup>UNCITRAL Model Law, *supra* note 11, at Part One, art. 2(f), Part Two, ¶¶ 30-31.

<sup>14</sup>Jay Lawrence Westbrook, *Locating the Eye of the Financial Storm*, 32 BROOK. J. INT’L L. 1019 (2007) [hereinafter Westbrook, *Locating the Eye of the Financial Storm*]; Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2279 (2000) [hereinafter Westbrook, *A Global Solution*].

<sup>15</sup>See Westbrook, *A Global Solution*, *supra* note 14, at 2285-86.

<sup>16</sup>UNCITRAL Model Law, *supra* note 11, at arts. 25-27; see also 11 U.S.C. §§ 1525-27 (2006).

<sup>17</sup>Council Regulation 1346/2000, 2000 O.J. (L 160) (EC), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:EN:PDF> [hereinafter EU Regulation]. The European Union Insolvency Regulation requires automatic recognition of an insolvency proceeding initiated in a

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the EU Regulation embodies the concept of a main proceeding and a proceeding that is nonmain or secondary to the main proceeding.<sup>18</sup>

It was hoped that the adoption of the Model Law in many of the world’s principal commercial centers, as well as agreement on the EU Regulation, would lead to more effective administration of cross-border insolvencies.<sup>19</sup> Although progress has been made in the procedural coordination of cases, and cooperation and coordination are now statutory requirements in many jurisdictions, neither the Model Law nor the EU Regulation has been able to solve the problems that continue to plague cross-border insolvency proceedings involving large business enterprises.

B. CENTER OF MAIN INTERESTS: COMI

Application of the COMI principle in cross-border cases has not, to date, simplified cross-border insolvency law or provided a structure through which a single court can control the insolvency proceedings of a multinational enterprise.<sup>20</sup> Issues regarding COMI in the United States have included whether a proceeding in the Cayman Islands for an entity registered but not doing business there should be recognized as a main or nonmain proceeding, or not at all.<sup>21</sup> Parties have litigated the question of the COMI of an enterprise

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member state. *Id.*; see also Jennifer Greene, *Bankruptcy Beyond Borders: Recognizing Foreign Proceedings in Cross-Border Insolvencies*, 30 BROOK. J. INT’L L. 685, 724 (2005). A case opened in one of the nations of the European Union must be recognized and given effect in all Member States where secondary proceedings have not already been brought. Case C-444/07, *MG Probud Gdynia sp. z o.o.*, [2010] E.C.R. I-417, 2010 WL 183531 (E.C.J.). For a comprehensive history of the effort to develop a European cross-border insolvency law, see BOB WESSELS, *INTERNATIONAL INSOLVENCY LAW* ¶ 10095, ¶¶ 10435-39 (2d ed. 2006). An important milestone in laying the groundwork for the Model Law was a report by MIGUEL VIRGOS & ETIENNE SCHMIT, *REPORT ON THE CONVENTION OF INSOLVENCY PROCEEDINGS* (1996), available at <http://aei.pitt.edu/952/> [hereinafter VIRGOS-SCHMIT REPORT].

<sup>18</sup>EU Regulation, *supra* note 17, at pmbl. (12), arts. 2(h), 3(3). Also like the Model Law, the EU Regulation fails to define “center of main interest.” Recital (13) states that the center of main interests should “correspond to the place where the debtor conducts the administration of its interests on a regular basis and is therefore ascertainable by third parties.” The VIRGOS-SCHMIT REPORT, *supra* note 17, at 52, states that the registered office ordinarily corresponds to the debtor’s head office. The EU Regulation and the Model Law both create a presumption that the COMI of an entity is the location of its registered office. EU Regulation, *supra* note 17, at art. 3(1); UNCITRAL Model Law, *supra* note 11, at art. 16(3).

<sup>19</sup>See Jay Lawrence Westbrook, *Chapter 15 at Last*, 79 AM. BANKR. L.J. 713 (2005) [hereinafter Westbrook, *Chapter 15 at Last*].

<sup>20</sup>The term COMI is not defined in the Model Law and, as discussed below, the statute does not even attempt to deal with corporate groups. The only effort to specify the location of a debtor’s COMI is Article 16(3) of the UNCITRAL Model Law, *supra* note 11, which provides that, “[i]n the absence of proof to the contrary, the debtor’s registered office, or habitual residence in the case of an individual, is presumed to be the center of the debtor’s main interests.” The U.S. adopted the principle in 11 U.S.C. § 1516(c) (2006), which uses the phrase “in the absence of evidence to the contrary.” See *In re Tri-Continental Exch. Ltd.*, 349 B.R. 627, 634-35 (Bankr. E.D. Cal. 2006). According to the Model Law, an insolvency case filed in the debtor’s COMI is designated the main proceeding and any other cases are designated as nonmain proceedings. UNCITRAL Model Law, *supra* note 11, at art. 3(1)-(3).

<sup>21</sup>Compare *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 389 B.R.

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that transferred some of its business to the United States;<sup>22</sup> of an enterprise that did business in Australia, Canada and the United States via the internet;<sup>23</sup> of a fraudulent enterprise;<sup>24</sup> and of a businessman who moved to the United States after insolvency proceedings had been brought against him in the country of his former residence.<sup>25</sup> Different interpretations of the COMI standard have resulted in conflict, not cooperation.<sup>26</sup> Although one of the purposes of chapter 15 was to simplify and streamline the question of recognition in the United States and to separate it from the seemingly more difficult issue of the relief to be granted, the COMI principle has not advanced this goal.<sup>27</sup>

Many of the above-cited cases involved relatively simple business organizations, usually consisting of one entity, not a multiplicity of separate corporate entities. As noted above, however, the typical multinational enterprise is organized into separate legal units, with a separately incorporated or established unit in each jurisdiction.<sup>28</sup> Even if a subsidiary is wholly dependent on its parent, and if its cash is swept on a daily basis into one worldwide account controlled by the parent, each subsidiary has a separate board of direc-

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325 (S.D.N.Y. 2008) (no recognition), *In re Basis Yield Alpha Fund (Master)*, 381 B.R. 37 (Bankr. S.D.N.Y. 2008) (no recognition), and *SphinX, Ltd. v. Official Comm. of Unsecured Creditors of Refco Inc. (In re SphinX, Ltd.)*, 371 B.R. 10 (S.D.N.Y. 2006), *affirming* 351 B.R. 103 (Bankr. S.D.N.Y. 2006) (Cayman proceeding recognized as a nonmain proceeding), with *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011) (recognition on different facts), *In re Fairfield Sentry Ltd.*, 440 B.R. 60 (Bankr. S.D.N.Y. 2010) (same), and Order Recognizing Foreign Proceeding, *In re Saad Invs. Fin. Co. (No. 5) Ltd.*, Case No. 09-13985 (KG) (Bankr. D. Del. Dec. 17, 2009), ECF. No. 47 (same).

<sup>22</sup>See *In re Gold & Honey, Ltd.*, 410 B.R. 357 (Bankr. E.D.N.Y. 2009).

<sup>23</sup>*In re Betcorp Ltd.*, 400 B.R. 266 (Bankr. D. Nev. 2009).

<sup>24</sup>*In re Tri-Continental Exch. Ltd.*, 349 B.R. 627.

<sup>25</sup>*In re Ran*, 607 F.3d 1017 (5th Cir. 2010). The result in this case is that the Israeli estate representatives appear forestalled from proceeding against him, leading to the perverse possibility that the U.S. will become a haven for individuals fleeing their creditors.

<sup>26</sup>For example, in proceedings involving the collapse of Stanford International Bank and other Stanford entities, an English court recognized receiver-managers appointed by a court in Antigua and Barbuda, on the premise that the COMI was there, whereas a court in Canada recognized a receiver appointed by a court in Texas. See *In re Stanford Int'l Bank Ltd. (In Receivership)*, [2010] EWCA (Civ) 137, 2010 WL 605796; *In re Stanford Int'l Bank Ltd.*, 2009 CarswellQue 9216 (Sept. 11, 2009), and 2009 CarswellQue 9211 (Sept. 11, 2009)(Que. Super. Ct.).

<sup>27</sup>See 11 U.S.C. § 1509(a)-(b)(2) (2006); *United States v. J.A. Jones Constr. Grp., LLC*, 333 B.R. 637, 638-39 (E.D.N.Y. 2005) (citing 11 U.S.C. § 1509 and noting that the procedural requirements of Chapter 15, which entail separation of proceedings for recognition and those for relief, were "designed to make recognition as simple and expedient as possible . . ." (quoting H.R. REP. NO. 109-31, at 112 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 175)); Kevin J. Beckering, *United States Cross-Border Corporate Insolvency: The Impact of Chapter 15 on Comity and the New Legal Environment*, 14 L. & BUS. REV. AMS. 281, 302 (2008).

<sup>28</sup>See *supra* note 3 and accompanying text. In 2010, the 100 largest U.S. public companies by revenue had an average of 109 foreign-nation subsidiaries. Richard Squire, *Strategic Liability in the Corporate Group*, 78 U. CHI. L. REV. 605, 619-20 (2011).

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tors or managers legally responsible for the management of the entity.<sup>29</sup> These complex organizations create tension between the need for uniform administration and the fundamental principle of insolvency law that each corporate entity, having distinct legal status, creditors, and assets, is treated as a separate debtor and cannot be routinely consolidated with its affiliates.<sup>30</sup>

There are no provisions in the Model Law or the EU Regulation that effectively deal with enterprises comprised of multiple entities or business groups. The ancillary case model on which both rely is designed for the benefit of a single legal unit that seeks limited relief in another jurisdiction—e.g., an order staying litigation or recovering assets for administration in a “main” case located elsewhere. The only provisions that are arguably relevant to affiliated corporate groups are the very general provisions of chapter IV of the Model Law,<sup>31</sup> incorporated into the Bankruptcy Code as sub-chapter IV of chapter 15, entitled “Cooperation with Foreign Courts and Foreign Representatives.”<sup>32</sup> These provisions require that the court and bankruptcy trustee, respectively, “cooperate to the maximum extent possible with a foreign court or a foreign representative.”<sup>33</sup> It has been convincingly argued that this provision requires cooperation among affiliates that are in separate insolvency proceedings, or at least that there be cooperation among their respective courts and estate administrators.<sup>34</sup>

Coordination and cooperation cannot be disputed as goals in the administration of insolvency proceedings involving affiliates. Nevertheless, although the principle may be cooperation “to the maximum extent possible,”<sup>35</sup> the assumption is that multiple courts and multiple estate administrators are involved. Legislation of a general rule such as “cooperation” has not overcome the conflicts that exist among estates and estate representatives. Even where

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<sup>29</sup>See, e.g., *Kashfi v. Philbro-Salomon, Inc.*, 628 F. Supp. 727, 734-35 (S.D.N.Y. 1986); *In re James River Coal Co.*, 360 B.R. 139, 172 (Bankr. E.D. Va. 2007); *In re Murray Indus., Inc.*, 119 B.R. 820, 823 (Bankr. M.D. Fla. 1990).

<sup>30</sup>United States insolvency law permits the “substantive consolidation” of separate, related entities, but only under limited circumstances. *In re Owens Corning*, 419 F.3d 195 (3d Cir. 2005); *Union Savings Bank v. Augie/Restivo Baking Co., Ltd.* (*In re Augie/Restivo Baking Co., Ltd.*), 860 F.2d 515 (2d Cir. 1988). Other systems do not recognize the concept at all, even though there may be circumstances under which a corporate veil will be pierced. See DANIEL STAEHELIN, NO SUBSTANTIVE CONSOLIDATION IN THE INSOLVENCY OF GROUPS OF COMPANIES, in *THE CHALLENGES OF INSOLVENCY REFORM IN THE 21ST CENTURY—FACILITATING INVESTMENT & RECOVERY TO ENHANCE ECONOMIC GROWTH* 213-19 (2006).

<sup>31</sup>UNCITRAL Model Law, *supra* note 11, at art. 25(1).

<sup>32</sup>11 U.S.C. §§ 1525-26 (2006).

<sup>33</sup>*Id.* §§ 1525(a), 1526(a). The U.K. adopted the provision regarding judicial cooperation in the permissive, providing that a court “may” cooperate. Cross-Border Insolvency Regulations, 2006, sch. 1, art. 25(1) (Great Britain).

<sup>34</sup>LEIF CLARK, ANCILLARY AND OTHER CROSS-BORDER INSOLVENCY CASES UNDER CHAPTER 15 OF THE BANKRUPTCY CODE 107-08 (2008).

<sup>35</sup>UNCITRAL Model Law, *supra* note 11, at ch. IV.

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cooperation is possible between estate administrators regarding principles such as asset preservation, the lack of a single forum in which to seek enforcement of rights limits the scope of any agreement, usually to a set of procedures called a protocol for facilitating communication and negotiation among parties.<sup>36</sup>

In any event, the courts have not treated the “cooperation” provisions of the Model Law as binding.<sup>37</sup> Although many U.S. and U.K. decisions speak of the common law principle of comity, there continue to be cases in which, notwithstanding the fact that all relevant jurisdictions were parties to the Model Law, courts have issued anti-suit injunctions purporting to bar proceedings in other courts.<sup>38</sup> Courts also continue to issue decisions that are in direct opposition to those of sister jurisdictions that have also adopted the Model Law.<sup>39</sup> No reported case in any jurisdiction holds that the cooperation and communication mandate of §§ 1525 and 1526 of chapter 15 create an enforceable right.

Practice under the EU Regulation, which also uses the COMI principle, has similarly failed to establish that the concept can serve as the basis for coordinating cross-border insolvencies involving affiliates. Like the Model Law, the EU Regulation contains the “presumption that an entity’s COMI is at the place of its registered office” but does not otherwise define the term.<sup>40</sup> Several early European decisions placed the COMI of a multinational group at the headquarters or “control center” of the group rather than at the place

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<sup>36</sup>Agreements among estates or estate administrators are often adopted in the form of protocols. See UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation, U.N. Sales No. E.10.V.6 (2010), available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/2009PracticeGuide.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2009PracticeGuide.html) [hereinafter UNCITRAL Practice Guide]; see also Note, *Developments in the Law—Extraterritoriality, Chapter 15 and Cross-Border Bankruptcy*, 124 HARV. L. REV. 1292, 1298 (2011).

<sup>37</sup>See, e.g., Press Release, Lehman Group of Companies Signs Cross-Border Insolvency Protocol (May 26, 2009), available at <http://dm.epiq11.com/LBH/document/GetDocument.aspx?DocumentId=1315906>. The agreement to cooperate among the Lehman entities was viewed by the insolvency administrators signing it as “more a charter than a legal document” and “an aspirational document that has been created for the benefit of those who choose to participate.”

<sup>38</sup>*Harms Offshore AHT v. Bloom*, [2009] EWCA (Civ) 632, 2009 WL 1725626 (U.K. court issued injunction against parties proceeding in U.S. court, despite the fact that both nations had adopted the Model Law; effect of Article 25 was never mentioned).

<sup>39</sup>Compare *Lehman Bros. Special Fin. Inc. v. BNY Corp. Tr. Servs. Ltd. (In re Lehman Bros. Holdings Inc.)*, 422 B.R. 407 (Bankr. S.D.N.Y. 2010), with *Perpetual Tr. Co. Ltd. v. BNY Corp. Tr. Servs. Ltd.*, [2011] UKSC 38, 2011 WL 2747853. See also *Reserve Int’l Liquidity Fund Ltd. v. Caxton Int’l Ltd.*, 2010 WL 1779282 (S.D.N.Y. Apr. 29, 2010), and the decision of the British Virgin Islands court attached as Ex. C to Docket No. 48 in that case, *Western Union Int’l Ltd. v. Reserve Int’l Liquidity Fund Ltd.*, BVIHC 2009/322, Judgment 2010 (although the B.V.I. has formally adopted the Model Law, the Model Law has never come into force in that jurisdiction).

