

A Theoretical Approach to Cooperation

A Theoretical Approach to Cooperation in Transnational Insolvencies: A European Perspective

Christoph G. Paulus,
Professor of Law, Humboldt University at
Berlin*

1. The Matrix

When we speak about cooperation in transnational insolvencies we assume a certain understanding of how to deal with these phenomena. For the sake of clarity it might be worthwhile to begin with an outline of this assumption. It can be expressed as a matrix. This matrix is based on several legal concepts and some legal developments. They all are well known. But bringing them to mind or keeping them there might help understanding the directions in which this rapidly expanding and changing area of law does or should develop.

1. Territoriality vs. Universality

The most fundamental dichotomy is that between the concepts of territorialism and universality. As to territorialism we are in the happy position to live in a world where different legal concepts are practised and applied. Without the shining example of Japan we would have greater difficulties to see advantages and disadvantages of this concept – the advantages being, *inter alia*, predictability through clear and unambiguous rules. The disadvantages are primarily the invitation, to debtors as well as creditors, for forum shopping.¹ Universality, in contrast, describes the claim of a local insolvency proceeding to be acknowledged and to extend the home effects of this proceeding worldwide. This approach does not necessarily (but in recent times more and more) come hand in hand with the reciprocal guarantee to acknowledge a foreign universality claim in the same way as the domestic law wants the foreign jurisdictions to accept its own universality claim.

2. Unity vs. Plurality

A second concept is, again, built on a pair of contrast: Unity vs. multiplicity. Unitary proceedings are the only one set of proceedings that deals with the debtor's insolvency worldwide. Multiple proceedings serve the same purpose by job sharing. It is primarily in this context that we think and talk about cooperation. The distribution of tasks varies both in terms of ranking and in terms of intensity. As to ranking, there is generally a need for the determination of one main proceeding to

which the other proceedings are subordinated. As to intensity, these subordinated proceedings might be full-fledged insolvency proceedings. They may follow the patterns of the respective local insolvency laws like the secondary proceedings in the EU Regulation (also called parallel proceedings). Or, as an alternative, they might be just ancillary proceedings like in Australia, Switzerland or the US. Ancillary proceedings reduce the expenditure for the job sharing to a degree which is just necessary for protecting the local creditors without going through the whole domestic insolvency proceeding. Apart from these two concepts, in a particular insolvency proceeding the job sharing could also be done on a case-to-case basis by means of a protocol.

3. Convergence in the insolvency world

It is important to recognise that the matrix is not just fixed or defined by these more or less static concepts. There is at least one very powerful additional dynamic element that has to be taken into account. I am referring to the comparative and harmonizing work in the area of insolvency law – both national and transnational. This has reached a degree which would have been unthinkable of only some five or ten years ago. Insolvency law was always declared as something too complicated, too complex, and too much intertwined with local values and politics as to be accessible for mutual adjustment – let alone harmonization.

But today, wherever one looks around the globe there are attempts of harmonizing insolvency law, be it on a worldwide level – suffice it to mention here the UNCITRAL model law,² the IMF paper³ and the present World Bank Insolvency Initiative – be it on a regional level such as the EU regulation, the NAFTA Transnational Insolvency Project, or the Asian Development Bank with its "Regional Technical Assistance on Insolvency Law Reform (RETA).⁴ This development is remarkable insofar that it reduces the complexities of insolvency law on two levels: whereas the global attempts primarily provide the fundamentals or principles, the regional attempts go even further and begin to harmonize within smaller segments of the globe. Thus, the convergence of the respective national insolvency laws is approaching from two sides, so to speak.

It might be noted as an aside that this regionalism corresponds with another phenomenon: To my knowledge there exists no jurisdiction where legislation on insolvency law is left to the country's smaller units such as states, departments, provinces, Kantons, or Bundesländer; it is always the biggest unit – the nation – which is in charge with this legislation.⁵ It is, therefore, consistent that to the extent to which the economic units nowadays become even bigger and transcend the national borders the need for transferring legislative authority to these bigger units increases and becomes gratified (for Europe see below sub III 2). If one follows this development into the future one gets curious what a

A Theoretical Approach to Cooperation

ubiquitous and border-ignoring e-commerce might bring us in terms of insolvency law.

II. The Goals

These elements of the said matrix do not exist on their own but serve a separate purpose. Especially the dynamic recent development towards an approximation of the world's insolvency laws obviously hints at a need for a unitary proceeding. The goal seems to be that if there is a transnational insolvency it would be dealt with best if the world were a global village with just one insolvency law, one insolvency proceeding, and one insolvency court accordingly. Its opening would lead to a worldwide automatic stay and guarantee an equitable treatment of creditors – both in case of liquidation as well as reorganisation.⁶ In such a scenario cooperation is needed – if at all – for mastering linguistic or technical barriers rather than legal ones.

