CROSS-BORDER COOPERATION IN CASES OF INTERNATIONAL INSOLVENCY: SOME RECENT TRENDS COMPARED

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Memoire

My friendship with Ferd Stone extended for the best part of a quarter-century, commencing with my arrival at Tulane in the Fall of 1966 to join the uniquely privileged band of graduate students attached to the Institute of Comparative Law, of which Ferd himself was the Founding Director. I thus came to know him, successively, as inspired--and inspirational--teacher and academic guide; as cherished and invaluable colleague (during Tulane Summer Sessions held in Grenoble, and when he several times came as Visiting Professor to the University of Wales, Aberystwyth); and above all as staunch and irreplaceable friend, and family friend, whose company was truly life-enhancing. During the course of our correspondence--sustained from his side until very nearly the end of his life--he oftentimes made characteristically wry allusions to my developing interest in the law of insolvency. It is therefore not inappropriate that, as one whose training in comparative law properly began in his classroom, my contribution to this Commemorative Issue should take the form of a comparative survey of some recent, and highly significant, developments in the field of insolvency law touching upon its international aspects.

The Problem Stated

The insolvency laws of the different sovereign states of the world differ from one another in many ways, ranging from minor points of detail to the most fundamental matters of principle.[1] When systems are studied comparatively it is readily seen that a hypothetical test case would be dealt with in widely differing ways, depending upon the systems whose insolvency laws are applied to it. Sometimes the

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1. Indeed, such diversity can be encountered even inside the frontiers of a single political state, such as the United Kingdom, where the insolvency laws of England and Wales, Scotland, and Northern Ireland each contain numerous characteristics not shared in common with the other jurisdictions within the components of what is supposedly a "United" Kingdom.

variations can be quite dramatic--as where the debtor is exempted, by reason of status, from the application of any form of insolvency regime, and is thus denied the possibility of "going bankrupt" under the laws of the states in question."[2] Other, significant variations include the requisite criteria for opening insolvency proceedings; the nature and effects of those proceedings upon the debtor's person and property; the categories of exempted property which remain inaccessible to the creditors; the order of priorities in distributing the available property after realization; the scope for impeaching antecedent transactions whereby the debtor's estate has been appreciably depleted; and the policy and principles which are applied in respect of the rehabilitation of former bankrupts or, in the case of failed companies, those who have been involved in corporate management.

The above comments should serve to indicate the potential range of problems to be encountered in the case of an insolvent debtor, individual or corporate, whose financial interests are dispersed between two or more distinct jurisdictions. Typically, the rules for exercising insolvency jurisdiction are so designed as to render "foreign debtors" amenable to the local law, subject to their meeting certain minimum criteria (which may involve merely the presence of some assets, even of low value, within the jurisdiction or the fulfilling of a "doing of business" test). Thus, the debtor may be simultaneously amenable to the insolvency laws of a plurality of jurisdictions. Questions immediately arise as to whether plurality of proceedings is either admissible in principle, or desirable in practice. If it be argued that unity is the desired goal, a further range of problems has to be addressed. These include, the basis for determining which of the possible "centres" shall become the exclusive bankruptcy forum for the case in question. Consequential difficulties then follow regarding the necessity of according extra-territorial effect to proceedings which are thus concentrated into a single jurisdiction,[3] but which must perforce apply to a property located in other countries, and to claims which are properly governed by other systems of law. On the other hand, if the possibility of plurality of proceedings be admitted, or even necessitated, through a strict refusal by some systems to accord any extra-territorial effect to proceedings commenced elsewhere,[4] many

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2. *E.g.*, Under the insolvency laws of France, Belgium, and Luxembourg an individual cannot be the subject of insolvency procedures unless he or she is a trader (*commerçant*); under Italian law this exemption even extends to "small traders" (*piccoli imprenditori*; *see* Italian C.C. art. 2083).

3. This is generally known as "universality of bankruptcy," although the term is interpreted in different ways by various writers.