<sup>40</sup>The EU Regulation provides, “The ‘centre of main interests’ should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.” EU Regulation, *supra* note 17, at ¶ 13.

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of the registered office of the subsidiary,<sup>41</sup> but this line of authority came to an abrupt end when the European Court of Justice found in the *Eurofood* decision that the COMI of an Irish finance subsidiary of the Italian Parmalat group was in Ireland, where the subsidiary was registered, rather than in Italy, which was the headquarters and “control center.”<sup>42</sup> Although a more recent decision of the European Court of Justice takes a more flexible approach in emphasizing that the statutory presumption “can be rebutted if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from” locating the COMI at the entity’s registered office,<sup>43</sup> the COMI concept has not been effective in centralizing control over the insolvencies of affiliated entities in the European Union.

The *Eurofood* decision involved a finance subsidiary of a multinational enterprise, presumably established in Ireland for tax reasons.<sup>44</sup> A clear argument could be made—and was made, unsuccessfully—that its COMI was at

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<sup>41</sup>In *In re Daisytek-ISA Ltd.*, [2003] B.C.C. 562 (Ch), ¶ 14, 2003 WL 21353254, a French appeals court, after considerable litigation, accepted the fact that an English court had been the first to declare itself the COMI of a company registered in France because the headquarters of the corporate group was in England.

<sup>42</sup>Case No. C-341/04, *In re Eurofood IFSC Ltd.*, [2006] E.C.R. I-3813, 2006 WL 1142304 (E.C.J.); see also BOB WESSELS, BRUCE A. MARKELL & JASON J. KILBORN, INTERNATIONAL COOPERATION IN BANKRUPTCY AND INSOLVENCY MATTERS 114 (2009) [hereinafter WESSELS ET AL.]; Samuel L. Bufford, *International Insolvency Case Venue in the European Union: The Parmalat and Daisytek Controversies*, 12 COLUM. J. EUR. L. 429 (2006).

<sup>43</sup>Case No. C-396/09, *Interedil Srl v. Fallimento Interedil Srl*, [2011] E.C.R. \_\_\_, at ¶ 51, Celex No. 609CJ0396 (E.C.J. 2011), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62009CJ0396:EN:HTML>. Even before the *Interedil* decision, European lawyers found a basis to coordinate cases by stressing language in the *Eurofood* decision that the presumption that the COMI is at the registered office of the entity can be rebutted on a showing that the “head office functions” are located in the jurisdiction of a controlling parent. These advocates cited the language of the VIRGOS-SCHMIT REPORT that the place of a debtor’s registered office “normally corresponds to the debtor’s head office.” VIRGOS-SCHMIT REPORT, *supra* note 17, at 51; see also GABRIEL MOSS & TOM SMITH, THE EC REGULATION ON INSOLVENCY PROCEEDINGS—A COMMENTARY AND ANNOTATED GUIDE 8.39 (Gabriel Moss, I. F. Fletcher & S. Isaacs eds. 2002); Christoph Paulus, *Group Insolvencies—Some Thoughts about New Approaches*, 42 TEX. INT’L L.J. 819 (2007). The more recent *Interedil* decision also adopts this approach, but the “head office” concept itself does not necessarily point in the direction of one jurisdiction as the COMI. For example, the decision of the English court in *In re Kaupthing Capital Parties II Master L.P. Inc.* [2010] EWHC (Ch) 836, 2010 WL 910186, involving a limited partnership formed in the British territory of Guernsey (not an EU member state itself), illustrates the difficulty of determining what a third party investor would know or would guess about the control center of an entity. In a recent article, Wessels asks whether the COMI concept is “a comedy of errors” and sums up: “the conclusion seems clear: COMI will continue creating conflicts.” Bob Wessels, *COMI: Are English Courts Coming Out?*, 2 INT’L INSOLVENCY L. REV. 57 (2010). For other cases involving COMI conflict, see *Eurotunnel Fin. Ltd.*, Tribunal de Commerce [TDC] [Commercial Court] Paris, Aug. 2, 2006 (Fr.) (where an English registered company was engaged in business in England and France); *In re MPOTEC GmbH*, [2006] B.C.C. 681 (Trib. de Grande Instance (Nanterre)), 2006 WL 3102454 (involving a German registered company that was part of a French group); and *In re Ci4net.com, Inc.*, [2004] EWHC (Ch) 1941, 2004 WL 2578376.

<sup>44</sup>*Eurofood*, [2006] E.C.R. I-3813 at ¶ 17.

Parmalat's Italian headquarters, to which the funds borrowed in Ireland were transferred and then disbursed by the controlling parent corporation to subsidiaries throughout the world.<sup>45</sup> If the COMI of a non-operating subsidiary is not at the location of the parent, it would seem even more difficult to contend that a subsidiary with substantial independent operations has its COMI in the jurisdiction of its parent's headquarters.<sup>46</sup>

In any event, parent companies cannot easily manage a foreign subsidiary's insolvency even in the best of circumstances. Even if the headquarters of a group of companies is in the United States, a debtor-in-possession in a chapter 11 reorganization cannot be confident it can effectively control foreign operating subsidiaries by filing chapter 11 petitions for them in the United States. As a result of the difficulties of administering foreign insolvency cases involving affiliates, U.S. debtors usually keep foreign subsidiaries they wish to preserve out of formal proceedings altogether, and they obtain judicial approval to continue to advance funds by maintenance of the prepetition "cash management system."<sup>47</sup> Alternatively, the foreign subsidiary

<sup>45</sup>See *id.* at ¶ 22.

<sup>46</sup>Critics of the principle of pure universalism in cross-border insolvency cases have called attention to the inequity of requiring a worker in one nation, who would have a priority in the home state, to file a claim in the insolvency proceedings of the company in another nation if the worker would have no such priority there. See Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 709-11 (1999) [hereinafter LoPucki, *Cooperation*]. The United States recognizes few priorities and in particular does not afford workers a substantial priority for severance payments. Most European nations provide workers with much better protection than the United States; however, there are wide differences as to priorities for taxes, consumer obligations, and tort obligations. See Janis Sarra, *An Investigation into Employee Wage and Pension Claims in Insolvency Proceedings Across Multiple Jurisdictions: Preliminary Observations*, 16 NORTON J. BANKR. L. & PRAC. 5, art. 8 (2007). The leading proponent of universalism in the United States, Prof. Westbrook, has stated, as to the ability of one estate administrator to control multiple proceedings, "This ideal will not be reached in the near future." Westbrook, *Locating the Eye of the Financial Storm*, *supra* note 14, at 1020; see also *supra* text accompanying notes 31-39.

<sup>47</sup>See Robert K. Rassmussen, *Where are All the Transnational Bankruptcies? The Puzzling Case for Universalism*, 32 BROOK. J. INT'L L. 983, 992 (2007). For a case involving the cash management system of a group of debtors, see *Charter Co. v. Prudential Ins. Co. of Am. (In re Charter Co.)*, 778 F.2d 617 (11th Cir. 1985). An example of subsidiaries of a U.S. parent filing in Europe at the same time as the parent filed in the United States is the *Collins & Aikman* group of cases, discussed below. There are also a few other examples of petitions by the subsidiaries of American companies in England, and they also illustrate the resulting complexities and delays. See, e.g., *In re Federal-Mogul Global, Inc.*, 300 F.3d 368 (3d Cir. 2002); *In re T&N Ltd.*, [2004] EWHC (Ch) 2361, 2004 WL 2495805; *Freakley v. Centre Reins. Int'l. Co.*, [2004] EWHC (Ch) 2740, 2004 WL 2775879 (involving English subsidiaries of Federal Mogul Corp.); *In re BRAC Rent-a-Car Int'l Inc.*, [2003] EWHC (Ch) 128, 2003 WL 117146 (holding that English administration proceedings could be opened with respect to English subsidiary of the Budget Rent-a-Car system despite its incorporation in Delaware). In the *Federal Mogul* case, the U.S.-U.K. conflict was resolved after a delay of several years in a Global Settlement Agreement pursuant to which the U.S. debtors agreed to fund company voluntary arrangements in the U.K. that were approved there and incorporated in a U.S. plan of reorganization confirmed by the Delaware Bankruptcy Court. See Confirmation Order, *In re Federal-Mogul Global Inc.*, Case No. 01-10578 (Bankr. D. Del. Nov. 16, 2007), ECF No. 13674, 2007 WL 4180545, at \* 17.

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may be financed locally, making it even more subject to foreign creditor pressure (and less able to file an effective insolvency case in the United States).<sup>48</sup> In the relatively rare case where a U.S. debtor has foreign operations in its own name, or where its major assets move from jurisdiction to jurisdiction (e.g., an airline or shipping company), the debtor in a newly filed case ordinarily obtains a “first day” order permitting it to make full payment to its foreign creditors, on the premise that foreign creditors, not subject to the effective jurisdiction of the U.S. courts, cannot be stayed from interfering with the enterprise’s continuing business.<sup>49</sup>

It appears that similar procedures have been developing in Europe. Even where a controlling parent files an insolvency case for a subsidiary in the parent’s home jurisdiction, rather than in the location of the subsidiary’s registered office, based on the more liberal construction of the EU Regulation discussed above,<sup>50</sup> the creditors of the other European subsidiaries are provided the treatment they would have received in a local insolvency proceeding so they have no incentive to open secondary proceedings in their home jurisdiction.<sup>51</sup> These *ad hoc* arrangements avoid the expense and discontinui-

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<sup>48</sup>Basak Akbel & Monika Schnitzer, *Creditor Rights and Debt Allocation within Multinationals*, 35 J. BANKING & FIN. 1367 (2010).

<sup>49</sup>*See, e.g., In re Aerovias Nacionales de Colombia, S.A. Avianca*, 303 B.R. 1, 6 (Bankr. S.D.N.Y. 2003); Order, *In re Am. Airlines Corp.*, Case No. 11-15463 (SHL) (Bankr. S.D.N.Y. Nov. 29, 2011), ECF No. 50; Order, *In re Pan Am. Corp.*, Case Nos. 91-B-010080 through 91-B-010087 (CB) (Bankr. S.D.N.Y. Jan. 8, 1991); *see also* Allan L. Gropper, *The Payment of Priority Claims in Cross-Border Insolvency Cases*, 46 TEX. INT’L L.J. 559, 569-71 (2011). The decision of the Seventh Circuit in *In re Kmart Corp.*, 359 F.3d 866, 869 (7th Cir. 2004), *cert. denied*, 543 U.S. 986 (2004), stated in passing that it would treat the Bankruptcy Court’s “first-day” order authorizing immediate satisfaction of the prepetition claims of international vendors in the same fashion as domestic “critical vendors” order. However, there is no indication that the parties brought to the Court’s attention the particular issues raised by the existence of foreign creditors and their ability to ignore the U.S. bankruptcy stay. In any event, although the *Kmart* decision invalidated the “critical vendor” order there, it leaves open the possibility of specific findings under § 363(b) that would justify a critical vendors order, and such findings are seemingly more easily made with respect to foreign vendors than domestic vendors.

<sup>50</sup>*See supra* text accompanying note 42.

<sup>51</sup>This type of procedure has even been given a name—virtual contractual secondary proceedings. Michael Menjucq & Reinhard Dammann, *Regulation No. 1346/2000 on Insolvency Proceedings: Facing the Companies Group Phenomenon*, 9 BUS. L. INT’L 145, 154 (2008). A similar principle has been called “virtual territoriality.” *See* Edward J. Janger, *Virtual Territoriality*, 48 COLUM. J. TRANSNAT’L L. 401 (2010). The proceedings involving Collins & Aikman, a manufacturer of automobile parts, headquartered in the United States, are instructive. Collins & Aikman had 23,000 employees in 17 countries, including 24 facilities in Europe employing 4500 people. *In re Collins & Aikman Corp. Grp.*, [2005] EWHC (Ch) 1754, [2], 2005 WL 4829623. Members of the group filed proceedings in the United States, Canada, and the United Kingdom. There was no attempt to sustain the proposition that its COMI was in the United States and that it could file all of its European subsidiaries there, but the European subsidiaries did contend that their COMI was in London, the European headquarters. In a decision that predated the *Eurofood* judgment discussed at notes 42-46, *supra*, an English court granted administration orders for 24 companies in the European group and ruled that the COMI of all the companies was in London because London was the controlling nerve center. *See Collins & Aikman*, [2005] EWHC (Ch) 1754. After creditors in Spain and Germany threatened to open local cases because they would obtain better treatment

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ties that follow the opening of subsidiary insolvency proceedings, but there are substantial costs, and the arrangements appear to an outside observer to be questionable in light of the construction of the EU Regulation in the *Eurofood* decision.<sup>52</sup>

Another example of the difficulty of coordinating cross-border insolvency proceedings is provided by the major cross-border cases involving Nortel Networks Ltd., which had operations that were integrated but dispersed in 140 jurisdictions throughout the world. The parent companies filed in Canada, the European subsidiaries filed in the U.K., and the U.S. subsidiaries filed in Delaware. The Delaware bankruptcy court recognized the Canadian and the U.K. proceedings, respectively, as foreign main proceedings under chapter 15 of the Bankruptcy Code, on the premise that Canada was the COMI of the Nortel parent and the U.K. was the COMI of the European subsidiaries.<sup>53</sup> The cases were uniquely successful in providing for a cross-border sale of assets, as the three groups were able to dispose of much of their world-wide property on a going-concern basis, including the sale of a substantial patent portfolio in a public auction.<sup>54</sup> However, the Model Law, as adopted in the United States, Canada, and the U.K., has no mechanism for

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under their laws than under English law, the U.K. administrators avoided the costs and complications of separate proceedings by promising those creditors better treatment than they would receive under U.K. law. This clearly raised serious issues under English law. See *In re Collins & Aikman Corp. Grp.*, [2006] EWHC (Ch) 1343, 2006 WL 1666894. However, the creditors were able to convince the U.K. judge to deviate from the U.K. distribution scheme, on the theory (among others) that the administrators had made a promise to the Spanish and German creditors and that they were morally bound to make good on their promise. See Gabriel Moss, *Group Insolvency—Choice of Forum and Law: The European Experience under the Influence of English Pragmatism*, 32 BROOK. J. INT'L L. 1005, 1018 (2007) (footnote omitted); see also Janger, *supra*, at 436. It may be questioned how often this principle could be utilized in subsequent cases.

<sup>52</sup>Like the Model Law, the EU Regulation does not deal expressly with the reality of corporate groups, nor does it authorize affiliates to file in the same venue. The EU Regulation also fails to deal effectively with a reorganization. Drafted before most European nations seriously considered the possibility that a bankruptcy case could avoid liquidation of the debtor, the structure of the EU Regulation contemplates that each entity in a nonmain proceeding will liquidate its assets, make a distribution to creditors (including priority creditors) in accordance with local law, and then distribute any surplus to the main proceeding, to be distributed to creditors or the equity holders there. See EU Regulation, *supra* note 17, at arts. 28, 35. The EU Regulation contemplates that only the main proceeding may have the character of a reorganization proceeding. See *id.* arts. 2(c), 3(2)-(3), 31, 34. The EU Regulation is under review at present.

