

# SILOS: ESTABLISHING THE DISTRIBUTIONAL BASELINE IN CROSS-BORDER BANKRUPTCIES

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## INTRODUCTION

The first two decades of law reform related to cross-border bankruptcy are the paired story of the UNCITRAL Model Law (Chapter 15 in the United States) and the EU Insolvency Regulation (the EU Reg).<sup>1</sup> Both seek to create an architecture whereby a court located at a debtor's center of main interest (COMI) can coordinate the insolvency of a debtor with assets and operations in multiple jurisdictions. The Model Law focuses on the automatic recognition of foreign representatives, and the creation of an ancillary proceeding to administer local assets and claims or transfer them for administration in the main case.<sup>2</sup> The EU Reg creates a structure where the main case, "opened" at the debtor's COMI, administers the case, while secondary winding up proceedings are opened in jurisdictions where the debtor has an establishment.<sup>3</sup> Both statutes focus on centralizing administrative power in the "main case." Centralized, or at least coordinated, administration should facilitate rescue (reorganization) where efficient, and allow for a value maximizing liquidation or going-concern sale where necessary.

Law reform efforts have paid relatively less attention to how assets should be administered in the main case pending at the debtor's COMI.<sup>4</sup> Indeed, short of establishing a norm of cooperation with the main case, the same can be said with regard to ancillaries. Governing law has been

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1. See U.N. COMM'N ON INT'L TRADE LAW, UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT AND INTERPRETATION, U.N. Sales No. E.14.V.2 (2014) [hereinafter MODEL LAW]; 11 U.S.C. § 1501 et seq.; Council Regulation 2000/1346, On Insolvency Proceedings, 2000 O.J. (L 160) 1 (EC) [hereinafter EU Insolvency Regulation].

2. MODEL LAW, *supra* note 1, arts. 15–17 (recognition), 20–21 (effect of recognition and discretionary relief).

3. EU Insolvency Regulation, *supra* note 1, arts. 3–4.

4. It would be wrong to say that no attention was paid. Jay Westbrook has written thoughtfully on the topic of how to administer assets for distribution (Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27 (1998)) and lays out an approach to the priority rules applicable in the main proceeding. John Pottow too has given serious thought to the issue. John A. E. Pottow, *Greed And Pride In International Bankruptcy: The Problems Of And Proposed Solutions To "Local Interests"*, 104 MICH. L. REV. 1899 (2006). Indeed, there are similarities between Pottow's approach and mine that will be discussed below. The issue is only just being addressed seriously within law reform efforts for the first time.

assumed to be domestic bankruptcy law in the main, and a subset of domestic bankruptcy law in the ancillary jurisdiction, though with a norm of deference to and cooperation with the coordinating court (comity). Law reformers and harmonizers have not ignored domestic bankruptcy law. On a parallel track, UNCITRAL has promulgated the Legislative Guide on Insolvency that provides a template for modernizing domestic bankruptcy law.<sup>5</sup> The Legislative Guide does not, however, address cross-border issues.

As such, the next decade, or at least the next round, of law reform is likely to be devoted to developing and harmonizing the procedures for administering the main case pending at the debtor's center of main interest in a manner that facilitates cooperation in cross-border cases.<sup>6</sup> In particular, the goal of these efforts should be to adopt measures that: (1) facilitate cooperation by ancillary courts; (2) minimize the effects and incentives for forum shopping; and (3) minimize the conflicts of interest faced by those charged with administering assets in multiple jurisdictions. I would like to further suggest that the success of these efforts is going to turn largely on the ability to distinguish harmonized and global bankruptcy procedures from locally determined substantive rights—finding the proper scope for *lex fori* (law of the forum) and *lex situs* (law of the location of the property or cause of action) respectively.

Modified universalism has animated the first generation of bankruptcy harmonization, and operated based on the hope that differences of outcome in individual cases that resulted from differences among local laws would be tolerated under the principle of comity. Under modified universalism, an ancillary court is encouraged to follow the direction of the main court, so long as the main case is in a jurisdiction with a reasonable or modern bankruptcy system. Deviations from a territorial distribution under local law should be tolerated based on the assumption that, over time, national gains and losses would be a “rough wash,” and that, in the aggregate, “transactional gain” would outweigh the cost.<sup>7</sup>

This approach has worked reasonably well, particularly where common law countries are involved, and there is a willingness to apply a relatively strong norm of comity.<sup>8</sup> But, where differences of outcome have seemed

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5. U.N. COMM'N ON INT'L TRADE LAW, UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW, U.N. Sales No. E.05.V.10 (2004) [hereinafter UNCITRAL LEGISLATIVE GUIDE].

6. I have made this suggestion elsewhere. Edward J. Janger, *Universal Proceduralism*, 32 BROOK. J. INT'L L. 819 (2007); Edward J. Janger, *Virtual Territoriality*, 48 COLUM. J. TRANSNAT'L L. 401 (2010); Edward J. Janger, *Reciprocal Comity*, 46 TEX. INT'L L.J. 441 (2011).

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

8. *In re Maxwell Commc'n Corp. plc*, [1992] B.C.C. 372; *Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings Plc*, [2007] 1 A.C. 508 at 16;

significant (*Qimonda*)<sup>9</sup> or secured creditors are involved (*Treco*)<sup>10</sup> this willingness to cooperate has broken down. In those cases, the need to protect local creditor expectations has trumped the norm of international cooperation. Concerns about local entitlements have trumped comity. Problems have also emerged where corporate groups are involved, and it has proven difficult to determine the relationship between the cases pending at the group's center and cases opened by subsidiaries in foreign countries.<sup>11</sup> As a result, there has been consistent uncertainty about whether a secondary or ancillary court will cooperate with the court of the main proceeding, or apply its own law to local assets in order to protect local creditor expectations.

The comity-based approach relies on courts to enforce foreign judgments notwithstanding differences of treatment. The problem with this lies not with the courts, that often do cooperate *ex post*, but with the parties themselves. Where differences of treatment exist along with uncertainties about enforcement, opportunities for arbitrage and gaming arise. These opportunities for a party to litigate or bargain for an increased distribution can delay administration and frustrate the goal of global coordination, even when cross-border cooperation is clearly in the firm's best interest. Indeed, as Judge Allan Gropper has pointed out elsewhere, the need to avoid the threat of local secondary or ancillary proceedings (or "secondaries") and the cost of seeking recognition has simply led debtors in many cases to pay the non-financial creditors who are beyond the reach of the forum court.<sup>12</sup> This functional territorial blackmail can be expensive, limits the ability of global companies to restructure, and undercuts the goal of equal treatment.