4. This is the case with countries such as Japan, The Netherlands and Sweden, as to which see the respective reports for those countries by M. ITO, J.H. DALHUISEN, and M. BOGDAN in: I.F. Fletcher (ed.) CROSS-BORDER INSOLVENCY: NATIONAL

practical difficulties ensue concerning the extent to which these parallel proceedings are to function in relation to each other. If these multiple proceedings are not to become mutually competitive, some way must be found to enable them to interrelate with one another, preferably in such a fashion that one set of proceedings becomes the main, or primary, administration with the others standing in an ancillary relationship.

Given that it is one and the same debtor whose affairs are undergoing administration, and given also that the distribution of assets and the dispersal of creditors and their claims can exhibit the characteristic of randomness, there is clearly a strong case for striving towards some kind of coordination in cases of international insolvency, in the hope of thereby attaining a greater degree of overall "fairness" of outcome, both within individual cases and across the run of such cases, viewed over a span of time. Such a spirit of internationalism involves the acceptance of some "hard" results. Seen purely through the eyes of those claimants who happen to be grouped in one of the concerned jurisdictions in any particular case, the "windfall" advantage, occasioned by the presence locally of assets of the debtor which would amply satisfy their claims, if dealt with in isolation, may be denied them if the pursuit of an "internationalist" solution requires the repatriation of those assets either in totality, or at least to such extent as will facilitate an equalization of the rate of dividend payable to all claimants of equivalent degree, in every one of the involved jurisdictions. It is therefore not surprising to discover that, in the world of reality (in contrast to what is generally advocated in the theoretical treatises which this subject has spawned in some abundance) internationalist collaboration is historically very much the exception rather than the rule. In practice, the approach of most legal systems to matters of cross-border insolvency has been aptly, if cynically, summed up in the expression: "*Nehmen ist seliger als Geben.*"[5]

AND COMPARATIVE REPORTS (1991). The negative position formerly prevalent under German law towards recognition of the effects of foreign bankruptcies has been redressed in modern times, as explained below.

5. "It is more blessed to receive than to give." *See* RAAPE, DEUTSCHES INTERNATIONALES PRIVATRECHT II (1939) 288. *Cf.* the English decision in Felixstowe Dock and Railway Co. v. U.S. Lines, Inc. [1988] 2 All E.R. 77, in which Hirst, J. concluded that undue inconvenience and hardship would be caused to local creditors if he sanctioned the repatriation to the U.S.A. of assets within the United Kingdom which were the property of a United States Corporation undergoing Chapter 11 bankruptcy proceedings in America.

International Cooperation: Challenge and Response

A. The Unmet Challenge

Since at least the Middle Ages, regular examples have occurred of international insolvencies which have generated intractable difficulties for those concerned.[6] These international failures vary in scale of magnitude, but all are alike in one respect: the differences between the insolvency laws of the respectively concerned systems have the effect of compounding the economic misery experienced by all parties, since the complexities encountered in any cross-border insolvency will inevitably increase the overall cost of the administration, while simultaneously impeding the efficiency of the process of recovery and realization of such assets as may remain theoretically available to be distributed among the creditors. Despite the enormity and frequency of such disasters the historic challenge for civilized, mercantile societies to devise some ordered and workable system for resolving these problems has largely gone unanswered. From the eighteenth century onwards some European states established bilateral treaties aimed at regulating insolvencies where assets were dispersed between the states in question,[7] but the resulting instruments were often cumbersome, and the potential complexities which would be engendered by a network of diverse, and possibly irreconcilable, treaties concluded on a bilateral basis were always daunting.

One or more multilateral treaties would seem to be more suitable as a vehicle for achieving a framework within which to deal with the problems of international insolvencies, not least because in practice the cross-border interests of debtors will frequently fail to match the pattern of international agreements concluded bilaterally by the states to which they and their creditors are principally attached. Historically, however, such efforts as have been directed towards the creation of multilateral bankruptcy treaties have, with very few exceptions, been unsuccessful. Prominent examples of such failures are the Model Treaty on Bankruptcy produced in 1925 by the Fifth Hague Conference on Private International Law, and the First Project for an EEC Bankruptcy Convention, which was under active consideration between 1960 and 1980. In contrast to these treaties, mention can be made of the success

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6. *Cf.* the historic saga of the Ammanati banking failure of 1302, described by K.N. Nadelmann in *Bankruptcy Treaties*, 93 U. PA L. REV. 58, 58-59 (1944) *reprinted in* KURT H. NADELMANN, CONFLICT OF LAWS: INTERNATIONAL AND INTERSTATE, at 299-336 (1972).