<sup>53</sup>See Order, *In re Nortel Networks Corp.*, Case No. 09-10164 (KG) (Bankr. D. Del. Feb. 27, 2009) (chapter 15), ECF No. 40 (relating to the Canadian proceedings); Order, *In re Nortel Networks UK Limited*, Case No. 09-11972 (KG) (Bankr. D. Del. June 26, 2009) (chapter 15), ECF No. 36 (relating to the U.K. proceedings).

<sup>54</sup>One reason for the great success of this sale of assets as a going concern by entities in separate proceedings appears to be that they had some common control. The monitor/administrators in the Canadian and U.K. proceedings were all associated with the firm of Ernst & Young, and they controlled the U.S. debtors-in-possession as well. Separate proceedings were also opened in France, primarily to deal with issues raised by the French employees, and in a few other jurisdictions, but they did not interfere with the coordinated sale of most of the valuable assets as a going concern.

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reconciling or even reducing disputes between the affiliates' estates. For example, the U.S. and Canadian courts both ruled that efforts by the Pension Regulator in the U.K. to liquidate the amount of the group's pension liability there violated the U.S. and Canadian bankruptcy stays, respectively.<sup>55</sup> The English pension proceedings nevertheless continued,<sup>56</sup> and the English estate representatives responded with motions in the U.S. and Canadian courts so they could pursue lawsuits against the U.S. and Canadian estates and their officers and directors for allegedly having engaged in a "general pattern" in which they "transferred value away from" the European debtors "to the benefit of other entities within the Nortel Group."<sup>57</sup>

Even more seriously, the Model Law's broad and general prescription for "cooperation and communication" has provided no assistance in allocating the proceeds of the sale of the Nortel business as a going concern. Over \$7 billion in proceeds has been escrowed pursuant to an Interim Funding and Settlement Agreement, with no apparent progress to date in working out a formula to allocate the funds.<sup>58</sup> The Model Law has little to offer other than a direction to cooperate that has often been honored in the breach.<sup>59</sup>

### C. ABSENCE OF AN EFFECTIVE INSOLVENCY LAW OR CREDIBLE COURT SYSTEM

Even where the COMI can be identified, it may be situated in a jurisdiction where the law and justice system do not advance the goal of one worldwide proceeding able to restructure the assets of a multinational enterprise.

One problem is the absence of a credible reorganization law in many, if not most, nations. Some nations in Europe do not have any workable reorganization law,<sup>60</sup> despite recent efforts in several nations to strengthen these

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<sup>55</sup>See *In re Nortel Networks, Inc.*, 669 F.3d 128 (3d Cir. 2011); *In re Nortel Networks Corp.*, 2010 Carswell Ont. 1597 (Ont. Super. Ct.), *aff'd* 2010 Carswell Ont. 4112 (Ont. Ct. App.), *leave to appeal denied*, 2011 Carswell Ont. 303 (Can. Sup. Ct.).

<sup>56</sup>See *Bloom v. Pension Regulator*, [2010] EWHC (Ch) 3010, 2010 WL 4974768, *aff'd* [2011] EWCA (Civ) 1124, 2011 WL 4832401.

<sup>57</sup>Motion for Relief from the Automatic Stay ¶ 7, *In re Nortel Networks, Inc.*, Case No. 09-10138 (KG) (Bankr. D. Del. Dec. 13, 2010), ECF No. 4590. The parties have more recently agreed to toll any such claims until the bankruptcy case is closed. See Order Approving Stipulation at Ex. 1, ¶ 7, *In re Nortel Networks, Inc.*, (Dec. 17, 2010), ECF No. 4623.

<sup>58</sup>*In re Nortel*, 669 F.3d at 131; Chief Justice Warren K. Winkler, Opening Remarks of the Mediator 3 (Apr. 24, 2012), available at <http://www.nortelmediation.com>. For a further discussion of the Nortel allocation difficulties, see *infra* notes 96-104.

<sup>59</sup>The Model Law also lacks choice of law rules that would provide a framework for beginning to solve cross-border disputes. By comparison, the EU Regulation contains extensive and binding provisions relating to the choice of a governing law in cross-border insolvency disputes. See EU Regulation, *supra* note 17, at arts. 4-15.

<sup>60</sup>WESSELS ET AL., *supra* note 42, at 198; Christoph G. Paulus, *Global Insolvency Law and the Role of Multinational Institutions*, 32 BROOK. J. INT'L L. 755, 760 n.18 (2007).

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provisions.<sup>61</sup> Italy, for example, does not have a law providing for the reorganization of a large enterprise; when Parmalat, the multinational food company that was later the subject of the *Eurofood* decision, collapsed in December 2003, the Italians had to use emergency, special-purpose legislation in an effort to provide a framework for the restructuring.<sup>62</sup> Germany adopted a new insolvency law in 1999 that provided for the possibility of a reorganization, but there were few successful reorganization cases under the statute.<sup>63</sup> Germany has revised its law again, but the results are not in.<sup>64</sup>

Outside of Europe, many countries have adopted new legislation but do not possess a judicial system that, in the eyes of creditors, is seen as fair to foreign interests.<sup>65</sup> China adopted a comprehensive new bankruptcy law in

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<sup>61</sup>Recent legislation in several countries has broadened the possibility that a business can be reorganized rather than liquidated and has provided more authority to current management to remain in control. For example, the U.K. has amended its insolvency legislation several times, in part to enhance the possibility of reorganization and to reduce the power of creditors (particularly secured creditors) to impede or prevent rehabilitation. Nick Segal, *The Effect of Reorganization Proceedings on Security Interests: The Position under English and U.S. Law*, 32 BROOK. J. INT'L L. 927, 934 (2007). France has adopted legislation of *redressement judiciaire et sauvegarde* to enhance the possibility of reorganization in business cases. Robert Weber, *Can the Sauvegarde Reform Save French Bankruptcy Law?: A Comparative Look at Chapter 11 and French Bankruptcy Law from an Agency Cost Perspective*, 27 MICH. J. INT'L L. 257, 284 & n.17 (2005). For recent developments in German insolvency law, see *infra* note 63.

<sup>62</sup>SAMUEL L. BUFFORD, UNITED STATES INTERNATIONAL INSOLVENCY LAW 505-17, 583 n.53 (2009); LISA PAUL, GLOBAL INSOLVENCY & RESTRUCTURING YEARBOOK 2004/05, at 104 (2004). The Italian airline, Alitalia, was also "restructured" in accordance with special purpose legislation similar to that used in Parmalat. Emanuella Agostinelli, *The 'Counter-Reform' of the Italian Bankruptcy Law*, J. INT'L CORP. RESCUE 147 (2008) (vol. 5, issue 3); Caroline Brothers, *Bankruptcy Filing Nudges Alitalia toward a Rescue*, N.Y. TIMES, Aug. 30, 2008, at C3, available at <http://www.nytimes.com/2008/08/30/business/worldbusiness/30alitalia.html>.

<sup>63</sup>Among other things, the law did not provide an effective means for a debtor company to obtain financing, and German insolvency administrators were unsympathetic to the concept of a reorganization. Christoph G. Paulus, *Germany: Lessons to Learn from the Implementation of a New Insolvency Code*, 17 CONN. J. INT'L L. 89, 92 (2001).

<sup>64</sup>A new German insolvency law, with the goal of having "insolvency law be increasingly understood as an opportunity to reorganise a company," went into effect on March 1, 2012. *Reform of Insolvency Law*, GERMAN MINISTRY OF JUSTICE, [http://www.bmj.de/EN/Subjects/Economy/Reformof%20InsolvencyLaw/\\_node.html](http://www.bmj.de/EN/Subjects/Economy/Reformof%20InsolvencyLaw/_node.html) (last visited Apr. 18, 2012). The primary reforms include (1) a three-month period after filing of an insolvency petition, but before "commencement" of the case, for the debtor and key constituencies to negotiate a reorganization plan under court supervision but without involvement from insolvency administrators; (2) the possibility of impairing shareholder interests, including through debt-equity swaps; and (3) establishment of a preliminary creditors' committee during the three-month "pre-commencement" period, which can counter the tendency of insolvency administrators to rapidly liquidate the debtor's assets. Leo Plank et al., *The New German Insolvency Code: Decoding Improvements and Remaining Risks*, 31 AM. BANKR. INST. J. 46, 46-47, 55 (Mar. 2012).

<sup>65</sup>The adoption of new bankruptcy legislation in developing nations has been promoted vigorously by the International Monetary Fund, which published its "Orderly and Effective Insolvency Procedures" in 1999, and the World Bank, which followed with a lengthy study entitled "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems," in 2001. See Paulus, *supra* note 60, at 756 n.6. Both the World Bank and the IMF have required nations to reform their insolvency legislation as a condition to receipt of loans or grants. WESSELS, *supra* note 17, at 58. Similarly, UNCITRAL has adopted a comprehensive "Legislative Guide to Insolvency Law," containing principles for national legislatures to consider

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2006 after years of study, but few reorganization cases have been accepted by the courts.<sup>66</sup> Despite the sophistication of the law, there are observers who advise that “the worst scenario for the outside investor or secured creditor seems to be the formal insolvency of the entity in the [People’s Republic of China].”<sup>67</sup> Wessels et al. take the position that neither Asia nor Latin America is a destination “where reliable, predictable and effective multinational proceedings can be had.”<sup>68</sup>

The history relating to the default of Asia Pulp & Paper and certain of its subsidiaries, members of the Indonesian conglomerate Sinar Mas Group, is recounted at length by Wessels et al., citing a report of the Asian Development Bank.<sup>69</sup> The debtors initially instituted a standstill, freezing \$13.9 billion in financial debt, most or all of it owed to foreign creditors. When subsequent negotiations broke down, financial creditors sought the appointment of managers in the High Court of Singapore, the “place of incorporation” (but not the principal place of business) of the main member of the group. Although the High Court of Singapore expressed concern over allegations that the owners had siphoned off a billion dollars of revenue as the group began to experience significant financial strain, the court refused to appoint managers because most of the assets were held in subsidiaries located in Indonesia and China. The Singapore court was “not at all optimistic” that an order appointing judicial managers in Singapore would be recognized in the jurisdictions where the companies’ assets were located, Indonesia and China, as well as a “conflict of opinions from the parties’ Indonesia and China Legal Advisors.”<sup>70</sup> It accordingly concluded that the “judicial managers

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when reforming their insolvency laws. See TERENCE C HALLIDAY & BRUCE C. CARRUTHERS, *BANKRUPT: GLOBAL LAWMAKING AND SYSTEMIC FINANCIAL CRISIS* 157–65 (2009).

<sup>66</sup>See Charles D. Booth, *The 2006 PRC Enterprise Bankruptcy Law: The Wait is Finally Over*, 20 SING. ACAD. L.J. 275, 306 (2008); Deryck A. Palmer, *A Retrospective of the Enterprise Bankruptcy Law, in RECENT DEVELOPMENTS IN BANKRUPTCY LAW IN CHINA* 29, 29–30 (2010) (noting that “very few meaningful cases have been filed under the Enterprise Bankruptcy Law”).

<sup>67</sup>Graham Ridler, *Restructuring in the PRC—The Outside Looking In*, INSOL WORLD, 4th Q. 2009, at 31. Ridler contends, “It is still better to do a deal than to try to chase assets in the PRC or seek the protection of the local courts.” *Id.* The author of this paper does not endorse this or other criticisms of foreign legal systems. The point, for purposes of this paper, is that there exists concern on the part of creditors as their ability to enforce their rights in some countries and in the ability of some courts to administer a complex cross-border insolvency case.

<sup>68</sup>WESSELS ET AL., *supra* note 42, at 254.

<sup>69</sup>See *id.* at 162–63.

<sup>70</sup>*Deutsche Bank A.G. v. Asia Pulp & Paper Co.*, [2002] SGHC 257, ¶ 58 (Sing. High Ct.), *aff’d*, [2003] SGCA 19, [2003] 2 S.L.R. 320 (Sing. Ct. App.); see also WESSELS ET AL., *supra* note 42, at 163 (quoting ASIAN DEVELOPMENT BANK FINAL REPORT 16–17 (2005)). The *Asia Pulp & Paper* litigation spilled over into the United States and other jurisdictions. See, e.g., *Export-Import Bank of the U.S. v. Asia Pulp & Paper Co.*, No. 03-8554 (DCP), 2008 WL 465169 (S.D.N.Y. Feb. 6, 2008) (granting summary judgment for plaintiff on \$107 million in loans to defendant and its subsidiaries); *Beloit Corp. v. Asia Pulp & Paper Co., Ltd.*, Adv. Pro. No. 01-927, 2001 WL 1820017 (Bankr. D. Del. Sept. 28, 2001); Fidelity

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would not be able to make any headway in the discharge of their duties outside Singapore.”<sup>71</sup> The inability of creditors to have recourse to a legal system leaves debtors with the ability to veto a consensual debt restructuring.<sup>72</sup>

In Latin America, there has been significant reform, but in some countries it has been based on a model in which the courts play a minor role. Argentina has a reorganization law, called the *concurso preventivo*, but it has also adopted a form of prepackaged bankruptcy called the *acuerdo preventivo extrajudicial* or “APE,” which the U.S. courts have recognized in § 304 proceedings.<sup>73</sup> The APE provides for limited judicial involvement in a creditor-approved plan. A new law in Brazil modifies the Argentine procedures by limiting judicial involvement even further, reducing the vote to approve a plan to a majority.<sup>74</sup> Mexico amended its bankruptcy laws in 2000 in order to satisfy certain conditions of the North American Free Trade Agreement. However, its insolvency law is still vastly different from the laws of the United States and Canada, the other two parties to that treaty; as one example, Mexico subordinates the rights of secured creditors to administrative and employee claims.<sup>75</sup>

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Advisor Series VIII v. APP China Grp., Ltd., [2007] SC 35 (Com), ¶ 189, [2007] Berm. L.R. 35 (Sup. Ct. Berm.).

<sup>71</sup>*Asia Pulp & Paper Co.*, [2002] SGHC at ¶ 189.

<sup>72</sup>HALLIDAY & CARRUTHERS, *supra* note 65, at 200–10, recount at length the inability of creditors in other cases to obtain redress in the Indonesian courts, as well as inability to bolster the “commercial courts” or to establish an effective mediation program. They cite cases where “appeals to the Supreme Court led to several ignominious and inexplicable rulings that counteracted any expertise or independence of the Commercial Court.” *Id.*

It is again emphasized that the author does not endorse any specific criticism of any judicial system. Indonesian insolvency proceedings have been recognized in the United States under chapter 15 of the Bankruptcy Code. See Order Granting Recognition of Foreign Main Proceeding, *In re* PT. Arpeni Pratama Ocean Line Tbk, Case No. 11-15691 (ALG)(Bankr. S.D.N.Y. Jan. 12, 2012), ECF No. 27. On the other hand, creditor concerns exist. For example, after the default of Thai Petrochemical Industries on \$3.7 billion in debt, foreign creditors initially were able to enforce their security agreements in the Thai courts, and an Australian liquidator took over as acting chief executive. However, the liquidator could only operate with the protection of armed guards, and the former controlling shareholder was eventually able to oust the foreign liquidator and regain control through a decision of a Thai court. See *TPI Bankruptcy Case Casts Shadow over Thailand*, ASIA LAW, June 2003, available at <http://www.asialaw.com/Article/1972543/Search/Results/TPI-Bankruptcy-Case-Casts-Shadow-Over-Thailand.html?Keywords=Restructuring%3B+bankruptcy%3B+Hong+Kong>.