In the last few years a second approach has emerged, focusing on choice-of-law rather than comity. A comity-based approach demands cooperation from the ancillary court and acquiescence to different distributional outcomes. A choice-of-law approach has the potential to make cooperation a two-way street. Under a choice-of-law (or virtually territorial) approach, the main case pending at the debtor's COMI would respect the territorial priorities and distributions that would have been

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McGrath v. Riddell (*In re* HIH Cas. & Gen. Ins. Ltd.), [2008] UKHL 21 at 36, 1 W.L.R. 852 (H.L.) 863 (Lord Hoffmann).

9. Jaffé v. Samsung Elec. Co., Ltd. (*In re* Qimonda), 737 F.3d 14 (4th Cir. 2013); *In re* Qimonda AG, 462 B.R. 165 (Bankr. E.D. Va. 2011).

10. *In re* Treco, 240 F.3d 148 (2d Cir. 2001).

11. *Re* Enron Directo Sociedad Limitada (July 4, 2002) (unreported); Daisytek ISA Limited, [2004] BPIR 30; MG Rover, [2005] EWHC (Ch) 874; Case C-341/04, Eurofood IFSC Ltd., 2006 E.C.R. I-3854.

12. Allan Gropper, *The Payment of Priority Claims in Cross-Border Insolvencies*, 46 TEX. INT'L L.J. 559, 569 (2010) ("U.S. debtors in Chapter 11 reorganization cases with substantial assets . . . abroad . . . invariably try to pay in full not only foreign priority creditors but all foreign creditors, with the possible exception of foreign financial creditors (usually banks) . . .").

applied had a case been opened in the secondary jurisdiction. This approach minimizes (and may eliminate) differences in treatment, and along with it, the incentives and opportunities for gaming.

Instead of imposing its own priority rules, the main might respect foreign priorities, to mirror a hypothetical territorial distribution. Framed as a procedure, John Pottow has labeled this approach a synthetic secondary.<sup>13</sup> Framed as a choice-of-law principle, I have called it “virtual territoriality.”<sup>14</sup> Framed as a corollary to the principle of comity, I have also called it “reciprocal comity.”<sup>15</sup> Whatever the name, the vision is the same: allow the case pending at the debtor’s COMI to distribute assets according to a hypothetical territorial distribution.

As a practical matter, this approach was pioneered in the *Collins & Aikman* case. Collins & Aikman Europe SA was an automobile parts maker whose European operations were centered in the United Kingdom but previously had operations and subsidiaries in other EU countries.<sup>16</sup> The administrator promised certain foreign creditors that if they refrained from opening secondary cases, they would be given the distribution they would have received had they opened the local case. The UK court permitted this, after some common law hoop-jumping, even though it was arguably inconsistent with Article 4 of the EU Reg’s requirement that the forum court apply its own bankruptcy law.<sup>17</sup> This approach has been followed in other cases in the United Kingdom,<sup>18</sup> and current proposed amendments to the EU Reg would expressly validate this approach.<sup>19</sup> Similarly, the report of Working Group V following the Fourth UNCITRAL International Insolvency Law Colloquium in December 2013 suggested that

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13. John A. E. Pottow, *A New Role for Secondary Proceedings in International Bankruptcies*, 46 TEX. INT’L L.J. 580, 584 (2011).

14. Janger, *Virtual Territoriality*, *supra* note 6, at 408.

15. Janger, *Reciprocal Comity*, *supra* note 6, at 456.

16. *Re Collins & Aikman Europe SA*, [2006] EWHC (Ch) 1343.

17. EU Insolvency Regulation, *supra* note 1, art. 4. Article 4 requires the “country of opening” to apply its own bankruptcy law (subject to a number of exceptions). It provides in pertinent part: “Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened, hereafter referred to as the ‘State of the opening of proceedings.’” *Id.*

18. *See, e.g., In re MG Rover*, [2005] BPIR 1162 (Ch) (Eng.); *see also Barr v. Charterhouse Group Int’l, Inc. (In re Everfresh Beverages, Inc.)*, 238 B.R. 558 (Bankr. S.D.N.Y. 1995); *In re Artimm, S.r.L.*, 335 B.R. 149 (Bankr. C.D. Cal. 2005) (carve-out for U.S. pension fund claim from U.S. assets being sent to Italy for Italian distribution).

19. *Proposal for a Regulation of the European Parliament and of the Council Amending Council Regulation (EC) No 1346/2000 On Insolvency Proceedings*, COM (2012) 744 final (Dec. 12, 2012) [hereinafter *Proposal to Amend the EU Insolvency Regulation*]. For a discussion of the proposed amendments, see Bob Wessels’s contribution to this volume, *Contracting Out of Secondary Insolvency Proceedings: The Main Liquidator’s Undertaking in the Meaning of Article 18 in the Proposal to Amend the EU Insolvency Regulation*, 9 BROOK. J. CORP. FIN. & COM. L. 63 (2014).

UNCITRAL's work regarding corporate groups and directors' obligations might also use "choice-of-law" to facilitate cross-border coordination.<sup>20</sup> It also listed the harmonization of choice-of-law principles in cross-border bankruptcies as among its highest priorities for future work.<sup>21</sup>

This idea—using choice of law principles to implement virtual territoriality—is motivated by a principle that might be called "global best interests." In a coordinated case, the distributional baseline, for the purposes of negotiation and perhaps, someday, cramdown, would be determined by calculating the amount that would be received in a hypothetical territorial liquidation. Local claims would be entitled to a minimum distribution based on their local priorities, though limited to the assets that would have been available in a territorial case had one been filed. The practical task imposed on courts (and administrators) is to calculate the hypothetical territorial distribution. This task places great pressure on the ability to locate claims and assets for the purpose of distribution.

In this Article, I will seek to make two related points. First, I will explore some of the difficulties with locating claims and assets, but argue that ultimately the task is not too hard. Second, I will try to explain why it is worth the trouble, by articulating a principle of global best interests that can offer a practical basis for allocating value in, and a normative basis for, pursuing global reorganizations.