7. For an account of these early treaties, see K. LIPSTEIN in: I.F. Fletcher (ed.) CROSS-BORDER INSOLVENCY: COMPARATIVE DIMENSIONS (1990) at 223-236. *See also* K. Nadelmann, *loc. cit. supra* n. 6.

of the Nordic Bankruptcy Convention of 1933[8] and of the less certain achievements of the Montevideo Private International Law Treaties of 1889 and 1940 and the Havana Treaty of 1928.[9] All these are examples of cooperation on a regional basis between states sharing generally close legal and cultural affinities. In the absence of such established interstate relationships the difficulties of achieving a satisfactory agreement are of a very high order. This is attributable in large part to the special nature of insolvency proceedings, with their comprehensive effects upon the debtor's status and patrimony. The individualized characteristics of each nation's bankruptcy laws can be shown to be intimately linked to many aspects of the economic and social culture of that community so that vital, interlocking provisions exist between the insolvency law and the general law of the system in question. Hence, any treaty whose terms could result in a perturbation of the established assumptions underlying the debtor-creditor relationship is likely to be regarded with suspicion and even hostility. This problem is further compounded by the widespread practice under most insolvency laws of according priority status to the claims of state and public authorities--especially those of the revenue-collecting departments--whereby those claims must be fully satisfied before any payment can be made to the ordinary, unsecured creditors. Thus, if the provisions of a bankruptcy treaty to which States A, B, and C are parties operate in such a way that, in a given case, the main bankruptcy administration is to be located in State A, any requirement whereby all assets located in B and C must be repatriated to State A and there administered according to its law of bankruptcy, are likely to have unwelcome consequences from the point of view of the nonpreferential creditors from States B and C. The latter may experience the chagrin of seeing what were formerly "local" assets being administered largely for the advantage of the fiscal authorities in State A. Small wonder, therefore, that draft treaties containing peremptory schemes for regulating international insolvency, based upon the twinned concepts of unity and universality, generally fail to commend themselves to those who are invited to subscribe to them.[10]

8. *See* M. Bogdan, (1985) 35 ICLQ 49.

9. *See* J.M. DOBSON in I.F. Fletcher (ed.) CROSS-BORDER INSOLVENCY: COMPARATIVE DIMENSIONS (1990) at 237-262.

10. This was the case with the First Project for an EEC Bankruptcy Convention tacitly abandoned some time after 1980. *See* I.F. FLETCHER, CONFLICT OF LAWS AND EUROPEAN COMMUNITY LAW (1982) Ch. 6; D.L. LASOK and P.A. STONE, CONFLICT OF LAWS IN THE EUROPEAN COMMUNITY (1987) Ch. 10.

B. Modern Responses

1. *On the International Level*

In the light of what is stated above, the most promising way forward at the level of international treaty formation would appear to be by way of less ambitious, and more pragmatic, proposals aimed at establishing a basic framework for cooperation in cross-border insolvency matters. In this way, opportunities can be provided for minimizing the costly inefficiencies endemic to the present chaotic state of affairs in which the maxims "*Sauve Qui Peut!*" and "*The race to the swiftest!*" are seen to prevail over the idealized principles of "collectivity" and "equality between creditors" to which the individual, national systems of insolvency law invariable purport to subscribe.[11]

The most recent example of an international bankruptcy treaty, which was concluded among the 23 states which currently belong to the Council of Europe, was opened for signature in Istanbul, Turkey on June 5th, 1990. The original plan for this convention was formulated along the lines just advocated, namely to achieve certain limited, but worthwhile, objectives. These included the creation of a set of rules which would enable the office holder--trustee, liquidator or equivalent--in insolvency proceedings opened in one contracting state to take effective action in any of the others, first to protect and subsequently to reclaim and realize such assets of the debtor as may be located in the jurisdiction in question.