However, even though we have already reached remarkable progress within a very short period of time we still have a long way to go – and those who are impatient will say that we are actually creeping on this way.⁷ We are still far from being able to cope with all the various insolvency situations – especially not the most complicated ones such as handling the problems resulting from a corporate group's insolvency.⁸ But it is indispensable to know the goal since it provides the orientation as to the direction in which we should or have to go. On our journey we are dependant on the help of the above-mentioned concepts; they serve as tools for the construction of this way into future. They all contain some elements, which can be useful for approaching the goal. The deficiencies of this mix compared to the ideal are – or, at least, should be – softened by cooperation.

Therefore, rather than arguing with labels such as territorialism vs. universalism one should not hesitate to do cherry-picking and to construe something which serves the practical needs and brings us forward on our common way. The name for such construction is of secondary interest – if at all.

III. The EU Regulation

1. The "is"

An excellent example for such cherry picking is the EU regulation. It contains elements of territoriality and universality as well as of unity and multiplicity; and it provides for cooperation. It does even so in such an extensive manner that – in my opinion – nothing but the fear from stepping on new land prevents the continental European judges to enter into protocol-agreements. It is commonly said that this form of cooperation needs statutory permission to the judge; if this were really true,⁹ such permission – irrespective of the silence about the judge's powers in this respect – should now be derived at least from the initial considerations which

put a strong emphasis on the need for asset value maximization, see, e.g., 2, 4, 5, etc.

The Regulation is the compromise that was finally found after some 30 years of common endeavours.¹⁰ It is based on the idea of a unitary proceeding with a universalistic approach. Therefore, it is provided for the automatic recognition of the once opened main proceeding with its double reference to both the opening, art. 16, and the effects, art. 17. Insofar, one might say that Europe has come pretty close to the above mentioned goal: they have not created a global village but at least an European one – with one insolvency law, art. 18. As to the deficiencies of this approach for the world outside of Europe, see below sub 2.

However, even within this area the realization of this goal is not yet fully possible. The differences of the respective substantive laws are still too big to be over bridged by just one law.¹¹ Therefore, the regulation provides for the possibility of secondary proceedings¹² that are territorialistic in their effect – not in the recognition of their opening. Nevertheless, since this territoriality is a consequence of the primary goal of one universalistic proceeding one might call this form of territoriality a modified one. This approach does not ignore the world around but – quite to the contrary – recognizes it. In case of an opened secondary proceeding, there is a multiplicity of cases – in the most extreme, there are as many proceedings as there are member states.

According to the Regulation, this distortion of the primary goal of just one proceeding shall be mitigated by the extensive cooperation duties and possibilities as set down in art. 31 seq.¹³ It remains to be seen whether or not this is a realistic and viable assumption; one might be sceptical in sight of the almost complete lack of cooperation experience among continental European insolvency practitioners. Under these auspices, it is very unfortunate that the Council did not accept an amendment proposed by the European Parliament. The former institution wanted to press the universalistic approach a little bit further by adding a few words to art. 29:¹⁴ This article provides for the right to file a petition for a secondary proceeding. Whereas such right was originally, i.e. in the then still Convention, given to anybody in the respective country who had this right according to the local insolvency law, it was proposed by the Parliament to restrict this right by the necessary consent of the administrator of the main proceeding – thereby implying, of course, that a main proceeding is already pending. The Parliament justified this amendment by referring to the principle of unity of the proceeding, which makes the multiplicity of proceedings undesirable. In my opinion, a very convincing argument.

The Council's reaction to this breath taking step forward amplifies that we actually have to fight for every inch on our way towards the final goal. The Council just stated: "the Committee studied in depth the proposed

A Theoretical Approach to Cooperation

amendments put forward in the European Parliament's Opinion on the draft Regulation on insolvency proceedings. The Committee did not think it appropriate to adopt the proposals made by the European Parliament.¹⁵ Thus, the original Convention text remains the official one in the Regulation – thereby opening avenues to multiple proceedings.

2. *The "is not"*

From an inside perspective the regulation is nevertheless a grand step forward; from an outside perspective, however, it is probably disappointing. Since according to the wording of the regulation, there exist just member states but no one outside – as is the case with the two other recently enacted Directives on the reorganisation and winding up of credit institutions¹⁶ and insurance undertakings¹⁷ respectively. Thus, for non-members of the "Club" the regulation might even appear as a step backward since all what it appears to have done is go back to the territoriality principle with a territory covering all member states.

One reason for this closed shop policy is certainly that these Club members have a long lasting history in common – both in economic and in legal terms. However, the global market does not care such tradition, it requires solutions for its tendency towards globalisation. They have to be found – and they can be – in various ways: In England one obviously thinks of introducing the UNCITRAL model law,¹⁸ the German legislator, on the other hand, has already announced that the regulation shall form the model for the German international insolvency law, to the extent possible; i.e., the Regulation's term 'member state' shall be read as 'any state in the world'. Still another way is what one always tries with a jurisdiction that sticks to the territoriality principle: one enters a bi- or multilateral agreement on cooperation and/or extension of the universality principle – be it modified or not. This is what the Scandinavian countries did – and probably do – consider with each other.