## I. IMPLEMENTING CHOICE-OF-LAW IN CROSS-BORDER CASES

In previous articles, I have argued for an approach to cross-border bankruptcies called "universal proceduralism."<sup>22</sup> Universal proceduralism contemplates a centrally administrated bankruptcy case located at the debtor's COMI that handles distribution and other matters of substance according to a choice-of-law principle that I call "virtual territoriality."<sup>23</sup> This approach is situated within the academic debate between the competing approaches of "cooperative territoriality" advocated by Lynn Lopucki and "modified universalism" pioneered by Jay Westbrook.<sup>24</sup> Current law reform efforts have been animated by a commitment to modified universalism, and, up until now, the differences between modified universalism and universal proceduralism have not mattered much as a

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20. U.N. Comm'n on Int'l Trade Law, Working Group V (Insolvency Law), Rep. on its 44th Sess., July 7–25, 2014, para. 5, U.N. Doc A/CN.9/798 [hereinafter Forty-fourth Session Working Group Report].

21. *Id.* para. 24.

22. See articles cited *supra* note 6.

23. *Id.*

24. Lynn Lopucki, *The Case for Cooperative Territorialism in International Bankruptcy*, 98 MICH. L. REV. 2216 (2000); Westbrook, *Theory and Pragmatism*, *supra* note 7.

practical matter. This is because, with a few key exceptions, the broad architecture contemplated by the UNCITRAL Model Law, the UNCITRAL Legislative Guide, and the EU Regulation are broadly consistent with either approach. The next phase of reform—addressing the problem of corporate groups—however, will place the differences in high relief.

The model law is silent with regard to the law to be applied in main and ancillary cases. The assumption, of course, is that the forum court (main or ancillary) will apply its own law. But this leaves open a question, familiar to first-year law students in the United States confronted with the *Erie* decision: does that law include the forum's own choice-of-law principles?<sup>25</sup> To put it another way, under its domestic bankruptcy law, does a forum court have the authority to apply foreign law to a legal question? If the answer is yes, then a further question arises: which choice-of-law questions are determined by choice of forum or *lex fori*, and which choice-of-law questions are determined by the location of the cause of action itself or *lex situs*? The EU Insolvency Regulation and the Legislative Guide are not silent on this point, and the approach they follow has caused some practical problems.<sup>26</sup>

#### A. CHOICE-OF-LAW UNDER THE EU REGULATION AND LEGISLATIVE GUIDE

The current approach to choice-of-law in cross-border bankruptcies is hobbled by an anachronistic view of the distinction between substance and procedure.<sup>27</sup> It is axiomatic that a forum court should apply its local procedural law to a case. Forum choice determines choice of procedure. By contrast, the governing law with regard to substantive rights is determined by the location of the claim, or, where property based claims are involved, by the location of the property. Bankruptcy law has historically been viewed as procedural, and, therefore, choice of forum has dictated the choice of applicable bankruptcy law.

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25. *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938); *Klaxon v. Stentor*, 313 U.S. 487 (1941).

26. Article 4 of the EU Reg (EU Insolvency Regulation, *supra* note 1, art. 4) and recommendations 31–34 of the Legislative Guide (UNCITRAL LEGISLATIVE GUIDE, *supra* note 5, recs. 31–34) do create problems for Universal Proceduralism, and they are the focus of the discussion below.

27. Paradoxically, in the US, the “bankruptcy is procedural” argument has been seized by bankruptcy minimalists to argue that domestic bankruptcy law should be limited to the procedures necessary for administering the debtor's assets. THOMAS JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (2001); Charles W. Mooney Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931 (2004). By contrast, in the cross-border bankruptcy context, the procedural nature of bankruptcy law has been embraced by bankruptcy maximalists to enforce centralization in the main case. *See, e.g.*, Jay Lawrence Westbrook, *Locating the Eye of the Financial Storm*, 32 BROOK. J. INT'L L. 1019 (2007).

But the formal designation of bankruptcy law as procedural breaks down under modern practice. Rules relating to priority, treatment of contracts, avoidance, and governance all reside within modern bankruptcy statutes, and the effects of those rules are quite substantive.<sup>28</sup> Nonetheless, the modified universalist clings to the historical classification of bankruptcy as procedural and embraces the category creep. If bankruptcy law is formally categorized as procedural, then forum choice determines applicable law. Westbrook has argued, for example, that the major aspects of bankruptcy law—control, priority, avoidance and bankruptcy policy—should all be determined by forum choice.<sup>29</sup> The existing instruments, as well, continue to treat bankruptcy law as a procedural black box.<sup>30</sup>

The Legislative Guide embraces a broad view of *lex fori concursus*. Recommendation 30 states clearly that the forum court should apply its private international law (choice-of-law) rules to determine the *validity* of claims: “The law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings should be determined by the private international law rules of the State in which insolvency proceedings are commenced.”<sup>31</sup>

However, the forum’s bankruptcy law will govern the *treatment* of those claims in an insolvency proceeding. Recommendation 31 states: “The insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) should apply to all aspects of the commencement, conduct, administration and conclusion of those insolvency proceedings and their effects.”<sup>32</sup>

There are a number of exceptions to this rule—for labor claims, settlement of payments and a few others—but the rule is clear, the forum’s bankruptcy law is treated as unitary. Indeed, Recommendation 34 brings the point home, stating, “[a]ny exceptions . . . should be limited in number and be clearly set forth or noted in the insolvency law.”<sup>33</sup>

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28. 11 U.S.C. § 507 (priority), § 365 (executory contracts), §§ 544–550 (avoidance), §§ 321–333 (governance) (2012).

29. Westbrook, *Locating the Eye of the Financial Storm*, *supra* note 27, at 1021 (“The close integration among bankruptcy rules and policies in each jurisdiction applies to the big four of bankruptcy policy: control, priority, avoidance, and reorganization policy.”). *See also* Westbrook, *Theory and Pragmatism*, *supra* note 7; Jay Lawrence Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT’L L. 499 (1991).

30. UNCITRAL LEGISLATIVE GUIDE, *supra* note 5, recs. 30–34; EU Insolvency Regulation, *supra* note 1, arts. 3–4.

31. UNCITRAL LEGISLATIVE GUIDE, *supra* note 5, rec. 30.

32. *Id.* rec. 31.

33. *Id.* rec. 34.

The EU Reg takes a similar approach. Article 4 provides:

Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened, hereafter referred to as the ‘State of the opening of proceedings’.<sup>34</sup>

Again, there are exceptions, and the list is somewhat longer than in the Legislative Guide, but the basic approach is that the forum court will apply its own bankruptcy law, lock, stock, and barrel.