<sup>73</sup>See *Argo Fund Ltd. v. Bd. of Dirs. of Telecom Arg., S.A. (In re Bd. of Dirs. of Telecom Arg.)*, 528 F.3d 162 (2d Cir. 2008); *In re Bd. of Dirs. of Multicanal, S.A.*, 307 B.R. 384 (Bankr. S.D.N.Y. 2004); *In re Bd. of Dirs. of Multicanal, S.A.*, 314 B.R. 486 (Bankr. S.D.N.Y. 2004), *aff'd & remanded on other grounds sub nom. Argentinian Recovery Co. v. Bd. of Dirs. of Multicanal, S.A.*, 331 B.R. 537 (S.D.N.Y. 2005). On § 304 generally, see *supra* notes 9–10 and accompanying text.

<sup>74</sup>Christopher Andrew Jarvinen et al., *Current Developments Under the New Bankruptcy and Restructuring Law in Brazil*, 906 PLI/COMM 445, 457 (2008).

<sup>75</sup>Emilie Beavers, *Bankruptcy Law Harmonization in the NAFTA Countries: The Case of the United States and Mexico*, 2003 COLUM. BUS. L. REV. 965, 968, 985 (2003).

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It is not the thesis of this paper that an effective and fair insolvency law must resemble the U.S. Bankruptcy Code, but the absence of laws that provide a meaningful possibility of reorganization and a court system that foreign creditors view as neutral has material consequences. The most common response to the financial distress of a business enterprise, particularly in those parts of the world where there is no access to an effective insolvency regime, is an attempt to negotiate a resolution acceptable to both the debtor and its principal creditors, usually the lenders. This effort at a “work out” usually follows a familiar pattern, as the debtor and its lenders each retain expert advisors, enter into an informal standstill and attempt to agree on the capital structure of the rehabilitated enterprise.<sup>76</sup>

Effective negotiation over the terms of a restructuring, however, requires the existence of a known law and a court system that will treat creditors equitably if the negotiations fail.<sup>77</sup> Where an effective insolvency law and impartial court system is absent, negotiation of a restructuring, which tends to be lengthy under the best of circumstances, can be even more drawn out. The debtor usually obtains a significant advantage, as the creditors cannot effectively enforce their rights, or if the enterprise is located in a jurisdiction that has no reorganization law, can only enforce their rights through what may be an economically ruinous liquidation.<sup>78</sup> Moreover, where there is no enforceable governing law, bargaining proceeds in a vacuum. Effective negotiation takes into account the treatment that the respective parties would

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<sup>76</sup>See INSOL INT'L, STATEMENT OF PRINCIPLES FOR A GLOBAL APPROACH TO MULTI-CREDITOR WORKOUTS (2000), available at <http://www.insol.org/pdf/Lenders.pdf> [hereinafter INSOL PRINCIPLES] (set of guidelines modeled after the principles used by the “London Club” to govern restructurings and exchanges in connection with defaults in sovereign debt); John Armour & Simon Deakin, *Norms in Private Insolvency Procedures: the “London Approach” to the Resolution of Financial Distress*, 1 J. CORP. L. STUDIES 21, 34-37 (2001); Conrad B. Düberstein, *Out-of-Court Workouts*, 1 AM. BANKR. INST. L. REV. 347 (1993). The INSOL Principles have been endorsed by the World Bank, the Bank of England, and the British Bankers Association. See generally ESTEBAN C. BULJEVICH, *INNOVATIVE APPROACHES FOR CREDITORS, CORPORATES AND SOVEREIGNS* 3-23 (2005); HALLIDAY & CARRUTHERS, *supra* note 65, at 81-85; WESSELS ET AL., *supra* note 42, at 189-95; Neil Cooper, *The INSOL International Statement of Principles for a Global Approach to Multi-Creditor Workout*, 2002 NRTN-ASBL 295 (2002); Pat Kent, *The London Approach*, 33 BANK OF ENG. Q. BULL. 110 (1993).

<sup>77</sup>Armour & Deakin, *supra* note 76, at 42-44.

<sup>78</sup>Halliday and Carruthers conclude, referencing two of the countries they studied, Indonesia and China:

The efficacy of lending to troubled companies depends heavily on the predictability that courts will liquidate companies that don't effectively reorganize. In Indonesia that predictability never came; indeed, courts became a haven for debtors. . . . In China the use of bankruptcy law and institutions by courts is too little, too variable, too uncertain, and too understudied to know how much banking action in practice is being conditioned by the changing legal environment.

HALLIDAY & CARRUTHERS, *supra* note 65, at 375.

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likely obtain if there were a formal insolvency proceeding.<sup>79</sup> Where no such proceeding is available, the absence of clarity can reduce the incentives to compromise and result in a loss of value to the detriment of all parties.

D. THE ACADEMIC RESPONSE

Legal scholars, who have long been pressing for the adoption of cross-border insolvency rules, have written about the benefits of universalism as a governing principle.<sup>80</sup> Others have pointed out the difficulties, described above, that exist in today’s world, making it unrealistic to posit a single centralized proceeding, particularly for groups of affiliated debtors.<sup>81</sup> Even those who have argued most strongly for universalist principles recognize that universalism is premised on, among other things, an identity of laws and legal cultures that does not exist today and may never exist.<sup>82</sup> These scholars concede that we should work toward a more modest “modified universalism” that accepts the general premise of universalism—that the assets of a multinational enterprise should be administered on a worldwide basis by one court and in one proceeding—but that reserves discretion to local courts to evaluate the fairness of COMI procedures.<sup>83</sup>

Other legal scholars have developed an entirely different construct for dealing with cross-border insolvency—a form of contractualism.<sup>84</sup> The cross-

<sup>79</sup>See Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648, 678 (2010) [hereinafter Baird & Rasmussen, *Antibankruptcy*] (“[M]any companies could restructure their operations outside of a formal chapter 11 proceeding. Chapter 11 provided the benchmark against which reorganizations took place.”); see also WESSELS ET AL., *supra* note 42, at 193; Randall J. Newsome, *Vanishing Trials—What’s the Fuss All About?*, 79 AM. BANKR. L.J. 973, 976 (2005) (“[E]xperienced chapter 11 players are much more capable of predicting outcomes . . . thus facilitating reorganization outside of bankruptcy.”).

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<sup>80</sup>See, e.g., WESSELS ET AL., *supra* note 42, at 50–70; Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177 (2000); Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvency: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457 (1991) [hereinafter Westbrook, *Theory and Pragmatism*]; Westbrook, *A Global Solution*, *supra* note 14; Westbrook, *Chapter 15 at Last*, *supra* note 19.

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<sup>81</sup>See, e.g., LoPucki, *Cooperation*, *supra* note 46; Lynn M. LoPucki, *The Case for Cooperative Territorialism in International Bankruptcy*, 98 MICH. L. REV. 2216 (2000); Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT’L L. 31 (2001). These scholars are sometimes called “cooperative territorialists.”

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<sup>82</sup>Westbrook, *Theory and Pragmatism*, *supra* note 80, at 468–69; Westbrook, *A Global Solution*, *supra* note 14, at 2298 (suggesting that the principles of universalism in cross border insolvency should possibly be applied only to companies of a certain size and a certain level of multinational activity).

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<sup>83</sup>Samuel L. Bufford, *Global Venue Controls Are Coming: A Reply to Professor LoPucki*, 79 AM. BANKR. L.J. 105, 117 (2005); Westbrook, *A Global Solution*, *supra* note 14, at 2301. The Model Law, like the EU Regulation, provides that the interests of local creditors must be protected before relief is granted, such as the transmission of funds from the ancillary jurisdiction to the main proceeding. UNCITRAL Model Law, *supra* note 11, at arts. 21(2), 22(1). The Model Law also permits local creditors to open local proceedings to assert their rights. *Id.* art. 28 (local proceeding may be commenced if debtor has assets in the State).

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<sup>84</sup>See Sefa M. Franken, *Three Principles of Transnational Corporate Bankruptcy Law: A Review*, 11

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border contractualists agree that a single unified proceeding is a worthwhile goal, particularly as it is most likely to provide a multinational enterprise with an opportunity for reorganization or sale as a going concern. However, they note the difficulties, identified above, in determining which forum and which law should govern in the event of insolvency and in obtaining cooperation from multiple insolvency administrators or courts controlling assets or operations in many different nations.<sup>85</sup> In order to promote certainty, efficiency, and a higher degree of cooperation, contractualists contend that a company should designate in its corporate charter or in another of its fundamental documents the law that would apply in the event of insolvency and the forum in which the insolvency case would be filed.<sup>86</sup> This position is premised on the fact that private international law generally recognizes choice of law and forum selection clauses, and that principles of private contractual choice should be displaced in insolvency matters only where the nature of an insolvency proceeding makes this unavoidable.<sup>87</sup>

It is precisely the unique nature of an insolvency proceeding that causes the universalists *and* the cooperative territorialists to reject contractualism.<sup>88</sup> The critics of contractualism emphasize that bankruptcy is a collective proceeding, affecting not only those who have chosen to give credit to the debtor, but many involuntary or “non-adjusting creditors,” such as workers who are owed wages, severance and benefits; counterparties to rejected contracts, who assert damages for breach of contract; tax and other governmental authorities paid in arrears; and tort claimants and others with unliquidated or contingent claims.<sup>89</sup> It is particularly unfair to these latter parties, it is argued, to allow choice of law and forum issues to be subject to the control of a

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EUR. L.J. 232 (2005); Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT'L L. 1 (1997) [hereinafter, Rasmussen, *A New Approach*]; Robert K. Rasmussen, *Resolving Transnational Insolvencies through Private Ordering*, 98 MICH. L. REV. 2252 (2000); Robert K. Rasmussen, *Where Are All the Transnational Bankruptcies? The Puzzling Case for Universalism*, 32 BROOK. J. INT'L L. 983 (2007); Alan Schwartz, *Contracting About Bankruptcy*, 13 J.L. ECON. & ORG. 127 (1997).

<sup>85</sup>Rasmussen, *A New Approach*, *supra* note 84, at 3-4.

<sup>86</sup>*Id.* at 4.

<sup>87</sup>*Id.*

<sup>88</sup>The rejection extends to contractualism as a governing principle in cross-border and in domestic bankruptcies. Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. ILL. L. REV. 503 (2001); Lynn M. LoPucki, *Contract Bankruptcy: A Reply to Alan Schwartz*, 109 YALE L.J. 317 (1999) [hereinafter LoPucki, *Contract Bankruptcy*]; David A. Skeel, Jr., *Markets, Courts and the Brave New World of Bankruptcy Theory*, 1993 WIS. L. REV. 465 (1993); Tung, *supra* note 81; Elizabeth Warren & Jay Lawrence Westbrook, *Contracting Out of Bankruptcy: An Empirical Intervention*, 118 HARV. L. REV. 1197 (2005); Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 802 (2004).

<sup>89</sup>By contrast, consenting or “adjusting” creditors include financial creditors such as lenders, who have usually entered into long-term relationships, and trade creditors whose credit is usually more modest and of shorter duration but is also based on consent or at least trade practice. See, e.g., LoPucki, *Contract Bankruptcy*, *supra* note 88, at 337.

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debtor that will likely choose a jurisdiction favorable to its interests and unfavorable to the interests of creditors, particularly the non-adjusting creditors.<sup>90</sup> The anti-contractualists also scoff at the proposition that a debtor could reasonably designate, in the very first document evidencing its corporate existence, the locale of its unanticipated end, as if a place of burial had to be designated in every birth certificate.

### III. A NEW APPROACH

It is the thesis of this paper that arbitration can provide the new approach that is needed in light of the present realities of cross-border insolvency law. In arbitration, the debtor and its financial creditors would obtain the benefits of a speedier and less expensive proceeding, and the parties themselves could provide for a choice of the law and remedies in the event of a default. They could bring all the relevant subsidiaries and affiliates into the same proceeding and obtain an award that would be presumptively recognized and enforceable in the nations that have signed the New York Convention.<sup>91</sup> Most significantly, as discussed below, the form of arbitration contemplated is based on the consent of all affected parties, granted because of its potential to save significant going concern value and avoid the costs and uncertainties of duplicative parallel insolvency proceedings and extended litigation in multiple courts.<sup>92</sup>

In cross-border litigation, international commercial arbitration filled a need created by the great diversity in national legal systems and the perceived inability of some courts to enforce the law fairly, expeditiously, and without prejudice against foreign litigants.<sup>93</sup> An arbitral panel acts as a *de facto* “neutral tribunal” to decide disputes between nationals of different countries. Although judicial hostility to arbitration lasted even longer in in-

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<sup>90</sup>*E.g., id.*; see also Warren & Westbrook, *supra* note 88, at 1227, 1232; Westbrook, *A Global Solution*, *supra* note 14, at 2303–07; cf. Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 175 (2005) (“Contractualism is undesirable because it transforms the problem of the default of a business, a situation affecting a myriad of parties, known and unknown, into a process typically dominated by one party.”).

<sup>91</sup>United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517 [hereinafter New York Convention].

<sup>92</sup>Admittedly, arbitration is a form of contractualism. The most potent criticism of contractualism is that it permits certain parties, especially the debtor, to enter into enforceable arrangements governing an insolvency, to the disadvantage of non-consenting parties. See *supra* text accompanying notes 88–90. As discussed further below, arbitration of insolvency disputes as contemplated herein would not generate these concerns, as it would affect only those who had expressly agreed to the arbitration, leaving all others unimpaired, and it would place the smaller, non-adjusting creditors in a better position than they would have in many bankruptcy cases.

<sup>93</sup>Loukas Mistelis & Crina Baltag, *Recognition and Enforcement of Arbitral Awards and Settlement in International Arbitration: Corporate Attitudes*, 19 AM. REV. INT’L ARB. 319, 320 (2008).

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ternational than in domestic matters,<sup>94</sup> the use of arbitration in the resolution of cross-border commercial disputes is well established.<sup>95</sup> International commercial arbitration is today viewed as providing a neutral forum with impartial decision-makers whose rulings are *prima facie* enforceable in the 144 nations that are parties to the New York Convention—in theory, all of the world's commercial nations. It is suggested that international arbitration can provide an equally useful means for resolving cross-border insolvency disputes.

## IV. ARBITRATION OF CROSS-BORDER INSOLVENCIES

## A. ARBITRABLE CONTROVERSIES

The principal controversies suitable for the arbitration procedures envisioned by this paper are disputes between affiliates that are debtors in bankruptcy proceedings in different nations and debt restructurings of business enterprises. It is not assumed that arbitration would be useful or appropriate in connection with the resolution of similar disputes in domestic business cases or in consumer bankruptcies.

1. *Disputes Between Affiliates*

Disputes between affiliates in separate insolvency proceedings pending in different nations have proven particularly intractable. The *Nortel* cases provide a good example. As discussed above, the debtors in the principal cases, located in Canada, the United States, and the United Kingdom, were able to agree to the sale of much of the enterprise as a going concern.<sup>96</sup> The initial

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<sup>94</sup>Hostility persisted long after the Federal Arbitration Act of 1925 signaled a change in policy in favor of the enforceability of an agreement to arbitrate a domestic dispute. See *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983); *Campaniello Imps. Ltd. v. Saporiti Italia S.p.A.*, 117 F.3d 655, 665 (2d Cir. 1997). The United States finally adhered to the main cross-border agreement addressing international commercial arbitration, the New York Convention, in 1970. See David M. Kall, Note, *The United States' Double Standard Regarding Domestic Enforcement of International Arbitration Awards*, 8 OHIO ST. J. ON DISP. RESOL. 401, 413 (1993).