IV. Possible Improvements

The next steps for improving the law for transnational insolvencies could be the following:

1. *Trust in one's own insolvency law*

One often heard argument for parallel proceedings is the alleged need for protecting the locals in their trust into the domestic (insolvency) law. This is probably in most cases a mere fiction which serves the purpose of sticking to one's own law.¹⁹

2. *Convergence of insolvency priorities*

The above-mentioned worldwide endeavours of the IMF and the World Bank might lead to an approximation of the insolvency priorities – and, thereby, leading

to a greater mutual trustworthiness. The notable beginning of Austria and Germany in abolishing the tax priority is already an important achievement. A minor step – but a step, after all – is the EU Consideration 21, which allows tax authorities to lodge their claims in a foreign proceeding. This calls a halt to the often heard argument that one's own insolvency law is not designed to collect other countries' taxes.

3. *Unbundling of universalism*

The universality concept – as described – contains in fact a bundle of issues, e.g., recognition of the opening and recognition of a number of effects. One might consider applying universality not on all issues but as a first step, only on a selected number – such as, e.g., lodging of claims or collection of assets, etc.

4. *New institution*

In order to improve cooperation one might want to think of introducing a supra-national institution – be it a court or be it a bureau –, which does this cooperation or coordinates it at least. This institution should be formed (or served) by experts, which are independent in the respective cases. By introducing such a neutral institution, the readiness to cooperation might be increased due to the fact that one is not dealing with another jurisdiction but an independent team of experts. Moreover, this would make it easier for continental European judges to make use of such cooperation. If they should feel bound by the explicit wording in art. 31 seq. EU Regulation which refers only to administrators they then had the "escape" to ask for private expertise of that supra-national institution. This is common ground for judges and well accepted by all European jurisdictions.

Notes

- * This paper was delivered as a speech on July 21, 2000 on the annual meeting of the ABA in London.
- 1 See, in addition, e.g. Bebchuk/Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 *The Journal of Law and Economics*, p. 775 seq. (1999).
- 2 For the text, see, e.g. <http://uncitral.org/en-index.htm>.
- 3 Legal Department, International Monetary Fund, *Orderly and Effective Insolvency Procedures*, 1999.
- 4 A more comprehensive list can be found in: *Reducing the Risks of International Insolvency – A Compendium of Work in Progress*, A Report Prepared by Deloitte & Touche and the Group of Thirty (on file with the present author).
- 5 Best example is besides the US Constitution the legislation in Switzerland with her federal *Schuldbetreibungs- und Konkursgesetz* from April 11, 1889 as amended on December 16, 1994.
- 6 See, e.g., 134 *Entscheidungssammlung des Bundesgerichtshofs* (German Supreme Court in Private Law Matters – Collection of ist Decisions), p. 39 seq. (Nov. 14, 1996); Thomas Laut, *Universalität und Sanierung im internationalen Insolvenzrecht*, 1997.
- 7 For an argument pro this estimation, see below sub III 1 (the Council's reaction to proposed changes of the Regulation).
- 8 This is especially true since the insolvency of corporate groups is

A Theoretical Approach to Cooperation

not even dealt with in most national insolvency laws – Argentina being one of the glorious exceptions.

- 9 I have argued elsewhere that already the existing insolvency law permits the German judge to cooperate in a manner that is consistent with what their Common Law-colleagues do when they enter protocols: Paulus, "Protokolle" – ein anderer Zugang zur Abwicklung grenzüberschreitender Insolvenzen, 19 *Zeitschrift für Wirtschaftsrecht (ZIP)*, p. 977 seq. (1998). In addition, in the AIOC case, a Swiss Bankruptcy Office has entered into a protocol.
- 10 For this history, see, e.g., Trautman, Westbrook, Gaillard, Four Models for international Bankruptcy, 41 *Am. J. of Comparative Law*, 573, 586 seq. (1993). See also Hanisch, Grenzüberschreitende Insolvenz – Drei Lösungsmodelle im Vergleich, *Festschrift (=Essays in honor of) Hideo Nakamura*, 1996, p.221 seq.
- 11 See also Consideration 11.
- 12 The one cherry that was not picked by the Regulation is the ancillary proceeding.
- 13 See also Consideration 20.
- 14 Report on the Proposal of a Regulation of the Council on Insolvency Proceedings (9178/1999 – C5-0069/1999 – 1999/0806 (CNS)) from Feb. 23, 2000, p. 6/19.
- 15 Council 6816/00 JUSTCIV 25, p. 1, from April 6, 2000.
- 16 2258. Council – ECOFIN: Press Release: Brussels (08.05.2000) – Press: 141 – Nr. 8204/00.
- 17 2265. Council – Internal Market: Press Release: Brussels (25.05.2000) – Press: 180 – Nr. 8829/00.
- 18 See also M. Virgós, The 1995 European Community Convention on Insolvency Proceedings: an Insider's View, *Forum internationale* No. 25, March 1998, p. 9.
- 19 W.Lüke, Das europäische internationale Insolvenzrecht, 111 *Zeitschrift für Zivilprozeß*, 275, 283 (1998).