This approach has led to a paradox under both the EU Reg and the Model Law. On the one hand, a debtor’s foreign assets and claims are dealt with in the “main” case where the law of the COMI is applied for distributional and other purposes. On the other hand, local creditors are free to (and the administrator may need to) open a secondary or ancillary case. Under the Model Law, the ancillary court would need to decide whether to administer assets locally or send them to the main for central administration.<sup>35</sup> This decision would require a further determination as to whether local creditor interests were “sufficiently” or “adequately protected.”<sup>36</sup> Under the EU Reg, the secondary proceeding would necessarily be a winding-up proceeding applying local law.<sup>37</sup> Presumably, only residual assets would be available for central administration.

This has created a difficult dynamic, particularly in Europe. Rescue, going concern sale, or coordinated liquidation, can often only be accomplished if one can avoid opening secondaries. Cases like *Collins & Aikman* managed a workaround, but such a result would not have been possible without the flexibility of a common law court.<sup>38</sup> The Model Law does not by its terms empower a court to engage in a choice-of-law inquiry, so unless such power exists within local law, the baseline for “adequate protection” would be local entitlements.

## B. PROPOSAL FOR CHANGE

The *Collins & Aikman* approach has gained additional vitality as a result of pending proposals to amend the EU Reg.<sup>39</sup> Those proposals, if adopted, would codify a version of the *Collins & Aikman* approach. The proposed amendments to the EU Reg give the administrator in the main case the power to make a binding promise to foreign creditors that he would

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34. EU Insolvency Regulation, *supra* note 1, art. 4(1).

35. 11 U.S.C. § 1521(a) (2012).

36. 11 U.S.C. § 1521(b). Chapter 15 uses the term “sufficient protection.” Article 21 of the Model Law uses the term “adequate protection.”

37. EU Insolvency Regulation, *supra* note 1, art. 3(3)

38. *Re Collins & Aikman Europe SA*, [2006] EWHC (Ch) 1343 (Eng.). See *supra* text accompanying note 16.

39. *Proposal to Amend the EU Insolvency Regulation*, *supra* note 19.

match their hypothetical territorial distribution.<sup>40</sup> Second, the proposal would give the administrator in the main case the power to offer that promise as a defense to the opening of a secondary.<sup>41</sup>

The proposed amendments achieve this result in two statutory steps. First, proposed Article 18(1) allows the liquidator to make a binding promise to comply with a hypothetical territorial distribution, and allows the court in the main proceeding to honor that promise:

The liquidator appointed by a court . . . may . . . give the undertaking that the distribution and priority rights which local creditors would have had if secondary proceedings had been opened will be respected in the main proceedings. Such an undertaking . . . shall be enforceable and binding on the estate.<sup>42</sup>

Second, to give teeth to this promise outside the main jurisdiction, the liquidator has standing to appear in a foreign jurisdiction to oppose the opening of a secondary. In a case where the undertaking described above has been given, the court in the non-main jurisdiction is strongly importuned not to open a case:

Upon request by the liquidator in the main proceedings, the court referred to . . . shall postpone the decision of opening or refuse to open secondary proceedings if the opening of such proceedings is not necessary to protect the interests of local creditors, in particular, when the liquidator in the main proceedings has given the undertaking referred to in Article 18 (1) and complies with its terms.<sup>43</sup>

While these two provisions are framed as procedural, they give the liquidator the power to make a binding promise that might otherwise have been beyond her power. There should be no mistake that the effect of this is substantive. Courts will be required to interpret and enforce these “undertakings,” and in order to do so, it will be necessary to make a substantive determination—to calculate “the distribution . . . which local creditors would have had if secondary proceedings had been opened.”<sup>44</sup>

The European Union is not the only place where this approach is catching on. UNCITRAL has recognized that in its current work on corporate groups and officers and directors’ obligations, the ability to calculate and enforce a hypothetical territorial distribution through the use of a synthetic secondary may facilitate cross-border administration of a

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40. *Id.* para. 28(a)(1).

41. *Id.*

42. *Id.*

43. *Id.* para. 34(2).

44. *Id.* para. 28(a)(1).

bankruptcy case.<sup>45</sup> It has also listed a project to harmonize choice-of-law rules as an avenue for future work.<sup>46</sup>

Finally, the need for reform is highlighted by the inconsistent approach to foreign law courts have followed using a comity-based approach. For example, in *Condor*, the foreign representative of a Saint Kitts and Nevis debtor exercised its foreign avoidance powers in a Chapter 15 case.<sup>47</sup> In that case, a foreign insurance company opened an ancillary case in the United States, seeking to avoid a fraudulent conveyance to its U.S. subsidiary.<sup>48</sup> The Fifth Circuit held that, while Chapter 15 does not grant a foreign representative the U.S. Bankruptcy Code's avoidance powers, the foreign administrator could pursue an avoidance action using the avoidance powers available under the law of the main jurisdiction, Nevis. By contrast, in *Qimonda*, U.S. licensees of a German corporation were able to claim protections available under the U.S. law limiting the debtor's power to reject intellectual property licenses even though the patents were held by a German licensor, and German law, it was argued, would have allowed rejection.<sup>49</sup>

The synthetic secondary/virtual territoriality approach embodied in the proposed amendments to the EU Reg might alleviate the tension and inconsistency embodied in the recent cases. However, these proposals also turn modified universalism on its head by validating a virtual territorial approach to distribution. In order to determine whether the promise is being honored, it will be necessary to locate claims, assets, applicable bankruptcy priorities, and applicable non-bankruptcy property rights. This is not impossible, but it may be complicated. How to do so is discussed in the next section.

### C. LOCATING CLAIMS AND ASSETS FOR THE PURPOSE OF DISTRIBUTION

Harmonizing choice-of-law rules for the purpose of distribution might seem like a daunting task. However, some of the work has been done already. The Global Principles for Cross-border Insolvencies of the

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45. Forty-fourth Session Working Group Report, *supra* note 20, para. 16.

46. *Id.* para. 24.

47. *Tacon v. Petroquest Res. Inc. (In re Condor Ins. Ltd.)*, 601 F.3d 319, 323 (5th Cir. 2010).

48. *Id.* at 320. See also 11 U.S.C. §§ 1519–1521 (2012).