<sup>95</sup>In addition to the New York Convention governing international commercial arbitration generally, conventions governing international arbitration include the Inter-American Convention on International Commercial Arbitration, known as the Panama Convention, and the Washington Convention of 1965 that established the International Center for the Settlement of Investment Disputes ("ICSID"), designed to facilitate settlement of certain investment disputes between signatory states and foreign investors that are nationals of other signatory states. These conventions are supported by arbitral institutions such as the International Chamber of Commerce's International Court of Arbitration, founded in 1923, the London Court of International Arbitration, the International Centre of the American Arbitration Association, and ICSID itself, located in Washington D.C. These institutions are not courts but administrative bodies that administer arbitrations, provide rules and structure and in some cases nominate or appoint arbitrators.

<sup>96</sup>Order, *In re Nortel Networks Inc.*, Case No. 09-10138 (KG) (Bankr. D. Del. Nov. 12, 2009), ECF No. 1889 (approving entry into escrow agreement); Order ¶ 45, *In re Nortel Networks, Inc.* (June 11, 2011), ECF No. 5935 (approving sale of patents and requiring sale proceeds to be held in escrow pursuant to Interim Funding and Settlement Agreement). See generally *supra* text accompanying notes 53–59.

agreement of the three estates was documented in an “Interim Funding and Settlement Agreement,” in which the parties resolved to escrow the proceeds of sales and then, in the words of the judge hearing the U.S. cases, to “negotiate in good faith to attempt to reach agreement on the terms that would govern the allocation protocol process,” with the allocation of the proceeds to be based in part on “the respective contributions of the various Nortel entities to the value of the assets sold.”<sup>97</sup> If the parties were not able to agree on a consensual allocation, they would “obtain a binding determination on the allocation pursuant to an agreed upon allocation protocol . . . to be determined (absent a consensual agreement) in a single cross-jurisdictional forum.”<sup>98</sup>

The problem—so far insoluble—is that there is no “single cross-jurisdictional forum” acceptable to all of the parties or able to assume control over the dispute. The parties first proceeded to mediation, but five full days of mediation assisted by a U.S. district court judge failed.<sup>99</sup> The U.S. and Canadian estate representatives then filed motions in the U.S. and Canadian courts, respectively, seeking an order establishing “an allocation protocol pursuant to the Interim Funding and Settlement Agreement.”<sup>100</sup> The U.K. debtors responded by asserting that the matter should be remitted to arbitration,<sup>101</sup> which the U.S. and Canadian debtors have opposed.<sup>102</sup> The motions are *sub judice*, and the U.S. and Canadian courts have directed the parties to attempt again to mediate the matter.<sup>103</sup> The *Nortel* sale proceeds remain in escrow.<sup>104</sup>

Intercompany claim issues were also prominent in the insolvency proceedings of Spansion, Inc., a U.S. semiconductor device company (“Spansion U.S.”), and its Japanese subsidiary, Spansion Japan Limited (“Spansion Ja-

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<sup>97</sup>*In re Nortel Networks Corp.*, 426 B.R. 84, 95 (Bankr. D. Del. 2010).

<sup>98</sup>*Id.*

<sup>99</sup>See News Release, Nortel Networks Corp., Nortel Announces Unsuccessful Conclusion to Mediation Process (April 13, 2011), available at [http://www2.nortel.com/go/news\\_detail.jsp?cat\\_id=8055&oid=100272268&locale=en-NO&lcid=1](http://www2.nortel.com/go/news_detail.jsp?cat_id=8055&oid=100272268&locale=en-NO&lcid=1).

<sup>100</sup>Motion, *In re Nortel Networks, Inc.* (Apr. 25, 2011), ECF No. 5307.

<sup>101</sup>Opposition & Cross-Motion to Compel Arbitration, *In re Nortel Networks, Inc.* (May 19, 2011), ECF No. 5444.

<sup>102</sup>Reply, *In re Nortel Networks, Inc.* (June 2, 2011), ECF No. 5571.

<sup>103</sup>Order, *In re Nortel Networks, Inc.* (June 17, 2011, as amended June 29, 2011), ECF Nos. 5752, 5822. While mediation was pending, motions to dismiss and objections to claims of U.K., Irish, and French affiliates against the U.S. debtor were filed in the U.S. Bankruptcy Court, causing the Bankruptcy Judge to enter an order requesting that the mediator consider a postponement until the motions, which were potentially material to the mediation, could be decided. Order for the Mediator to Consider Postponement, *In re Nortel Networks, Inc.* (Aug. 3, 2011), ECF No. 6079. Ultimately, a number of the affiliate claims were dismissed, and the mediation proceeded. *In re Nortel Networks, Inc.*, Case No. 09-10138 (KG), 2012 WL 954120 (Bankr. D. Del. Mar. 20, 2012).

<sup>104</sup>Chief Justice Warren K. Winkler, Opening Remarks of the Mediator (Apr. 24, 2012), available at <http://www.nortelmediation.com>. This website contains general information about the mediation.

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pan").<sup>105</sup> Spansion Japan filed first under the Corporate Reorganization Law of Japan on February 10, 2009. The U.S. companies filed in Delaware on March 1, 2009, and an order under chapter 15 recognizing the Japanese case as a foreign main proceeding was entered on May 28, 2009.<sup>106</sup> Despite the order of recognition, the parties engaged in protracted litigation, including over a substantial administrative claim that Spansion Japan filed against Spansion U.S. that was still unresolved at the time of confirmation of the U.S. plan of reorganization.<sup>107</sup> The Japanese subsidiary also filed a \$761 million claim for damages allegedly arising out of the rejection of a 2007 foundry agreement. After confirmation, the U.S. debtors announced a lawsuit against the Japanese estate seeking \$90 million in alleged preferential transfers and \$88.1 million in intercompany prepetition debt.<sup>108</sup> It appears that the litigation was ultimately resolved, but not until after the parties had incurred substantial costs and delay.<sup>109</sup>

The disputes involving the affiliates of Lehman Brothers, which involved 75 distinct bankruptcy proceedings relating to its more than 7,000 subsidiary entities in over 40 countries, were even more protracted. It took the insolvency administrators of the 18 major foreign subsidiaries of Lehman Brothers seven months to work out a protocol that contained general principles of coordination and cooperation, and in which the administrators agreed to cooperate in attempting to calculate the inter-company claims among the group. Even that document, however, provided that the protocol was not a legally enforceable agreement and expressly reserved to the respective administrators the right to act independently.<sup>110</sup> Moreover, the administrators of the largest non-U.S. affiliate, Lehman Brothers International (Europe), based in the United Kingdom, refused to sign,<sup>111</sup> and they publicly planned a lawsuit seeking \$100 billion in damages from the U.S. parent.<sup>112</sup>

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<sup>105</sup>See generally *In re Spansion, Inc.*, 426 B.R. 114 (Bankr. D. Del. 2010).

<sup>106</sup>*Id.*

<sup>107</sup>*Id.* at 121.

<sup>108</sup>See Complaint, Claims Agent of Spansion, Inc. v. Spansion Japan Ltd., Adv. No. 10-51300 (KJC) (Bankr. D. Del. June 25, 2010), ECF No. 1 (adversary proceeding associated with lead case *In re Spansion Inc.*, Case No. 09-10690 (KJC) (Bankr. D. Del.)).

<sup>109</sup>For the settlement of the U.S. avoidance action against the Japanese estate, see Order Regarding Stipulation of Settlement, *Spansion Japan* (Oct. 26, 2010), ECF No. 100.

<sup>110</sup>Motion to Approve Cross-Border Insolvency Protocol, *in In re Lehman Bros. Holdings Inc.*, Case No. 08-13555 (JMP) (Bankr. S.D.N.Y. May 26, 2009), ECF No. 3647.

<sup>111</sup>See Philip Aldrick & Helia Ebrahimi, *PwC Rejects Global Plan for Lehman Recoveries*, TELEGRAPH (May 26, 2009), <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/5389607/PwC-rejects-global-plan-for-Lehman-recoveries.html> (discussing the resistance to the protocol among certain Lehman affiliates and quoting one of Lehman's UK administrators, Tony Lomas, who stated, "There is a concern that there will be differences of opinion, which could give rise to potential litigation between affiliates. We don't want to be morally blocked from doing anything like that.").

<sup>112</sup>Danny Fortson, *Lehman UK Arm to Sue for \$100bn*, SUNDAY TIMES ONLINE (Aug. 30 2009), <http://thesundaytimes.co.uk/sto/business/article183292.ece> (sign-in required).

Costly litigation over intercompany claims subsequently ensued in both the U.S. and U.K. court systems.<sup>113</sup> At one time there were three competing plans filed with the U.S. Bankruptcy Court. One plan, filed by creditors, proposed the global substantive consolidation of many of the U.S. debtors and certain foreign affiliates, arguing that Lehman's creditors throughout the world had dealt with it as an integrated entity, that it had a global centralized cash management system, and that it engaged in a massive volume of intercompany transactions on a non-arm's length basis.<sup>114</sup>

As it turned out, the debtors were able to avoid the costs, uncertainties, and delays that would have followed the solicitation of votes on three competing plans by negotiating a Global Settlement that, among other things, included bilateral settlements with most of the foreign affiliates.<sup>115</sup> The Global Settlement reduced the claims of the foreign affiliates from \$327.8 billion to \$61.4 billion, including a reduction in guarantee claims against the U.S. parent from \$223 billion to \$11.2 billion. Nevertheless, the settlement process took almost eighteen months to run its course, and the foreign affiliate claims were during this time the most serious impediment to a resolution of the largest chapter 11 cases in U.S. history.<sup>116</sup>

It is suggested that the availability of arbitration to resolve affiliate claims

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<sup>113</sup>See, e.g., Debtors' Disclosure Statement for Third Amended Joint Chapter 11 Plan at 54, *In re Lehman Bros.* (Sept. 1, 2011), ECF No. 19629 (summarizing litigation history in the English courts between U.S. and U.K. Lehman affiliates over the ownership of certain assets).

<sup>114</sup>See Disclosure Statement for Amended Joint Substantively Consolidating Chapter 11 Plan for Lehman Bros. Holdings Inc. and Certain of Its Affiliated Debtors, Proposed by Ad Hoc Group of Lehman Bros. Creditors, *In re Lehman Bros.* (Apr. 27, 2011), ECF No. 16316.

<sup>115</sup>See Debtor's Memorandum of Law in Support of Plan Settlements, *In re Lehman Bros.* (Nov. 29, 2011), ECF No. 22769; PRICEWATERHOUSECOOPERS, LEHMAN BROTHERS INTERNATIONAL (EUROPE) IN ADMINISTRATION: JOINT ADMINISTRATORS' PROGRESS REPORT FOR THE PERIOD 15 MARCH 2011 TO 14 SEPTEMBER 2011, at 18 (2011), available at [http://www.pwc.co.uk/eng/issues/lehmans\\_joint\\_administrators\\_progress\\_report\\_140409.html](http://www.pwc.co.uk/eng/issues/lehmans_joint_administrators_progress_report_140409.html) (discussing U.K. affiliate's agreement in principle to formally support U.S. debtors' Third Amended Plan).

<sup>116</sup>The Third Amended Plan of Lehman Brothers Holdings Inc. and its debtor affiliates was finally confirmed on December 6, 2011. Order Confirming Modified Third Amended Joint Chapter 11 Plan of Lehman Brothers Holdings Inc. and Its Affiliated Debtors, *In re Lehman Bros.* (Dec. 6, 2011), ECF No. 23023. It bears noting that intercompany claims are particularly difficult to resolve because multinational business enterprises often fail to take the same care in accounting for intercompany transfers as third-party transactions. Squire, *supra* note 28, at 616 ("Corporate groups are notoriously bad at keeping track of which assets and liabilities properly belong to which of their constituent members."). Moreover, laws differ markedly as to the recognition that should be afforded to intercompany claims. For example, in the United States, a claim filed by an affiliate is subject to enhanced scrutiny but is not automatically subordinated, whereas in many European countries a claim filed by an affiliate is automatically subordinated to the claims of general unsecured creditors. See Martin Gelter, *The Subordination of Shareholder Loans in Bankruptcy*, 26 INT'L REV. L. & ECON. 478, 479-82 (2006) (contrasting the U.S. doctrine of equitable subordination, which "usually requires an element of specific inequitable conduct going beyond mere undercapitalization," to the German and Austrian rules that deem "a shareholder loan or an act equivalent to a shareholder loan . . . to 'substitute for equity' if it was granted or not immediately terminated at a time when the company was in a financial 'crisis.'"); see also Michael R. Tucker, *Debt Recharacterization During*

would provide an alternative method of dispute resolution that would benefit all parties. Arbitration would provide one or more neutral decision-makers who, in the absence of a supranational court, could bind independent estate administrators. Although in the *Spansion* and *Lehman* cases the affiliates were able to settle their disputes, there was great cost, substantial litigation, and significant delay. The *Nortel* disputes remain unresolved. Submission of the disputes to arbitration would have resolved the claims far more quickly and with far less cost, while fulfilling the Model Law's mandate of cooperation "to the maximum extent possible."<sup>117</sup>

## 2. Arbitration of Debt Restructurings

Arbitration could also play a critical role in the restructuring of the debt of a multinational enterprise. Arbitration would be particularly useful where the COMI is in a nation with a weak or non-existent reorganization law or a court system believed to be unlikely to enforce the rights of foreign creditors. However, even in countries with a well-functioning judicial system and a sophisticated insolvency law, a workout is often the principal method for dealing with the financial distress of an enterprise.<sup>118</sup> Where assets are located in many different jurisdictions, a workout may be the only practical method for restructuring an enterprise.<sup>119</sup>

In all workouts, the task of the professionals for the debtor and the lenders is similar: to examine the debtor's business and operations, identify solutions to existing problems and determine how much the business can be expected to pay over a reasonable period of time under reasonably anticipated

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*an Economic Trough: Trashing Historical Tests to Avoid Discouraging Insider Lending*, 71 OH. ST. L.J. 187, 190 (2010).

<sup>117</sup>See UNCITRAL Model Law, *supra* note 11, at art. 25(1) (an insolvency court "shall cooperate to the maximum extent possible with foreign courts or foreign representatives"); *id.* art. 26(1) (an estate administrator "shall cooperate to the maximum extent possible with foreign courts or foreign representatives"). As noted above, this mandate of cooperation arguably applies even in the absence of an order of recognition where separate insolvency proceedings have been filed for affiliates. LEIF CLARK, *supra* note 34.

<sup>118</sup>In Germany, the workout or composition, led by the debtors' principal lenders, is still the principal means for restructuring debt. See Klaus Kamlah, *The New German Insolvency Act: Insolvenzordnung*, 70 AM. BANKR. L.J. 417, 417 n.2 (1996). It remains to be seen how the recently effective revisions to the German insolvency law will affect this preference. See *supra* note 64. The goal of French law is to keep a business enterprise out of formal insolvency proceedings by a preventative mechanism. The French have also devised an extra-statutory procedure called the *mandat ad hoc*, or *ad hoc* mediation, in which the president of the local commercial court can require a potential debtor and its principal creditors to negotiate toward a financial settlement. See Jean-Claude Hallouin, "La Lettre de France," 43 R.J.T. 177, 186-87 (2009) (Revue Juridique Themis). Other nations provide for a limited "suspension of payments" period during which the debtor can obtain relief from creditor pressure while it attempts to work out the issues with its principal creditors. See, e.g., KAREN HARMSSEN & MARIUS JITTA, INTERNATIONAL INSOLVENCY 45-76 (Beltzer et al. eds. 2006).