One of the fundamental issues of international insolvency law is that of according recognition to foreign insolvency proceedings, and of recognizing the office holder's competence and authority to act on behalf of the collective interests of those laying claim to the bankrupt's estate. Even where such recognition and authorization can be obtained, pursuant to the private international law of the country in which assets happen to be located, the delays encountered in the ordinary course of operation of the local legal process tend to defeat the object of the exercise. By the time the office holder obtains local authorization to act, the assets may either have been spirited abroad and placed out of reach, or have been seized and appropriated by (usually local) creditors who are well placed to take advantage of whatever direct means of satisfying their claims are available to them under the local law. These local attachments, if completed prior to the operative moment at which the foreign bankruptcy receives local recognition, will generally prevail

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11. Admittedly, in most legal systems the hallowed principle "*par est condicio omnium creditorum*" is not accorded its full, literal effect: the stratification of claims into preferential and nonpreferential subgroups is a near-universal practice.

against the claims of the foreign office holder, whose title can only be asserted by courtesy of the conflicts rules of that same local law. Hence, the practical utility of the provisions contained in Chapter II of the Istanbul Convention (comprising articles 6-15 inclusive) could be appreciable. These provisions allow the liquidator (which is the term used throughout the convention as a convenient way of referring to the office holder who has been appointed in the proceedings in question)[12] to exercise a range of powers, including the taking of steps necessary for the protection or preservation of the value of the debtor's assets, as from the date of his original appointment. These powers may be exercised in the other contracting states merely upon presentation of the prescribed, documentary proof of his appointment.[13] Although during this first stage the liquidator is not empowered to remove the assets from the state in which they are situated, the further provisions of the Convention do enable him to undertake acts of administration, management and disposal of the debtor's assets, in accordance with the powers conferred by the law of his appointment, including the possible removal of the assets from the territory of their *situs*.[14] Such removal is subject, however, to the law of the *situs* of the asset in question, and a procedure is established whereby other persons may object to the liquidator's proposed exercise of his powers in that territory. Thus the local court may interpose a veto on the repatriation of assets or their proceeds, where this repatriation would have the effect of defeating legitimate interests established under the local law of the *situs*.[15]

The provisions of Chapter IV of the Istanbul Convention (articles 29-32 inclusive) also promise to yield worthwhile practical benefits, in that they give rise to an obligation to inform all known creditors residing in the other States Parties whenever insolvency proceedings are opened in relation to their debtor. This notification is coupled with a requirement that all such creditors are to be eligible to lodge their claims in writing in the proceedings which the liquidator is conducting. Any claim so lodged may be drawn up in the creditor's own language, subject to the proviso that, if this is not also the language of the authority which has opened the proceedings, the claim

12. Appendix B of the Istanbul Convention lists by name the various types of office holder in each of the contracting states who are embraced by the term "liquidator" where used in the convention. Appendix A lists the various insolvency procedures under which such office holders' appointments may take place for the purpose of bringing them within the scope of chapter II.

13. Istanbul Convention, article 7 and 8, together with articles 2 and 3.

14. *Id.*, article 10(1).

15. *Id.*, articles 10(2), 11, 12 and 14(2).

must be accompanied by a translation in that language or in one of the two official languages of the Council of Europe (English or French).[16]