49. *Jaffé v. Samsung Elec. Co., Ltd. (In re Qimonda)*, 737 F.3d 14 (4th Cir. 2013). Global Rule 11 of the ALI/III Principles would apply the law of the “seat” of the IP owner (licensor) to govern the IP license. AM. LAW INST., *Global Rules on Conflict-of-Laws Matters in Insolvency Cases*, in TRANSNATIONAL INSOLVENCY: GLOBAL PRINCIPLES FOR COOPERATION IN INTERNATIONAL INSOLVENCY CASES ann. at 200, r.11, (2012), available at <http://www.iiiglobal.org/component/jdownloads/finish/557/5932.htm> [hereinafter *Global Rules*]. The court in *Qimonda* does not do a private international law analysis, however, so the question is not definitively answered.

American Law Institute and International Insolvency Institute offer a template. The choice-of-law “Annex” to the ALI/III Principles articulates a set of choice-of-law principles for cross-border cases.<sup>50</sup> In this section, I will set forth the contours of the Annex approach—not to endorse it, but simply to point out that a broadly intuitive approach to locating claims and assets will work for the vast majority of questions faced by a bankruptcy court. Broadly speaking there are four types of assets that concern us: (1) real property; (2) tangible movables; (3) intangibles; and (4) property whose ownership is registered in a registry. There are three types of claims against the debtor that matter: (1) secured claims—*in rem*; (2) claims against the debtor that are entitled to priority; and (3) claims against the debtor that would be entitled to *pari passu* treatment.

### 1. Assets

The Annex suggests the following rules for locating assets. Real property is located where it is physically located, unless there is a registry, in which case it is located where the registry is located.<sup>51</sup> Tangible movable property is also located where it is physically located, unless it is in transit, has been moved in a forum shop, is mobile goods, or is registered.<sup>52</sup> If it is in transit, it is located where it is going.<sup>53</sup> If it was recently moved in a forum shop it is located where it used to be.<sup>54</sup> Registered property, tangible or intangible, is located where the registry is located.<sup>55</sup> These are common sense rules, and predictable. Indeed, they track the approach followed in the United States by Article 9 of the Uniform Commercial Code prior to the 2000 amendments.<sup>56</sup> While there are rules for locating intellectual property rights, labor contracts, executory contracts and stock,<sup>57</sup> the Global Rules do not have a general rule for locating intangibles. This would be a task for the UNCITRAL project. One possibility would be to locate them where the debtor is located (as does the Uniform Commercial Code). Another approach might be to use general rules for locating contracts at the site of the transaction, to the extent there are rules for doing that. In short, there are a few intricacies, but the obstacle, if any, to a virtually territorial approach is not the ability or inability to articulate predictable principles for locating assets.

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50. *Global Rules*, *supra* note 49.

51. *Id.* r. 6.

52. *Id.* r. 7, 8.

53. *Id.* r. 7.2(b).

54. *Id.* r. 14.

55. *Id.* r. 6, 8.

56. UCC § 9-301 (pre-2000).

57. *Global Rules*, *supra* note 49, r. 10–11, 19–20.

## 2. Claims

The Annex suggests that claims should be located where the debtor is located.<sup>58</sup> As a general rule, this makes sense, but it requires a bit of unpacking and depends on the type of claim that we are talking about. The overarching principle of universalism is that a creditor knows where a debtor is located when they extend credit and can take that into account when they loan. For most debt contracts, this rule works. Indeed, to the extent that a *pari pasu* claim is involved, the creditor could presumably have asserted that claim against the debtor wherever assets are located and a foreign judgment would be recognized. The result is the same as treating the claim as if it were located at the COMI. So far, the exercise of locating claims is reasonably straightforward. For secured claims, however, the property aspect of the transaction will often be governed by the location of the collateral, not the debtor.<sup>59</sup> Where priorities are involved as well, the location of the debtor rule breaks down and the analysis becomes more complicated. We will take these situations in order.

### a. Secured Claims

Once an asset has been located, the inquiry becomes simple, up to a point. Assets located in a particular jurisdiction are governed by the property law and secured credit law of that jurisdiction. However, bankruptcy law often alters the treatment of secured creditors, and thus one must ask whether the bankruptcy law that governs the property rights of secured parties is going to be the bankruptcy law of the jurisdiction where the asset is located or the bankruptcy law of the jurisdiction where the debtor is located. A territorialist would choose the former. A universalist, the latter. A virtual territorialist would say that the main proceeding ought to treat the assets located in a foreign jurisdiction in the same manner as they would have been treated in a territorial case had one been opened.

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58. *Id.* r. 9.

59. The bankruptcy treatment of the locally determined property right could, as a practical matter, be handled under the bankruptcy law of the COMI or the jurisdiction where the property is located. This is an important distinction. Whether the stay limits the rights of the secured creditor, whether the property can be used or sold by the trustee, and the nature of adequate protection are all bankruptcy questions, and determining the applicable bankruptcy law may be as important as determining the applicable property law. In theory, this is one place where the modified universalist and the universal proceduralist would appear to part ways. The modified universalist would give universal effect to the bankruptcy law of the COMI. The universal proceduralist would allow the local assets to be administered under local bankruptcy law (whether in a secondary or in the main). As a practical matter, however, the difference may not be as great as it appears. The EU Reg excludes most in rem rights from coverage by the choice of law rule in Article 4. EU Insolvency Regulation, *supra* note 1, art. 4. The Legislative Guide advocates a broader approach to *lex fori*, but as a practical matter, it is comity rather than choice of law that will determine whether an ancillary or secondary court will acquiesce to the (foreign) main court's assertion of jurisdiction over local assets.

This latter approach is synthetic, but the other approaches might give rise to forum shopping by debtors for better bankruptcy treatment, or create an incentive to open a secondary that might endanger cooperation and coordination. The synthetic approach is followed by the Annex. Rule 15.1 states that “insolvency proceedings shall not affect the rights in rem of creditors or third parties . . . in respect of . . . assets . . . which are situated within the territory of another state at the time of the opening of proceedings.”<sup>60</sup> In other words, if a secondary is opened, then assets located in that jurisdiction will be governed by the bankruptcy law of that jurisdiction. Therefore, symmetry would require that, if no secondary is opened, the main case should determine the treatment of the secured creditor based on what would have happened had a secondary been opened.<sup>61</sup>

*b. Priority Claims*

Jay Westbrook has written thoughtfully about the treatment of priority claims in cross-border cases. He advocates an approach called “universal priority.”<sup>62</sup> Under that approach, the priority rules of the debtor’s COMI would govern regardless of the location where the claim arose. The difficulty with this approach is that some priorities are regulatory and local in nature, such as employee priorities, or priorities linked to the local law of fraud or local tort law. To apply foreign priorities might disturb the incentives built into the local remedial scheme. As an alternative, wearing his modified universalist hat, Westbrook suggests universal priority with cross filing. In other words, the local priorities might be applied in the ancillary, and then again in the main. This has the difficulty of potentially proliferating priorities, and also granting a windfall to a creditor who might earn a double priority. The virtual territorialist would instead situate the contract claim based on ordinary choice-of-law principles, locating the site of the contract, and granting the priority that would apply (if any) under local law. Again, this is the approach followed by the ALI/III principles. Principle 35 states that:

A claim that is governed by the law of a state other than that in which insolvency proceedings are taking place should in principle have only the priority it would have in a strictly territorial process conducted in the state

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60. *Global Rules*, *supra* note 49, r. 15.1.