<sup>119</sup>See *supra* text accompanying note 75.

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circumstances, i.e., the terms and structure of a viable repayment plan.<sup>120</sup> Workouts, however, are often burdensome, expensive, and drawn out. The agreement to arbitrate would be designed to foster and effectuate, rather than supplant, the traditional workout by empowering neutral arbitrators to make a decision consistent with applicable law if the parties were unable or unwilling to bring the bargaining to an end. Thus, it is not expected that arbitrators would impede the parties' negotiations, and they obviously would have discretion to require the parties to return to the bargaining table.

Moreover, as discussed above, one hallmark of a workout is that the debtor and its lenders negotiate a restructuring against the backdrop of what the parties could expect to receive in a formal insolvency proceeding under controlling law.<sup>121</sup> Where assets are located in multiple jurisdictions and are subject to different laws and the potential control of competing insolvency administrators, it may be difficult, if not impossible, to speak of a controlling law, much less a controlling court.<sup>122</sup> An agreement to arbitrate would bring much needed clarity to the parties' negotiations by establishing objective legal principles upon which the parties could base their negotiations or, if necessary, on which the arbitrators could base their decision.

The substantive law that would govern an arbitration of the type contemplated is further discussed below. As an initial matter, it is necessary to establish the predicate to this arbitration (as any arbitration)—the consent of the affected parties to submit the matter to the decision of arbitrators.

3. *Consent to the Arbitration*

An insolvency arbitration must be based on the same fundamental principle of consent that governs any arbitration proceeding—i.e., that its effects are limited to those who have agreed to the arbitration.<sup>123</sup> Insolvency pro-

<sup>120</sup>A workout usually includes a standstill on repayment of principal to the financial creditors, in order to preserve the relative position of the parties, and it may or may not include a standstill on payment of interest (depending on financial capability). However, the borrower usually continues servicing its ordinary trade debt since each trade creditor is usually owed a relatively small amount and failure to pay would cause irreparable damage to the business. See the sources cited in note 118, *supra*.

<sup>121</sup>WESSELS ET AL., *supra* note 42, at 193; see also *supra* note 77 and accompanying text.

<sup>122</sup>See HALLIDAY & CARRUTHERS, *supra* note 65, at 373-77; see also text accompanying notes 65-78.

<sup>123</sup>The first principle of arbitration is that it is based on consent, i.e., an agreement to arbitrate a dispute. *E.g.*, *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (“[A]rbitration is simply a matter of contract between the parties.”). In the United States, courts enforce arbitration provisions in accordance with contractual principles. *E.g.*, *AT&T Mobility LLC v. Concepcion*, \_\_\_ U.S. \_\_\_, 131 S. Ct. 1740, 1752 (2011) (“Arbitration is a matter of contract”); *Rent-A-Center, W., Inc. v. Jackson*, \_\_\_ U.S. \_\_\_, 130 S. Ct. 2772, 2776 (2010). The Federal Arbitration Act, 9 U.S.C. § 2 (2006), provides,

A written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

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ceedings are often considered unsuited to arbitration because bankruptcy is a collective process, in which an insolvency court takes control of all of the assets of the estate, requires creditors to file claims, and distributes either the proceeds of the liquidation of the assets or shares in a reorganized estate.<sup>124</sup> Bankruptcy is not premised on consent, but on a court's control over estate assets and its ability to adjust all of the claims and issues involving the administration of the estate.<sup>125</sup> Nevertheless, arbitration can coexist with traditional bankruptcy principles if the arbitration proceeding affects only parties who have agreed to the process.

This paper suggests the use of arbitration in two contexts—when there is a dispute between the estate representatives of formerly affiliated entities and in connection with a debt restructuring. In an arbitration involving affiliates of the same entity, only the estate administrators would have to consent to the arbitration. That consent would take place after the administrator's appointment and might be included in a protocol, a cross-border agreement between the estate administrators.<sup>126</sup> Under U.S. law, a court with jurisdiction over the pending bankruptcy would have to approve the agreement of the estate administrators to arbitrate a dispute.<sup>127</sup> Court approval would likely be required under some other systems, whereas in others consent by the estate administrator might provide an adequate basis for the arbitration proceeding. In any case, the number of consenting entities would be limited.

Consent to the arbitration of a debt restructuring raises more complex issues. Since the only parties who could be bound by the results of the arbitration are those who had consented, in most cases the affected parties would be limited to the debtor and its principal financial creditors, its lenders. The number of financial creditors whose consent would be required would thus be manageable. Although a plenary bankruptcy of a multinational enterprise may potentially involve thousands of creditors, there is invariably a group of

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Through the Federal Arbitration Act, Congress reversed "centuries of judicial hostility to arbitration agreements by placing arbitration agreements upon the same footing as other contracts." *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (internal citations omitted).

<sup>124</sup>See e.g., Alan N. Resnick, *The Enforceability of Arbitration Clauses in Bankruptcy*, 15 AM. BANKR. INST. L. REV. 183 (2007); Mark A. Salzberg & Gary M. Zinkgraf, *When Worlds Collide: The Enforceability of Arbitration Agreements in Bankruptcy*, 27 FRANCHISE L.J. 37 (2007).

<sup>125</sup>Jay Lawrence Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 MINN. L. REV. 595, 598, 605-06 (1983) [hereafter Westbrook, *Arbitration*].

<sup>126</sup>For a comprehensive discussion of the use of protocols to coordinate insolvency proceedings pending in different nations, see the UNCITRAL Practice Guide, *supra* note 36, ch. III. The Model Law provides that "cooperation referred to in articles 25 and 26 may be implemented by any appropriate means, including . . . (d) Approval or implementation by courts of agreements concerning the coordination of proceedings . . ." UNCITRAL Model Law, *supra* note 11, at art. 27(d). The U.S. version is identical. 11 U.S.C. § 1527(4)(2006).

<sup>127</sup>FED. R. BANKR. P. 9019(c) ("On stipulation of the parties to any controversy affecting the estate the court may authorize the matter to be submitted to final and binding arbitration.").

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financial creditors whose numbers are relatively few even if their debt is vastly greater than that of all other creditors combined. These entities have usually extended loans or other financial accommodations to the debtor, often with the guaranty of all the principal borrower's affiliates and subsidiaries, and they may be the only creditors to have claims against all of the members of the corporate group.<sup>128</sup> They would ordinarily be the only parties other than the debtor whose consent to a binding arbitration process would be required.

In a large and complex enterprise, there may be multiple groups of lenders and complex inter-creditor agreements.<sup>129</sup> It may be that the existence of multiple groups of lenders who would have to adhere to the arbitration process would require that the agreement to arbitrate be documented at the time the debt was put in place.<sup>130</sup> However, the number of parties whose consent would be required would still be manageable.<sup>131</sup>

Assuming that the debtor and the financial creditors were the only parties who would agree to the arbitration, all other creditors would have to be paid in full or left unimpaired by the arbitral proceeding and any restructuring that followed.<sup>132</sup> Although all non-consenting creditors could not be impaired, limitation of the effects of the arbitration to the lenders would not preclude the effective use of an arbitration process.

The non-impairment of trade and similar creditors is the hallmark of virtually all workouts, where financial creditors accept the benefits of an informal resolution that leaves the trade and other creditors unimpaired rather than risk the costs and uncertainties associated with in-court proceedings.<sup>133</sup> Even where a case is filed in court, financial creditors often agree to leave the non-financial creditors unimpaired and unaffected by the bankruptcy case al-

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<sup>128</sup>Squire, *supra* note 28, at 618-19.

<sup>129</sup>For example, Lehman Brothers had a prepetition capital structure that included senior, subordinated, and junior subordinated long-term debt (much of it issued by non-U.S. affiliates); syndicated credit facilities; and preferred stock. Debtors' Disclosure Statement for Third Amended Joint Chapter 11 Plan, Exh. 19 at 19-8 to 19-13, *In re* Lehman Bros. Holdings Inc., Case No.08-13555 (JMP) (Bankr. S.D.N.Y. Sept. 1, 2011), ECF No. 19629.

<sup>130</sup>The stage at which an agreement to arbitrate would be reached is discussed below. See *infra* text accompanying notes 138-39.

<sup>131</sup>In some cases, it might be possible for key suppliers or other major trade creditors to agree to the arbitration; if a trade creditor's position in the debtor's capital structure was important enough, the financial creditors might desire or even insist that the creditor be bound by a prospective arbitration. However, the involvement of trade creditors in the arbitration would necessarily be limited to the largest and most sophisticated trade creditors, as only they could be practically brought into the process.

<sup>132</sup>Non-impairment, as the term is defined in the U.S. insolvency law, means that there is no alteration of the creditor's "legal, equitable and contractual rights," and that the creditor's claim is reinstated, if necessary, and that all defaults are cured and damages flowing from the default are paid as part of the cure. 11 U.S.C. § 1124 (2006).

<sup>133</sup>See *supra* notes 75-78.

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together, in order to avoid delays of a protracted reorganization case.<sup>134</sup> Speed and certainty is the goal of prepackaged plans under U.S. law, which permit a debtor to solicit votes on a chapter 11 plan even before a filing and confirm a reorganization in the shortest possible time. In a prepackaged case, trade and other non-financial creditors are almost always wholly unimpaired.<sup>135</sup>

If the financial creditors are able to acquire some or all of the equity of the enterprise in a plan, their concessions to the trade creditors are likely to be influenced by the fact that the reorganized enterprise will be stronger and have a higher equity value if the trade creditors continue to support it. Where the restructuring is largely agreed to before the filing, all of the potential unsecured creditors may be paid before the petition date, leading to a case in which there are no general unsecured creditors.<sup>136</sup>

Based on the foregoing, the lenders' agreement to allow an arbitrator to restructure the financial debt without requiring commensurate concessions from the non-financial creditors would likely result in costs that are lower than those that lenders agree to pay in many reorganization cases to gain access to the court.<sup>137</sup>

In order to establish arbitration as a binding contractual obligation, the agreement to arbitrate a restructuring ought to be included in the initial documentation for the financial accommodations (ex ante agreement). The pro-

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<sup>134</sup>See, e.g., *In re Journal Register Co.*, 407 B.R. 520 (Bankr. S.D.N.Y. 2009) (all trade debt paid in full as a "gift" from the secured creditors); *In re Oneida, Ltd.*, 400 B.R. 384 (Bankr. S.D.N.Y. 2009) (all unsecured creditors paid in full, although senior secured creditors significantly impaired); *In re Granite Broad. Corp.*, 369 B.R. 120 (Bankr. S.D.N.Y. 2007) (same). Another reason for the enhanced position of trade debt in many cases is the common use today by most debtors of "just in time" inventory acquisition. Since suppliers do not provide goods until immediately before their use, the failure of any one supplier to provide its product to an assembly line, for example, can cause a business to shut down altogether. This provides each supplier with great leverage and may lead to their being left unimpaired by an insolvency filing.

<sup>135</sup>See, e.g., Confirmation Order, *In re CIT Grp. Inc.*, Case No. 09-16565 (ALG) (Bankr. S.D.N.Y. Dec. 8, 2009), ECF No. 193; NICHOLAS P. SAGGESE & ALESIA RANNEY-MARINELLI, A PRACTICAL GUIDE TO OUT-OF-COURT RESTRUCTURINGS AND PREPACKAGED PLANS OF REORGANIZATION § 4.64[f][2] (2d ed. 2000); Douglas G. Baird & Robert K. Rasmussen, *Beyond Recidivism*, 54 BUFF. L. REV. 343, 348 (2006).

<sup>136</sup>See, e.g., *In re Boston Generating, LLC*, 440 B.R. 302, 310 (Bankr. S.D.N.Y. 2010), where the debtors engaged in an 18-month restructuring process—one year before the filing and 6 months after—leading up to a sale of the debtors' assets and confirmation of a liquidating plan; the plan's disclosure statement stated that it was "unknown" whether there were any general unsecured claims against the debtors, in part because many such claims had already been paid. Disclosure Statement at 8 n.6, *In re EBG Holdings LLC*, Case No. 10-14419 (SCC) (Bankr. S.D.N.Y. Mar. 21, 2011), ECF No. 721.

<sup>137</sup>Any reorganization case has certain fixed costs that a debtor must pay, either to file or to confirm a plan, and that the lenders provide for, usually out of the value of their collateral. For example, in the United States, where costs of administration do not automatically take priority over the rights of secured debt, secured creditors are accustomed to the requirement that many expenses, such as the fees of the lawyers for the debtor and the creditors committee, are protected through the mechanism of a "carve out" for these parties. See Baird & Rasmussen, *Antibankruptcy*, *supra* note 79, at 674-75; Richard Levin, *Almost All You Ever Wanted to Know About Carve Out*, 76 AM. BANKR. L.J. 445 (2002).

cess of obtaining an agreement to arbitrate a restructuring will not be easy, and its difficulty will increase with the complexity of the debtor's capital structure and the number of different lenders, as it is likely that any one group of lenders will insist that other lenders be similarly bound. In any event, agreement to an arbitration process should ideally be obtained when the borrower and lenders agree to all the other terms that govern a default under the loan or other extension of credit.<sup>138</sup> From a lender's perspective, this would also be the best time to extract a commitment from the debtor and possibly the holders of equity to participate in a process that might adversely affect their interests. From the debtor's perspective, arbitration would commit the lending group to a rational restructuring procedure in the event of default, governed by known legal principles and subject to the control of neutral decision-makers. It would also, as discussed below, provide some protection against the restructuring being controlled by a minority of the most aggressive and intransigent members of the lending group.<sup>139</sup>

Although it might appear that the parties would have more flexibility if the agreement to arbitrate were reached only after an event of financial distress, in cross-border insolvency the concept of flexibility is a misnomer, in that neither the debtor nor the creditor may have easy access to a legal system with an effective insolvency regime. If a court cannot take control over a debtor's worldwide assets, it might become impossible to rehabilitate those assets for the benefit of all stakeholders or even sell them as a going concern. The dismemberment of a potentially valuable enterprise results in a loss of value that can reduce the recoveries of all stakeholders.

On the other hand, arbitration of cross-border insolvencies is admittedly a novel concept, requiring acceptance in the marketplace, and until there is greater acceptance of the principle, debtors and lenders might agree to submit a dispute to arbitration only after a default had taken place or was imminent. At that point, the lenders and the debtor would be able to ascertain the scope of the debtor's financial distress and whether a restructuring appeared feasible, which would generally be a precondition of the type of arbitration contemplated.<sup>140</sup> The parties would also be in a position to take into account the debtor's entire debt structure, would have current information as to its

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<sup>138</sup>Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 778 (2002).

<sup>139</sup>See *infra* notes 152-53 and accompanying text.