More debatable, from the aspect of the wish to advance the cause of international cooperation and to maximize the equal treatment of creditors, are the contents of Chapter III of the Convention. These enable secondary bankruptcies to be opened in any other State Party, solely on the basis that the debtor has been declared bankrupt through proceedings opened in accordance with the conditions specified in Chapter I, regardless of whether the debtor is insolvent in the state of secondary bankruptcy. Secondary proceedings may be opened at the request not only of the liquidator in the main bankruptcy, but also of any party with standing to do so according to the local law of the place where the request for a secondary bankruptcy is presented.[17] According to article 19, secondary bankruptcies are governed by the local law of the place where they are opened, and it is expressly provided by article 21 that the payment of claims out of the assets comprised in the secondary bankruptcy is to take place having regard to the preferential claims and security interests arising under the local law. This facility appears to afford ample opportunity for creditors--who may of course include the public authorities of the state in question--to "localize" the administration of the debtor's assets dispersed across a plurality of jurisdictions. In this way the claims of the office holder in the main proceedings will be held at bay, and the priorities and security interests arising under the local law will be enabled to prevail, at least to the extent that the local "asset pool" of property belonging to the debtor is sufficient to meet them. This will necessarily be at the expense of those creditors based in other jurisdictions who, though ostensibly entitled by virtue of article 20 to lodge claims in the secondary bankruptcy, are unlikely in most cases actually to receive any substantial return by way of dividend, given their nonpreferential status according to the local system of law. It follows from this that any alteration of the *situs* of assets of substantial value prior to the opening of an international insolvency could have seriously detrimental consequences for creditors who are based in the jurisdiction from which the assets are exported.

Article 40 of the Convention allows any state which becomes a party to it to reserve the right not to apply either Chapter II or Chapter III. To the extent that the right of reservation is exercised in relation to Chapter II, this will seriously weaken the Convention's value and effectiveness and indeed such reservations would seem tantamount to the negation of the basic purpose of the Convention itself. On the other hand, by contracting out of Chapter III in its concluded form states

16. *Id.*, articles 31, 32.

17. *Id.*, article 18.

would in fact be demonstrating their support for the "internationalist" philosophy of cross-border insolvency, by limiting the potential for some creditors to "localize" the processes of distribution of the bankrupt's property. But this is an option which few states are perhaps likely to prefer at the present time, since it entails the renunciation of the power to "ring fence" local assets for the benefit, principally, of local creditors (including the State itself). Thus, the capacity to bring about secondary bankruptcies under Chapter III is likely to be seen by most states as a necessary *quid pro quo* for the concessions granted under Chapter II whereby cross-border assistance is to be accorded to a foreign liquidator, including his being allowed to exercise his powers in their territory.

The Istanbul Convention has not yet come into force at the time of writing. According to article 34, a minimum of three ratifications are necessary in order to bring the Convention into force among the ratifying States.[18] It is therefore likely to be some time before any assessment can be made of the concrete results of the Convention, based upon full operational experience. Of special interest is the provision in article 35, whereby states which do not belong to the Council of Europe may procure an invitation to accede to the Istanbul Convention, provided that the Member States vote unanimously in favor of issuing the invitation. Thus the Convention could become a medium for the progressive development of the framework for international cooperation in insolvency matters, operating in a genuinely global context. This prospect should serve to ensure that the Convention is the object of widespread scrutiny in the years ahead.

A separate development to be noted involves those twelve European States which, in addition to being Members of the Council of Europe, also comprise the current membership of the European Community. Soon after the Istanbul Convention was opened for signature, the Twelve relaunched the Project for a Community Bankruptcy Convention, which had been dormant since 1980. This has now assumed a special urgency for the states concerned, in view of the impending completion of the Community's internal market by the end of 1992.[19] It can fairly be stated that, in the absence of proper arrangements to coordinate the administration of insolvent estates within the context of the European Community, the full attainment of the Internal Market cannot properly take place. At this stage, however, it is not known what kind of approach will be adopted under the Second Project, nor whether the errors of the First Project are destined

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18. Signatory states to the Istanbul Convention currently include: Belgium, France, Germany, Greece, Luxembourg and Turkey.

19. Single European Act (European Community, 17-28 February 1986), *passim*, esp. article 13.

to be repeated. It is to be hoped that the lessons of history will be learned, and that practical, even if limited, solutions are preferred to the grandiose, and unworkable, proposals which were conceived by the panel of experts to whom the task was originally entrusted.