61. Here, the Annex deviates from the modified universalist approach. The modified universalist would not do this. They would ask the ancillary to cooperate in administering secured claims according to the bankruptcy law of the debtor’s COMI.

62. Westbrook, *Universal Priorities*, *supra* note 4.

whose law governs the insolvency proceedings, and restricted to assets located in that state.<sup>63</sup>

It is important to note, however, that this result is not mandated by the Model Law or consistent with the Legislative Guide's recommendations on governing law.

*c. Pari Passu Claims*

For general unsecured claims, the modified universalist and the virtual territorialist reach the same result. To the extent that the claim is a recourse claim against the debtor, an unsecured creditor could pursue that claim in any jurisdiction where the debtor had assets by domesticating the judgment and seizing assets to the extent permitted by that jurisdiction's laws. The same would be true if a secondary were opened in that jurisdiction. Local creditors might claim in the secondary, but foreign creditors as well could claim through the foreign representative. The difference between the virtual territorialist and the modified universalist disappears where *pari passu* claims are involved, and the III/ALI principles recognize this through Principle 34 which mandates recognition and allowance of claims across jurisdictions.

One place where the Annex fails to achieve clarity is with regard to bilateral contracts. Rule 19 of the Annex states that the law governing bilateral contracts shall be the "jurisdiction of opening."<sup>64</sup> This rule is problematic, as the governing law may change depending on whether the contract rights are being enforced in the "main" or the "secondary," each of which has its own "jurisdiction of opening." This is precisely the confusion that led to the dispute in *Qimonda*.<sup>65</sup> The modified universalist would resolve this dispute by saying that the bankruptcy treatment of an executory contract will be handled by the law applicable to the main case. The virtual territorialist would choose instead the law of the jurisdiction to which the contract has its greatest relation—the situs of the transaction. For what it's worth, in *Qimonda* the result of both inquiries would likely have been Germany rather than the United States.<sup>66</sup>

The point here is, again, not to choose which result is right, but to suggest that the exercise of choosing the applicable law is not futile. However, where the two inquiries diverge, virtual territoriality would limit the incentive to forum shop for the favorable rule.

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63. *Global Rules*, *supra* note 49, r. 35.

64. *Id.* r. 19.

65. See *Jaffé v. Samsung Elec. Co., Ltd. (In re Qimonda)*, 737 F.3d 14 (4th Cir. 2013); *In re Qimonda AG*, 462 B.R. 165 (Bankr. E.D. Va. 2011).

66. See *supra* text accompanying note 49.

*d. Corporate Groups*

A second place where territorialism reasserts itself, even for unsecured non-priority claims is if the debtor has created foreign subsidiaries. Subsidiaries limit the assets against which local creditors may claim. The existence of territorial subsidiaries simplifies the choice of law inquiry in some ways and complicates it in others. With regard to legal non-bankruptcy treatment and calculation of a hypothetical territorial distribution, the existence of a subsidiary actually simplifies matters. Assets and claims are more likely to be located in the same jurisdiction. Creditor expectations may be linked more tightly to territorial assets. With regard to bankruptcy treatment, this is a place where the gap between modified universalism and virtual territoriality becomes quite wide. Corporate groups pose a problem for the modified universalist, in that they undercut equality of treatment, and lock in the asset/claim inequalities that *pari passu* treatment washes away for a consolidated debtor. The universal proceduralist would respect the corporate form and leave it at that. The modified universalist would take a different approach depending on whether the subsidiaries were truly operationally distinct or merely formal. In the next section, I will explain why, as a practical matter, the divide may not be as great as it seems, but for the moment, the difference seems quite fundamental.

Corporate groups are not just a problem for equality of treatment. They also complicate matters for centralized control. Officers and directors of subsidiaries face a difficult question: should they answer to the corporate parent and equity owner, or to local creditors (if the debtor is locally insolvent)? These questions loom large for the modified universalist. Should the interest of the group control the interest of the subsidiary? The question is not complicated for the universal proceduralist. The duties of directors and officers are determined by local law. The problem for the universal proceduralist is whether centralized control and coordinated governance is possible in the face of such conflicting duties.

But again, as I will explain in Part II, the difference may not be as great as it seems. First, the clarity added by corporate groups may actually make it easier to calculate a hypothetical territorial distribution, and hence a baseline entitlement. This in turn will make it possible to distinguish the territorial entitlement from the value that is created by coordinated administration (and is a proper subject for bargaining). To the extent that the value to the subsidiary (over and above the hypothetical territorial distribution) can be quantified, this may actually help the directors explain to local stakeholders and courts why it is the entity's best interest to follow the instructions of the corporate parent.

#### **D. ACTION ITEMS—CHOICE-OF-LAW IN CURRENT INTERNATIONAL INSTRUMENTS**

To the extent that it is deemed desirable to implement a choice-of-law based approach to cross border cases as outlined above, it will be necessary to make several adjustments to existing international instruments. The Model Law does not discuss choice-of-law, and many civil law jurisdictions that have adopted the Model Law might take the absence of authority as a denial of the power to engage in a private international law inquiry. It might be worthwhile for UNCITRAL to consider suggesting in its enactment guide a provision empowering countries to engage in the sort of choice-of-law inquiry described above where none exists under national law. Similarly, Article 34 of the Legislative Guide calls for strict limitation to the number of exceptions from the scope of bankruptcy law.<sup>67</sup> Thus, if choice-of-law is to be considered for purposes of distribution to secured and priority creditors, then it might be useful to add a subsection to Article 34 to govern cross-border cases. Finally, to the extent that these rules for locating assets and claims make sense, it might also make sense for UNCITRAL to undertake a project that would encourage harmonization around these rules.