<sup>140</sup>See Armour & Deakin, *supra* note 76, at 22 n.1 (distinguishing between "financial distress," where a firm has defaulted on its debt, and "economic distress," where "a firm is no longer economically viable."). Only the financially distressed firm is a candidate for a workout. See also *United Airlines, Inc. v. HSBC Bank USA, N.A.*, 416 F.3d 609, 612-13 (7th Cir. 2005) ("A firm that cannot meet its debts as they come due, but has a positive cash flow from current operations, is in financial but not economic distress. It is carrying too much debt, which can be written down in a reorganization. A firm with a negative cash flow, by contrast, is in economic distress, and liquidation may be the best option.").

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economic condition, and could estimate the cost of leaving unimpaired those parties who could not be brought into the arbitration. Lenders' concerns as to the concessions that might be required of them in arbitration would be reduced.

Although financial creditors might agree to leave the non-financial unsecured debt unimpaired, it is not likely that they would be willing to make substantial sacrifices without affecting the equity. It is also not assumed that an arbitration could simply eliminate equity interests without their consent to be bound by the results of the arbitration proceedings. If the equity in the debtor were widely dispersed, it might be difficult or even impossible to obtain express consent from the shareholders to be bound by an arbitral award. Nevertheless, in many cases, depending on local law and the provisions of the debtor's corporate documents, equity interests could be materially affected by the results of the arbitration, even in the absence of consent. For example, equity can often be substantially diluted by the issuance of additional shares or other changes in the capital structure of the debtor. In some cases, a shareholder vote may be required, but such a requirement might not make it materially more difficult to effectuate a debt—equity swap in connection with an arbitration than it is in a workout—or in a reorganization case in many parts of the world. In many countries, debt for equity conversions are prohibited even in an in-court proceeding, absent shareholder consent.<sup>141</sup>

Moreover, in many parts of the world, it is common for large companies to be controlled by a family that owns most or all of the shares.<sup>142</sup> This is particularly true in economically developing jurisdictions, where creditors' ability to enforce their rights may be problematic. Concentrated ownership would make it practical to obtain the consent of the owners of a family business to participate in a binding arbitration process, particularly at the time financial accommodations are solicited by the debtor and the terms are agreed to by the parties.

#### B. THE CHOICE OF APPLICABLE LAW

Parties to an arbitration are ordinarily able to choose a venue, the manner of selection of the arbitral panel, and the governing law. In an arbitration to resolve claims between the affiliates of a multinational enterprise, the respective administrators of the debtors would presumably decide the venue and

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<sup>141</sup>WESSELS ET AL., *supra* note 42, at 33 (citing INTERNATIONAL MONETARY FUND, ORDERLY AND EFFECTIVE INSOLVENCY PROCEDURES 63 & n.7 (1999), available at <http://www.imf.org/external/pubs/ft/orderly/>). In France, for example, the new *sauvegarde* procedures, as amended in 2008, still require the approval of two-thirds of the shareholders to implement a debt for equity swap. Adam Gallagher, *The Need for a New Overhaul of French Insolvency Law to Facilitate Debt-Equity Swaps*, 29 AM. BANKR. INST. J. 22, 46-49 (Apr. 2010).

<sup>142</sup>Deborah A. DeMott, *Guests at the Table?: Independent Directors in Family-Influenced Public Companies*, 33 J. CORP. L. 819 (2008).

composition of the arbitral panel. Since the choice of a law to govern a dispute can be outcome determinative, it might be unrealistic to expect the insolvency administrators of the affiliates to agree on the governing law. In any event, the parties could submit the question of governing law to the arbitrators, who would then determine the applicable law.

In a debt restructuring, on the other hand, the choice of a venue, a method for selecting the arbitrators, and a governing law would ideally be decided at the time arbitration is chosen as a dispute-resolution mechanism. Agreement on these issues would establish the procedures that would be used in the arbitration. A well-drafted arbitration clause could also address the scope of the arbitrators' authority and discretion, narrowing it in appropriate cases. For example, in the arbitration of a restructuring, the parties could agree that the arbitrators would have the power to impose a moratorium on the lenders' enforcement of remedies, but only for a limited time period. The arbitrators could be given express authority to terminate the arbitration if they found that the lenders were being unfairly prejudiced—for example, if the debtor took action in derogation of the moratorium, or if it were determined that the lenders would have to make unreasonably large concessions. An arbitration clause might also require the arbitrators to issue a preliminary report with findings as to the feasibility of the restructuring. As noted above, a firm must be economically viable to be a candidate for a successful workout.<sup>143</sup>

Selection of a governing law would also establish the substantive principles of insolvency law to be applied in the arbitration. To illustrate how this would work in the arbitration of the restructuring of a multinational enterprise, assume that the parties have chosen United States law to govern the arbitration.<sup>144</sup>

In such a case, it is envisioned that the arbitration would begin in a manner similar to a traditional workout, except that the parties would have the benefit of one or more arbitrators to foster the negotiations, impose some discipline on the process, and set deadlines. As in most workouts, the creditors would organize into one or more groups or committees.<sup>145</sup> The parties, as they do in workouts, would attempt to negotiate restructuring terms, but they would have the assistance of the arbitrators. If the debtor were able to

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<sup>143</sup>See *supra* note 140.

<sup>144</sup>This is not to contend that U.S. law must govern; it should be emphasized that the principles underlying this paper are not dependent on the application of U.S. law. However, U.S. law is the only law on which this author has any qualification to speak.

<sup>145</sup>Any lender who agreed to arbitration would also be required to consent not to transfer its interest unless the transferee also agreed to be bound by the arbitral proceeding. A similar requirement is not unusual in syndicated facilities where a majority of lenders have the power to direct the loan agent to undertake some action on behalf of the entire syndicate.

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come to an agreement with the affected creditors, the arbitration would become moot. If not, the arbitration would proceed in much the same fashion as in a prepackaged plan under chapter 11 of the Bankruptcy Code (assuming U.S. law applied). The arbitrators—or the parties, subject to the supervision of the arbitrators—would craft a plan that was designed to achieve as much consensus as possible. As in a prepackaged bankruptcy, the plan would be submitted to the impaired creditors, who would be able to vote to accept or reject it. If the only impaired creditors were unsecured, there would likely be only one “class” that would vote. If the lenders had different interests in collateral, or rights against separate subsidiaries, there would likely be multiple classes of creditors voting on the plan.

If the plan were accepted by the required vote of the classes of creditors,<sup>146</sup> the arbitrators would have to find that it met the standards set forth in the U.S. Bankruptcy Code regarding confirmation of a consensual plan. One of the most important requirements is that the plan be “feasible;”<sup>147</sup> obviously, the type of restructuring contemplated here is useful only if the parties are satisfied—and the arbitrators can find—that the enterprise can become profitable—in other words, that there is potential value in the reorganization.<sup>148</sup> A second critical finding is that the plan would satisfy the “best interests of creditors” test of the U.S. Bankruptcy Code, in that each impaired creditor must either accept the treatment provided under the plan or receive property worth at least as much as the creditor would receive in a liquidation.<sup>149</sup>

In a chapter 11 case in the United States, if any impaired class fails to vote in favor of the plan of reorganization, the plan proponent can ask the court to confirm the plan under the nonconsensual or “cramdown” provisions of the Bankruptcy Code.<sup>150</sup> If U.S. bankruptcy law were the governing law

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<sup>146</sup>Under United States law, a plan, to be accepted, must be approved by creditors who vote and hold two-thirds in amount and more than one-half in number of the affected claims in each class. 11 U.S.C. § 1126(c) (2006).

<sup>147</sup>Feasibility as set out in 11 U.S.C. § 1129(a)(11) (2006) requires that the confirmation of the plan “is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor. . . .”

<sup>148</sup>This condition could be built into the arbitration agreement itself. Indeed, if the arbitrators concluded at any stage of the proceedings that a restructuring was not feasible, they should terminate the process. The arbitration should also be terminated if leaving management in place during the course of the arbitration would result in material harm to the enterprise.

<sup>149</sup>11 U.S.C. § 1129(a)(7)(A) provides,

[E]ach holder of a claim or interest . . . (i) has accepted the plan; or (ii) will receive or retain under the plan . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date . . . .

<sup>150</sup>*See id.* § 1129(b). These provisions are components of the absolute priority rule, also called the “fair and equitable” principle. In brief, a class of secured creditors can be “crammed down” if the class: (i)

of the arbitration, the arbitrators would have authority to issue an award over the objection of a non-consenting class if the cramdown conditions were satisfied. For example, a secured class would be assured, in general, of receipt of the value of its collateral, in cash, and an unsecured class would be assured that in an arbitration the equity would not be allocated any value unless creditors were paid in full. The equity would be protected by what has been called, in U.S. law, the corollary to the absolute priority rule, that creditors cannot be paid more than in full for their claims.<sup>151</sup>

Although the arbitration of a restructuring would permit a plan to be imposed over the objection of dissenting parties, the principle that a minority can be bound by the will of the majority is well accepted, even outside court proceedings. For example, many syndicated loan agreements provide an agent or a majority or supermajority of lenders authority to agree to concessions in connection with a debt restructuring, a workout, or a bankruptcy.<sup>152</sup> In recent years, collective action clauses have been proposed as a solution to the “hold out” problem in the restructuring of debt, where a minority of the holders of a debt instrument refuse to accept a restructuring acceptable to the majority in order to obtain more favorable treatment.<sup>153</sup> Arbitration pro-

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retains its liens on any collateral retained by the debtor and receives deferred cash payments totaling the allowed holders' claims; or (ii) obtains the proceeds of its collateral sold under the plan; or (iii) realizes the “indubitable equivalent” of the above. A class of unsecured debt in a cramdown plan is entitled to full payment before any junior class (such as the equity) can receive or retain on account of its claims “any property.” In all cramdown plans the other requirements for a consensual confirmation apply, and in addition it is expressly provided that the plan not “discriminate unfairly.”

<sup>151</sup>See *New Eng. Coal & Coke Co. v. Rutland Co.*, 143 F.2d 179, 186 (2d Cir. 1944); *In re Exide Techs.*, 303 B.R. 48, 61 (Bankr. D. Del. 2003) (“[A] corollary of the absolute priority rule is that a senior class cannot receive more than full compensation for its claims.” (citation omitted)).

<sup>152</sup>See *In re Chrysler LLC*, 405 B.R. 84, 101 (Bankr. S.D.N.Y. 2009), *aff'd*, 476 F.3d 108, 119 (2d Cir. 2009), *vacated on other grounds*, 130 S. Ct. 1015 (2009).

<sup>153</sup>In bonds governed by English law, collective action clauses permit a trustee for the bondholders, instructed by a supermajority of holders, to forgive principal and interest. See Michelle M. Harner, *The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing*, 77 *FORDHAM L. REV.* 703, 745 (2008); Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 *YALE L.J.* 232 (1997). Bonds qualified under the United States Trust Indenture Act of 1939 are more restrictive and must provide that an individual holder's right to interest or principal cannot be impaired without its consent, except that a majority of holders with 75% of outstanding principal can agree to postpone interest payments for up to three years. Trust Indenture Act § 316(b), 15 U.S.C. § 77ppp(b) (2006). This provision, together with market practice, has limited the scope of the collective action clause in bonds subject to U.S. (usually New York) law, but many bonds issued abroad are not subject to the Act. For example, the Act does not apply to issuances which do not utilize any means of U.S. interstate commerce. HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, 3B *SECURITIES AND FEDERAL CORPORATE LAW* § 11:2 (2d ed. 2011). Further, the Act itself exempts debt securities if those securities are exempted by certain provisions of the Securities Act of 1933. 15 U.S.C. § 77ddd; see also BLOOMENTHAL & WOLFF, *supra*, at § 11:3; GUY P. LANDER, 14 *U.S. SECURITIES LAW FOR INTERNATIONAL FINANCIAL TRANSACTIONS AND CAPITAL MARKETS* § 4:36 (2d ed. 2010). This includes securities issued pursuant to exemptions under Regulation S—exempting certain foreign country issuances and resales—and Rule 144A—which exempts private placements to “Qualified Institutional Buyers.” John Cocchiarella & Robert Risoleo, *Pri-*

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cedures could afford the same benefits as a collective action clause, with the added protection of the oversight of expert arbitrators.

### C. ENFORCEABILITY OF AN AGREEMENT TO ARBITRATE

The New York Convention requires signatory States to honor agreements to arbitrate and to recognize and enforce arbitral awards granted in other States.<sup>154</sup> Under Article II(3) of the New York Convention, an arbitration agreement is enforceable unless it is “null and void, inoperative, or incapable of being performed.”<sup>155</sup> No authority has been found that arbitration of the type proposed in this paper is “incapable of being performed.” Similarly, Article V(2)(b) of the New York Convention permits a signatory nation to deny recognition or enforcement of an arbitral award if it “would be contrary to the public policy of that country.” This public policy exception has been given a very narrow construction, applicable only where “the forum state’s most basic notions of morality and justice” are at issue.<sup>156</sup> An agreement to arbitrate an insolvency dispute should not be denied enforcement on the basis that it transgresses “fundamental notions of morality and justice.”

Article V(2) of the New York Convention also provides, “Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: (a) the subject matter of the difference is not capable of settlement by arbitration under the law of that country.” No legal authority has been found to the effect that insolvency disputes are not arbitrable because of the nature of the subject matter. The subject definitely involves an economic interest, which is a core requirement for all international arbitration.<sup>157</sup> Bankruptcy has been considered a “sensitive issue” in the arbitration field, but antitrust, intellectual property, and corporate law issues are also sensitive subjects, and that has not led to a prohibition against arbitration in cases involving those issues.<sup>158</sup>

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*vate Placements, Resales, and Rule 144A and Regulation S Offerings*, 1866 PLI/CORP 47 (Feb. 2011). Moreover, the Trust Indenture Act also permits the SEC to issue an exemption from the Act’s application upon the request of an issuer. 15 U.S.C. § 77ddd(d); 17 C.F.R. §§ 260.4d-7, 260.4d-8 (listing technical requirements for applying for an exemption).

<sup>154</sup>New York Convention, *supra* note 91.

<sup>155</sup>The same provision appears at section 8(1) of the UNCITRAL Model Law on Commercial Arbitration, U.N. Sales No. E.08.V.4 (2008) (as amended in 2006), available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/1985Model\\_arbitration.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration.html).

<sup>156</sup>*Parsons & Whittemore Overseas Co. v. Societe Generale de L’Industrie du Papier (RAKTA)*, 508 F.2d 969, 974 (2d Cir. 1974); accord *Telenor Mobile Communs. AS v. Storm LLC*, 584 F.3d 396, 411 (2d Cir. 2009) (quoting *Europcar Italia, S.P.A. v. Maiellano Tours*, 156 F.3d 310, 315 (2d Cir. 1998)); see also Westbrook, *Arbitration*, *supra* note 125, at 613.

<sup>157</sup>FOUCHARD GAILLARD & GOLDMAN ON INTERNATIONAL COMMERCIAL ARBITRATION 340 (Emmanuel Gaillard & John Savage eds. 1999) [hereinafter INTERNATIONAL COMMERCIAL ARBITRATION].