2. *National Responses: Some Innovations Compared*

In the absence of any formal, worldwide structure to deal with the problems arising in the context of international insolvencies, practitioners have developed their own expertise for the purpose. Solutions have been devised which utilize a variety of formal and informal methods. In some celebrated cases the results can display an impressive blend of ingenuity and fairness, as in the case of the arrangement concluded in New York to resolve the difficulties ensuing from the collapse of the Herstatt Bank of Düsseldorf in 1974.[20] Such high-level expertise, and the international network of professional contacts which are an essential aspect of any operation of this kind, involve a considerable increment to the overall administrative costs, and it is therefore only expedient to resort to them in cases where the sums involved are of a commensurately high order of magnitude. One of the principal benefits which would accrue from the development of a properly coordinated system of international agreements is that the recovery and administration of a debtor's foreign assets would be attainable quickly and at relatively little cost, thus making this a realistic possibility even in cases where the property is of only moderate value. The fact that the total monetary amounts involved are not especially large does not necessarily diminish the significance of an insolvency for the creditors caught up in the failure, and it may well be the case that the inclusion of even a single overseas asset has an appreciable impact upon the level of dividend which the creditors will subsequently receive. It is arguable therefore that the parties who would experience the greatest proportionate benefit from improvements of the kind here advocated will be those involved in the fairly unspectacular, run-of-the-mill insolvencies in which there happen to be a few overseas assets which, under present conditions, the trustee or liquidator would deem it not worthwhile to attempt to repatriate, on grounds of cost and inconvenience.

The above consideration also serves to underline the importance of various recent initiatives undertaken at national level, either through

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20. Described by Kurt N. Nadelmann in *Rehabilitating International Bankruptcy Law: Lessons Taught by Herstatt and Company*, 52 N.Y.U.L. REV. 1 (1977), and in *The Lure in "International Bankruptcies" of Assets Located Abroad*, 33 I.C.L.Q. 431, 432-33 (1984). *See also* Becker, 62 AM. BANKR. L.J. 1290 (1976).

judicial activism or legislative innovation, to improve the opportunities for office holders in proceedings based in one jurisdiction to obtain assistance from the authorities of other countries, and to take effective legal action in those other jurisdictions in furtherance of their administration of the insolvent estate. These initiatives typically have the effect of according judicial cooperation under the law of the country in question to office holders from that state. A precondition for the according of such cross-border assistance is usually that reciprocal, or near-equivalent, facilities are available under the law of the other system in favor of office holders operating from the state in which assistance is sought. I propose to examine three examples of such provisions, namely the Ancillary Proceeding provision contained in section 304, U.S. Bankruptcy Code; the provision for cooperation between courts contained in section 426 of the United Kingdom Insolvency Act 1986; and the Proposal of the Australian Law Reform Commission for a new legislative provision to enable Ancillary Assistance to be given by Australian courts in relation to foreign insolvency proceedings concerning companies.[21]

As well as being the earliest in time to be enacted or proposed, the United States provision, dating from 1978, is in many ways the most remarkable, not least because of the liberal and flexible terms in which it is devised.[22] In particular, there is no absolute requirement that prior arrangements should have been established between the United States and the other jurisdiction concerned. Section 304 of the Bankruptcy Code simply establishes the facility for commencement of a case ancillary to a foreign proceeding through the filing with the U.S. Bankruptcy Court of a petition for this purpose, presented by a "foreign representative" (§ 304(a)). Various possible forms of relief which the court may grant in response to the petition are specified in § 304(b), but the granting of any relief is subject to the provisions of subsection (c), which require the court to be guided by the following considerations and policy objectives:

> . . . what will best assure an economical and expeditious administration of such estate, consistent with -
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> 1) just treatment of all holders of claims against or interest in such estate;

21. *See* Australian Law Reform Commission, Report No. 45--General Insolvency Inquiry (1988, 2 volumes) chapter 19, together with Draft Legislation, Clause CF2. The proposals are reproduced in I.F. Fletcher (ed.) *op. cit. supra* n. 7, at pp. 263-270.

22. Section 204 was originally proposed by the Commission on Bankruptcy Laws as early as 1973: H.R. Doc. No. 137, 93d Cong., 1st Sess., Part II, at p. 70 (1973); *see* Morales and Deutsch, 39 BUS. LAW. 1573 (1984), at p. 1586.