## **II. WHY BOTHER?**

Locating claims and assets can be difficult. Asking courts to apply foreign law can be confusing. Westbrook has argued that seeking to do so will not increase fairness and may undercut the goal of coordinated administration of cross border bankruptcy rather than furthering it. Hopefully, the discussion above demonstrates that the task is not a fool's errand. The question remains: why bother? What is to be gained from the effort to locate claims and assets for the purpose of distribution? In this section, I will argue that the benefit of a virtual territorial approach is that (1) it will facilitate rather than hinder cooperation by limiting incentives to forum shop; (2) it will provide a global distributional baseline for determining best interests (Pareto optimality); (3) it will provide a global basis for distinguishing pre-bankruptcy entitlements from bankruptcy-created going concern value; and (4) it will mute the sovereignty objection and thereby facilitate cooperation among courts.

Situating claims and assets is worth the trouble because it makes it possible to calculate a hypothetical territorial liquidation that respects the corporate form. This calculated hypothetical "local" distribution establishes what a claimant would receive in the absence of a globally coordinated administration. The amount that such a creditor would actually realize if they resorted to local remedies is the baseline against which a proposed

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67. UNCITRAL LEGISLATIVE GUIDE, *supra* note 5, art. 34.

coordinated disposition can be judged. It also establishes the quantum of firm value that is based on “entitlement,” and the benefits of coordinated administration (or “transactional gain”) that is the proper subject of bargaining.

#### **A. THE ABSENCE OF GLOBAL CRAMDOWN**

The generally accepted rationale for cross-border bankruptcy is that coordinated governance of a multinational enterprise will maximize value for stakeholders.<sup>68</sup> The greatest obstacles to value maximizing restructurings are coordination problems and conflicts of interest. These obstacles loom large in domestic cases, and even larger when one seeks to coordinate the restructuring of a multinational enterprise. There is no mechanism to bind (cramdown) dissenters across borders, and for that reason most global reorganizations reach only financial creditors. Even then, this coordination can only be achieved when the benefits of coordination are very large. Therefore, the acid test of a global restructuring regime is not the ability to gather assets, but the ability to obtain recognition, across borders, of the automatic stay, and, even more importantly, to bind a non-consenting claimant.

Comity and cooperation help in this regard, but, as has been discussed, they require a local court to accept outcome differences that will often implicate strongly held creditor interests and fundamental national policies. The calculation of a hypothetical distribution in a territorial liquidation provides the basis for a “justice” based claim to recognition, and undercuts both the entitlement claims of local creditors and the sovereignty objection of local courts.

#### **B. GLOBAL BEST INTERESTS AND THE DISTRIBUTIONAL BASELINE**

To confirm a Chapter 11 plan in the United States, one must satisfy the so-called “best interests” test.<sup>69</sup> Every creditor must receive at least what they would have received in a hypothetical Chapter 7 liquidation.<sup>70</sup> In cramdown, secured creditors are entitled to at least the liquidation value of their collateral and unsecured creditors are entitled to their pro rata share of the proceeds of the liquidated unencumbered assets before any junior creditor can receive a distribution.<sup>71</sup> The condition is one of Pareto optimality. It limits the cases where one can seek to reorganize, but it also establishes the limit to one’s moral and legal entitlement to a firm’s value.

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68. 11 U.S.C. § 1501(a) (2012).

69. 11 U.S.C. § 1129(a)(7).

70. 11 U.S.C. § 1129(b)(2)(B)(ii).

71. 11 U.S.C. § 1129(b).

In a domestic bankruptcy, value above and beyond the liquidation value is, in effect, created by the availability of a bankruptcy forum. While creditors can force a liquidation using state law remedies, the ability to preserve going concern value by reorganizing or conducting a going concern sale is value created by federal bankruptcy law.<sup>72</sup> This same distinction between liquidation-based entitlements and bankruptcy created going concern value can be made with even more moral force in cross-border cases with regard to territorial entitlements. When a cross-border enterprise fails, local creditors have the power to compel the liquidation of local assets, but not more. The cross-border bankruptcy architecture created by the Model Law, EU Reg and other international instruments is what creates the possibility of rescue or coordinated liquidation.

This recognition of the limits of territorial entitlement goes a long way toward minimizing the practical difference between the universal proceduralist and the modified universalist. The modified universalist fears that recognition of local entitlements will give local creditors a veto over the treatment of local assets, or that local asset inequalities will hamstring consensus on a coordinated disposition. This may be true in cases where the benefits of coordination are small, but in such cases coordinated administration may not actually be worth the trouble. The cases where coordinated administration is important are the ones where the firm's going concern increment exceeds the costs of coordination.

The cost of territorialism is that this increment of value will be lost because of the problem of territorial holdouts. The cost of modified universalism is that this value may also be lost if secondaries must be opened and outcome differences cause ancillary courts to resist or cooperate only after a considerable fight. Unfortunately, neither cramdown nor Pareto optimality are enshrined in the cross-border architecture. Local liquidation value is not stated as a baseline entitlement, and there has not been a mechanism, until now, to impose this limit on a non-consenting local creditor.

The genius of the proposed amendments to the EU Reg is that the combined effect of the undertaking contemplated by Article 18(1), and the discretion granted to the local court by Article 29a(2) to decline to open a secondary is to provide just such a mechanism for binding non-consenting foreign creditors to decisions made in the main case. The prerequisite is compliance with the global best interests standard described above.

This Pareto optimality condition stands in sharp contrast to the “rough wash” in return for “transactional gain” rationale for comity in cross-border

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72. Melissa Jacoby and I have made this point in a more detailed and systematic fashion elsewhere. Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy Cases*, 123 YALE L.J. 862, 925 (2014).

cases. The modified universalist instead turns to Kaldor-Hicks based efficiency claims, and these are hard sells when the institutions for enforcement are weak, as they are in the cross-border context.<sup>73</sup> The concept of the hypothetical territorial liquidation, offered by the virtual territorialist, offers a way to render the cross-border apparatus consistent with the usual bankruptcy criterion of “best interests.”<sup>74</sup> This is particularly important where the court at the debtor’s COMI must obtain cooperation through persuasion rather than command.

### C. THE PRACTICAL POLITICAL EFFECTS OF A GLOBAL BEST INTERESTS TEST

To make the point of the preceding section more concrete, creditors often base their objections to reorganization on a supposed legal entitlement, without realizing that legal entitlements have different practical values in different contexts. This point is most easily demonstrated in connection with a secured creditor who claims ownership of collateral and objects to any disposition that she does not approve. As a practical matter, her security interest may have a variety of values depending on the manner of disposition. As a legal matter, in a cross-border case, a secured creditor only has the power to insist on a territorial foreclosure under the procedures of local law. An unsecured creditor only has the power to levy on assets and sell them on the courthouse steps. It may be possible to obtain a higher value for these assets if sold as a group, or if not sold at all, but this is not necessarily value that the creditor has the power or right to realize.