<sup>158</sup>*Id.* at 344 (“As bankruptcy procedures also affect third parties, the courts alone are in a position to

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Case law in the United States has increasingly accepted the principle that arbitration agreements should ordinarily be enforced notwithstanding the bankruptcy of one of the parties to the arbitration.<sup>159</sup> Recent circuit court decisions have held that an arbitration clause will be enforced in a bankruptcy case even where the issue is considered “core,” so long as the arbitration will not “seriously jeopardize the objectives of the Bankruptcy Code.”<sup>160</sup> In bankruptcy cases in the United States, courts will not remit parties to arbitration where there is a need for a “centralized proceeding . . . augmented by [a] complex factual scenario, involving multiple claims . . .”<sup>161</sup> In any event, the law in the United States is unquestionably developing in favor of the enforcement of arbitration agreements within bankruptcy cases.<sup>162</sup>

The state of the substantive law outside the United States appears similar. A panel appointed by the International Chamber of Commerce (“ICC”) stated, in a decision holding that an arbitration should proceed in the face of a bankruptcy filing, “[T]he fact that one of the parties is subject to bankruptcy proceedings is not in itself sufficient to render a dispute non-arbitrable per se. . . . The only disputes which are excluded are those which have a direct link with pending bankruptcy proceedings, namely those disputes arising from the application of rules specific to those proceedings.”<sup>163</sup> In another ICC case, the tribunal decided that arbitration should continue despite the fact that the defendant was subject to insolvency proceedings.<sup>164</sup> In a third case, the ICC found that issues of liability could be determined through arbitration, despite an ongoing bankruptcy of one of the parties.<sup>165</sup>

European insolvency cases have also permitted parallel arbitration and insolvency proceedings. Under German law, “the fact that a law regulating a particular matter reserves the competence of national courts is of no signifi-

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open, supervise and close such proceedings, decide the admissibility of receivables, distribute the debtor’s property and so on. However, this does not prevent arbitrators from ruling on disputes involving bankruptcy law issues.”)

<sup>159</sup>Early decisions in the United States had emphasized “the clash of two federal statutes,” namely the Federal Arbitration Act and the Bankruptcy Code. *In re Al-Cam Dev. Corp.*, 99 B.R. 573, 575–76 (Bankr. S.D.N.Y. 1989).

<sup>160</sup>*MBNA Am. Bank v. Hill*, 436 F.3d 104, 109 (2d Cir. 2006); *see also Mintze v. Am. Fin. Servs., Inc.* (*In re Mintze*), 434 F.3d 222 (3d Cir. 2006). Core disputes are generally defined in 28 U.S.C. § 157(b)(2) (2006) as those disputes that could arise only in a bankruptcy case, usually involving proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor relationship.

<sup>161</sup>*U.S. Lines, Inc. v. Am. S.S. Owners Mut. Prot. & Indem. Ass’n* (*In re U.S. Lines, Inc.*), 197 F.3d 631, 641 (2d Cir. 1999).

<sup>162</sup>Alan N. Resnick, *The Enforceability of Arbitration Clauses in Bankruptcy*, 15 AM. BANKR. INST. L. REV. 183 (2007).

<sup>163</sup>ICC Case No. 6697, *Casa v. Cambior*, 1992 REV. ARB. 135 (Dec. 26, 1990).

<sup>164</sup>ICC Case No. 6632, Award of Jan. 27, 1993 (unpublished).

<sup>165</sup>ICC Case No. 7563, *Belgian Bank v. International Pool of Ins. Cos.*, 121 J.D.I. 1054 (1994).

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cance for determining the arbitrability of such a matter under German law.”<sup>166</sup> French courts generally permit international arbitration to proceed even when the subject matter is under the jurisdiction of the French insolvency courts, so long as the arbitration does not affect the rights of third parties.<sup>167</sup> Thus, the Paris Court of Appeals stated in *Almira Films* that “the impact of public policy on the arbitrability of a dispute does not cause arbitrators to be prohibited from applying rules of an imperative nature, but only . . . from allowing a violation of public policy.”<sup>168</sup> In a decision of the *Cour de cassation*, the arbitrators were authorized to liquidate a claim but could not require the payment of a debt that would otherwise be discharged in the bankruptcy or require a payment higher than the dividend payable to all other unsecured creditors.<sup>169</sup> The cases appear to be decided according to principles similar to the U.S. rule that an agreement to arbitrate will be enforced where it does not transgress core bankruptcy policies.

In any case, even these developing principles in favor of arbitration are of limited relevance to the arbitration of debt restructurings contemplated by this paper because they involve the enforceability of an arbitration agreement in connection with a *pending* bankruptcy proceeding, not an agreement to arbitrate a dispute entirely *outside* of a formal insolvency case.<sup>170</sup> There does not appear to be any authority that parties should not be able to agree to arbitrate a core insolvency dispute on condition that non-consenting parties be left unimpaired.<sup>171</sup>

Nor should these issues be considered non-arbitrable, just as there is no rule that the financial distress of an enterprise must always be administered

<sup>166</sup>INTERNATIONAL COMMERCIAL ARBITRATION, *supra* note 157, at 344; *see also* VESNA LAZIC, INSOLVENCY PROCEEDINGS AND COMMERCIAL ARBITRATION 147 (1998). R

<sup>167</sup>INTERNATIONAL COMMERCIAL ARBITRATION, *supra* note 157, at 344. R

<sup>168</sup>Cour d'appel [CA] [Paris court of appeal] Feb. 16, 1989, 1989 REV. ARB. 711 (Fr.).

<sup>169</sup>In that case, the *cour de cassation* found that an arbitration award would be against public policy and would be set aside if the result would violate the principle of equality of treatment of similarly situated creditors, as equality of creditors is “a matter of both domestic and international public policy.” *Cour de cassation* [Cass.] [supreme court for judicial matters] civ., Feb. 4, 1992, Jur. 181 (Fr.).

<sup>170</sup>The possibility that the debtor will become the subject of an insolvency proceeding notwithstanding an agreement to arbitrate is discussed *infra* notes 176-178 and accompanying text. R

<sup>171</sup>In Westbrook, *Arbitration*, *supra* note 125, there is a careful examination (from the vantage point of 1983) of the relationship between the policies underlying bankruptcy proceedings and those underlying international arbitration—a subject that has received much attention in the intervening years. Nevertheless, the encounter contemplated in the title to that article is the effect of an arbitral award in a bankruptcy case, not the use of arbitration to resolve disputes outside of an insolvency proceeding. A French commentator exploring the relationship between arbitration and bankruptcy stated that he knew of no case in which an arbitral tribunal had taken jurisdiction over disputed issues arising directly under bankruptcy law, but he did not reject the proposition that such disputes are arbitrable. Alexis Mourre, *Arbitrage et Droit de la Faillite: Reflexions sur L'Office du Juge el de L'Arbitre*, in *FAILLITE INTERNATIONALE ET CONFLICT DE JURISDICTION / CROSS-BORDER INSOLVENCY AND CONFLICT OF JURISDICTION* 153, 159 (Georges Affaki ed. 2007). R

in a formal court proceeding. As discussed above, one of the purposes of a workout is to avoid the costs and delay of a court case.<sup>172</sup> Arbitration of insolvency issues should not raise public policy concerns to any greater extent than does a workout—provided that those parties who have not agreed to the arbitration are left unimpaired. Subject to this limitation, arbitration of a restructuring would be consistent with the goal of any restructuring of debt—preserving value for the benefit of all stakeholders.

The usefulness of arbitration in resolving cross-border restructurings can be illustrated by reference to the *Asia Pulp & Paper* case, discussed above.<sup>173</sup> The debtors, part of a large Indonesian conglomerate, were engaged primarily in the lumber business. They had borrowed more than \$13.9 billion, much of it from foreign lenders. Although several of the principal holding companies were located in Singapore, the assets and operations were primarily located in Indonesia and secondarily in China. It will be recalled that the Singapore courts refused to order a winding up of the Singapore holding companies, principally because of concern that its orders would have no effect in Indonesia and China, notwithstanding detailed allegations that the equity owners and managers of the debtors had diverted assets and obstructed a workout to the disadvantage of the creditors.<sup>174</sup>

It is suggested that an arbitral award effectuating the workout would likely have had greater success in obtaining enforcement in the courts of Singapore, Indonesia, and China. Singapore has considerable case law on the enforcement of arbitration awards notwithstanding a bankruptcy filing. A recent opinion of its Court of Appeal sets forth a test for the enforcement of an arbitration agreement notwithstanding the filing of an insolvency petition that appears similar to the principles used in the United States and that would seemingly permit enforcement of an agreement to arbitrate a debt restructuring outside of an insolvency case.<sup>175</sup> Indonesia and China do not appear to have any written authorities, but both nations are signatories to the New York Convention. It is suggested that any signatory to the New York Convention would not lightly refuse to enforce an arbitral award.

#### D. A COURT FILING NOTWITHSTANDING AN AGREEMENT TO ARBITRATE

An enforceable agreement to arbitrate a restructuring would not rule out the possibility of the commencement of a formal insolvency proceeding involving the debtor. Such a filing could theoretically be a voluntary filing by

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<sup>172</sup>See *supra* text accompanying notes 76–79.

<sup>173</sup>See *supra* text accompanying notes 69–71.

<sup>174</sup>*Id.*

<sup>175</sup>See *Larsen Oil & Gas Pte Ltd. v. Petroprod Ltd.* (in official liquidation in the Cayman Islands and in compulsory liquidation in Singapore), [2011] SGCA 21 (Sing. Ct. App.).

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the debtor or an involuntary filing by the lenders who had consented to the arbitration. A court in the United States (the only jurisdiction whose law the author is qualified to write about) would have ample authority to dismiss such a case, as the Bankruptcy Code authorizes dismissal or suspension of a bankruptcy case in favor of out-of-court proceedings “if the interests of creditors and the debtor would be better served.”<sup>176</sup> This provision is designed to prevent the bankruptcy laws from being used by a recalcitrant party to derail out-of-court workout proceedings acceptable to the great majority.<sup>177</sup>

The trade and other creditors who are not parties to the arbitration could also commence an involuntary case but would ordinarily have no reason to do so. Arbitration, if successful, would leave them unimpaired. Such creditors rarely interfere with a workout or file a formal proceeding, since they are usually paid currently during the course of a workout and left unimpaired if it is successful.<sup>178</sup>

## V. CONCLUSION

Notwithstanding the general acceptance of arbitration in dispute resolution, it has been assumed that arbitration is inappropriate in connection with insolvency matters. This assumption has been based on the proposition that insolvency is a collective proceeding binding all creditors, who are required to claim their share of a res and are bound by the action of the insolvency court whether or not they participate. It is also based on the premise that prebankruptcy agreements that purport to affect the right of a debtor to file for bankruptcy and the terms on which a filing can be made should be subject to careful and skeptical judicial scrutiny.<sup>179</sup>

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<sup>176</sup>11 U.S.C. § 305(a)(1) (2006); see *In re Colonial Ford*, 24 B.R. 1014 (Bankr. D. Utah 1982).

<sup>177</sup>The legislative history states that

[t]he court may dismiss or suspend under the first paragraph [§ 305(a)(1)], for example, if an arrangement is being worked out by creditors and the debtor out of court, there is no prejudice to the rights of creditors in that arrangement, and an involuntary case has been commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment. The less expensive out-of-court workout may better serve the interests in the case.

H.R. REP. NO. 95-595, at 325 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6281. This principle has been found applicable where a foreign case has not been filed but the debtor is engaged in a good faith attempt to work out its debt problems. See *GMAM Inv. Funds Trust I v. Globo Comunicacoes e Participacoes S.A.* (*In re Globo Comunicacoes e Participacoes S.A.*), 317 B.R. 235 (S.D.N.Y. 2004). It has also been applied where a foreign insolvency case has been filed. See *In re Compania de Alimentos Fargo, S.A.*, 376 B.R. 427 (Bankr. S.D.N.Y. 2007); *In re Bd. of Dirs. of Multicanal, S.A.*, 314 B.R. 486, 522 (Bankr. S.D.N.Y. 2004), *aff'd in part and remanded on other grounds*, 331 B.R. 537 (S.D.N.Y. 2005).

<sup>178</sup>This rule obviously does not apply if there is risk that the passage of time would divest the debtor of certain rights, such as the right to pursue an avoidance proceeding. An effective standstill presumes that no creditor subject to the standstill agreement will materially improve its position during the moratorium. See *INSOL PRINCIPLES*, *supra* note 76, at 2 (Second Principle).

<sup>179</sup>It is recognized that courts in the United States are reluctant to enforce contractual or corporate

As discussed above, the principle that arbitration has no place in the insolvency sphere has been subject to significant erosion in recent years. Courts in the United States routinely enforce the agreement of a debtor, concluded prior to the filing, to arbitrate a dispute, notwithstanding a subsequent bankruptcy case. Although arbitration in connection with the basic terms of a debt restructuring or in a dispute among affiliates raises different issues, it should have sufficient benefits in cross-border cases to reduce concern about the absence of direct judicial control. In disputes among affiliates in insolvency proceedings in different nations, it would supply a cross-border decision-maker that does not exist today. In restructurings, the best protection available to the small or non-adjusting creditor is to be left unimpaired. Use of arbitration in insolvency situations encourages this result—by definition, arbitration can impair only those who have entered into the agreement to arbitrate.

In recent years, arbitration has been considered as a means of resolving disputes relating to sovereign debt defaults, another matter not subject to the effective control of any single court.<sup>180</sup> Arbitration should be considered as a means of resolving other cross-border debt disputes that are also not subject to the effective control of a single international court. There is a growing consensus, reflected in the Model Law on Cross-Border Insolvency and in recent jurisprudence, that, “ideally, bankruptcy proceedings should have universal application . . . .”<sup>181</sup> Properly constituted arbitral procedures appear well suited to attain this goal.

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charter provisions that preclude or condition a debtor’s ability to file an insolvency case. See Fallick v. Kehr, 369 F.2d 899, 904 (2d Cir. 1966) (case decided under pre-1978 Bankruptcy Act); Hayhoe v. Cole (*In re Cole*), 226 B.R. 647, 651–52 (B.A.P. 9th Cir. 1998); *In re Gen. Growth Props., Inc.*, 409 B.R. 43, 63–65 (Bankr. S.D.N.Y. 2009); *In re Kingston Square Assocs.*, 214 B.R. 713, 725 (Bankr. S.D.N.Y. 1997); *In re Shady Grove Tech. Ctr. Assoc. Ltd. P’ship*, 216 B.R. 386, 389 (Bankr. D. Md. 1958). See also Resnick, *supra* note 162.

<sup>180</sup>See Christoph G. Paulus & Steven T. Kargman, *Reforming the Process of Debt Restructuring—A Proposal for a Sovereign Debt Tribunal* 3 (2008), available at [http://www.un.org/esa/ffd/events/2008debtpanel/KargmanPaulus\\_SovereignDebtTribunal.pdf](http://www.un.org/esa/ffd/events/2008debtpanel/KargmanPaulus_SovereignDebtTribunal.pdf) (Preliminary Draft Presentation to the United Nations Workshop on “Debt, Finance and Emerging Issues in Financial Integration”). Although entitled a proposal for a “tribunal,” its authors do not envision an international court, but an “international arbitral tribunal for resolving disputes arising in sovereign debt restructurings.” This proposal followed the failure of the suggestion of the International Monetary Fund for a Sovereign Debt Restructuring Mechanism (“SDRM”) to act as an international court for the restructuring of debt issued by sovereign nations that had to be restructured. See Lee C. Buckheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317 (2002); Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT’L L. 299, 317–24 (2005).

<sup>181</sup>Cambridge Gas Trans. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC, [2006] UKPC 26, [16], 2006 WL 1546603 (judgment of Lord Hoffmann). See also, Westbrook, *Locating the Eye of the Financial Storm*, *supra* note 14, at 1021, endorsing the “ideal of a single worldwide proceeding in which one court or administrative body administers the default of a multinational corporation with the assistance of some courts as necessary.”

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