One does not want purely theoretical legal entitlements to stand in the way of a cooperative coordinated solution that would grant them a greater actual distribution. The hypothetical territorial liquidation baseline gives the debtor in the main case the ability to move past rough wash to transactional gain in the individual case. The administrator can call the objector’s bluff and say, “This is what you’d get if we liquidated. We’re offering you at least that much.”

Where courts are involved, the ability to calculate a hypothetical territorial liquidation also makes it possible to decide whether it is in the best interests of the estate to open a secondary case, and to decide whether the debtor’s proposed disposition of the estate complies with the undertaking described in proposed Article 18(1) of the EU Reg. Under the Model Law knowing the hypothetical territorial distribution would allow an

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73. The condition of Pareto optimality requires that everyone be made better off, while the Kaldor-Hicks efficiency criterion requires only that society as a whole be made better off, even if some members of society are made worse off.

74. See Edward J. Janger, *Virtual Territoriality*, 48 COLUM. J. TRANSNAT’L L. 401 (2010).

ancillary court to determine whether creditors' expectations are being sufficiently protected.

Once a distributional baseline has been calculated, however, it is possible to distinguish claims of entitlement based on ownership of or control over a portion of the estate from negotiations over reorganization value (that only exists as a result of the ability to arrange a coordinated cross-border disposition of those assets).

#### **D. FORUM SHOPPING**

In addition to establishing a distributional baseline, granting the main proceeding the power to offer foreign creditors at least their hypothetical territorial distribution reduces the stakes associated with forum choice and the incentive to open secondaries. Therefore, to the extent that debtors still engage in forum shopping, it is more likely to be based on the efficiency of a nation's bankruptcy statute and the expertise of a nation's bankruptcy courts than it is to be based on strategic gaming. Finally, to the extent that it is necessary to open a secondary or ancillary proceeding, the incentive will derive from the needs of estate administration rather than attempts to capitalize on priorities or creditor rights available in the secondary jurisdiction.

#### **E. RESPECTING NATIONAL POLICY CHOICES**

Differences among bankruptcy laws exist for a reason. Bankruptcy law allocates the cost of business failure among various constituencies, and different countries take different views of how these losses should be allocated. Some countries think it is essential to fully protect employees. Others care deeply about fraud victims, tax claimants, tort claimants, and so on. The relative priority positions are different, but not necessarily idiosyncratic. They have expressive content, and they also reflect a balance that is dependent on rights and entitlements that may exist elsewhere in the legal system. Similarly, governance rights are allocated differently in different systems. Some bankruptcy cases are run for the benefit of shareholders, some unsecured creditors, some secured creditors, etc. Again, this allocation of governance rights is likely to be considered, and may be balanced against other policy choices contained in the nation's business laws. Allowing the main court to respect the distributional baseline described above also carries with it a respect of the policy choices made by other countries.

#### **F. CORPORATE GROUPS AND THE CORPORATE FORM**

The concept of global best interests based on a hypothetical territorial distribution also provides a way for cross-border bankruptcy to manage and address the problem of corporate groups. It both limits the effects of asset

inequality and limits the scope of conflicting duties faced by directors of territorial subsidiaries.

### 1. Equality of Treatment

Indeed, *Collins & Aikman* was a group case, and the promised territorial distributions in that case were based on the existence of subsidiaries in the relevant countries. By locating claims and assets, and indeed subsidiaries, it was possible to centrally administer a case at the debtor's COMI while respecting the corporate form.<sup>75</sup>

One concern about the virtual territoriality/synthetic secondary approach raised by Westbrook and also by Irit Mevorach is that recognition of the corporate form with regard to assets and claims may elevate form over substance for many firms that are functionally and operationally centralized at the group-COMI.<sup>76</sup> Indeed, many groups manage cash centrally, and Westbrook has described territoriality, in such situations, as creating a sort of "asset roulette."<sup>77</sup> Using a "territorial liquidation" standard as the baseline for entitlement considerably limits the extent to which this will be a problem. A territorial claimant asserting local priority or security would bear the burden of establishing that the particular asset would be available for liquidation in the territorial case. This would considerably reduce the size of such entitlements, and hence, the bargaining leverage of the claimants against the subsidiary.

### 2. Governance: Clarifying Directors' Duties in Reorganization Cases

Another problem that has bedeviled cross-border bankruptcy cases is that where a firm organizes through territorial subsidiaries, the fiduciary duties of the directors, and potential obligations for wrongful trading may demand that they open a secondary case, while they may receive instructions from the corporate parent not to do so, and instead to cooperate with the global case. Again, if one can calculate a hypothetical territorial distribution, and promise to honor that distribution and/or share a portion of the reorganization value, then the local directors can justify their decision to follow instructions emanating from the main case by stating that it is maximizing value for the local claimants against the local subsidiary.

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75. See text accompanying note 16 *supra*.

76. Jay Lawrence Westbrook, *Breaking Away: Local Priorities and Foreign Assets*, 46 TEX. INT'L L.J. 601, 606–09 (2011); Irit Mevorach, *Cross-Border Insolvency of Enterprise Groups: The Choice of Law Challenge*, 9 BROOK. J. CORP. FIN. & COM. L. 226, 232–34 (2014).

77. Symposium, *International Insolvency Symposium: The Priority Dilemma*, 46 TEX. INT'L L.J. 437 (2011) (quoting Professor Westbrook's spoken remarks).

**CONCLUSION**

In sum, the goal of this essay has been twofold. First, I seek to establish that it is practically possible within a centrally administered case to calculate a hypothetical territorial distribution that can be used to establish a distributional baseline for claimants across jurisdictions. Second, I argue that this hypothetical territorial distribution, based on a choice-of-law approach, should form the basis for establishing the Pareto optimality of distributions in a coordinated administration. This ability to distinguish local liquidation value from going concern value will allow the debtor to quantify the transactional gain associated with cross-border cooperation, and further to quantify the transactional gain obtained by each claimant. This ability to distinguish claims based on entitlement from claims that seek to reallocate reorganization surplus will reduce the cost of comity, as differences of outcome should disappear as a political and moral consideration