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Current Problems and Trends in the Administration of Transnational Insolvencies Involving Enterprise Groups: the Mixed Record of Protocols, the UNCITRAL Model Insolvency Law, and the EU Insolvency Regulation

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Current Problems and Trends in the Administration of Transnational Insolvencies Involving Enterprise Groups: The Mixed Record of Protocols, the UNCITRAL Model Insolvency Law, and the EU Insolvency Regulation

Anthony V. Sexton*

Abstract

That commerce has become international in scope is a fact known to all in the legal community. Many large companies now have operating subsidiaries in a large number of countries, and those countries have radically different legal regimes. The law of insolvency is no different; indeed, the differences in legal regimes are of particular import as insolvency law is largely driven by jurisdictions’ policy preferences on the relationship between debtors and creditors. But when international enterprise groups go bust, domestic bankruptcy law is incapable of handling the private international law issues that are implicated. While there have been efforts in recent years to bring harmony to the chaos, it is increasingly clear that the current framework cannot adequately address the problems encountered by transnational enterprise groups. This Comment explores the current framework and proposes sensible first steps to address the framework’s shortcomings.

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* JD, University of Chicago. I would like to thank the CJIL editorial board for their assistance.
I. INTRODUCTION TO ISSUES IN TRANSNATIONAL INSOLVENCY

Insolvency is an incredibly complex area of the law and its practitioners must be generalists. In addition to the procedural and substantive complexities of the various insolvency regimes themselves, such cases involve a broad swath of substantive issues in nearly every area of the law, including intellectual

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property, debtor-creditor, employment, environmental, and administrative regulation, among others. The resolution of the substantive issues of law that arise in the insolvency context is inextricably intertwined with difficult policy considerations. This web is difficult to penetrate even when an insolvent company has operations in only one country or a handful of countries with closely related legal and economic systems, such as members of the EU.

But the ever-increasing scope of the global economy has resulted in an increasing number of companies that have operations in multiple countries. Although best practice generally results in separately incorporated business entities in each jurisdiction, separate incorporation generally does not lead to independent operation. As a result, the insolvency of the Venezuelan subsidiary in a corporate entity may lead to insolvencies of the US, Chinese, Singaporean, Channel Islands, and French subsidiaries. Absent any framework for such

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1 See Jay Lawrence Westbrook, et al, A Global View of Business Insolvency Systems 5 (Martinus Nijhoff 2010). According to Westbrook:

Insolvency law is often misunderstood as a sort of legal mortuary when in fact it is a hospital where the assets and the expertise of a business injured by management mistakes or the vagaries of the free market are recapitalized or rechanneled to renewed productivity and social benefit. The insolvency process is uniquely intertwined with many other aspects of a country’s laws. It is also the ultimate scale in that the right of entrepreneurs, workers, and creditors must be properly balanced if an economy is to reach its maximum potential.

Id (emphasis added).


3 See Janis Sarra, Oversight and Financing of Cross-Border Business Enterprise Group Insolvency Proceedings, 44 Tex Intl L J 547, 547–48 (2008). A perfect example of this integrated business is Lehman Brothers, which had separately incorporated business entities in multiple countries but which was financially integrated. For an insider’s perspective on the complex web that comprised Lehman, see generally Lawrence G. McDonald and Patrick Robinson, A Colossal Failure of Common Sense: The Inside Story of the Collapse of Lehman Brothers (Crown 2009). Judge Peck, the bankruptcy judge presiding over Lehman’s US bankruptcy proceedings (the “core” proceedings under Model Law analysis, meaning Judge Peck controls, to a large extent, Lehman’s bankruptcy worldwide) acknowledged the importance of retaining Lehman’s pre-petition cash management system—and honoring obligations thereunder—in an early order in the case. See In re Lehman Bros Holdings Inc, 2008 WL 4902202, *2 (SDNY Nov 6, 2008). The Lehman Brothers bankruptcy will serve as a touchstone for this Comment and is discussed further below.


[a] multinational firm [ ], operating like an octopus, can strategically spread its tentacles and conduct business through its subsidiaries. Subsidiaries are located around the world to accumulate market share, generate revenue, target demographics, develop product lines, and gain brand recognition. With the added layer of e-commerce, multinationals and their subsidiaries are operating in a global arena that collapses commerce into one marketplace.
transnational insolvencies, the value of the entire corporate enterprise would be
dragged down by the parochial rush to assets that would occur under the
independent insolvency regimes of each entity’s “host” jurisdiction. Furthermore, because large transnational corporations frequently have a huge
number of internal transactions among members of the enterprise group that do
not represent true sales or purchases of services, knowing where in the corporate
timeframe any given asset really belongs is challenging for any individual
jurisdiction. Avoiding the reduction of value that results from such a rush on
assets is at the heart of domestic insolvency regimes; therefore, in order to
achieve the aim of domestic insolvency regimes, a transnational framework is
required.

The call for a transnational framework for insolvency is not novel, and
commentators have explored the issue in depth for nearly twenty years. The
debate has often focused on whether the optimal framework for cross-border
insolvency should be grounded in “universality” or “territoriality.” Broadly, a
universalist approach attempts to unify cross-border insolvency proceedings into
one main case, while a territorialist approach acknowledges the primacy of
domestic law as applied to any entity incorporated within a particular sovereign

Id. Other commentators note that:
[the trend towards globalization has led to the emergence of corporations
whose business operations in various countries are closely interdependent. As
intercompany debt and intercompany guarantees are used to allocate money
within the conglomerate, the resulting web of intercompany obligations leads
to an interdependency that has potentially disastrous results when one of the
entities within the conglomerate becomes insolvent. Even an isolated
insolvency of one of the companies can trigger cross-defaults throughout the
corporate group.]


5 Tatiana V. Tkachenko, Legal Status of Bank Holding Companies (BHCs): US and European Bankruptcy
officer: “There need to be international standards when dealing with a global company that
collapses, otherwise, every country acts like ‘Every man for themselves’”).

6 See Sarra, 44 Tex Intl L J at 549–52 (cited in note 3). For a thorough explanation of transnational
asset tracing, see generally Felicity Toube, ed, International Asset Tracing in Insolvency (Oxford 2009). The
opic is generally beyond the scope of this Comment, but when particularly salient asset
tracing issues are presented, this Comment addresses the legal questions without fully explaining
the mechanics.


8 See, for example, Ian F. Fletcher, ed, Cross-Border Insolvency: National and Comparative Studies (JCB

9 See, for example, Jay Lawrence Westbrook, A Global Solution to Multinational Default, 98 Mich L
Rev 2276, 2277 (2000) (advocating a universalist approach); Lynn M. LoPucki, Cooperation in
(advocating a modified territorialist approach that acknowledges the shortcomings of universalism
and modified universalism).
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sphere. Both of those categorical approaches have been essentially abandoned in favor of “modified universality,” an approach that, in theory, allows for recognition of foreign insolvency proceedings whose effects reach across borders, while still respecting the role of domestic law. While there were historical efforts at treaties and conventions on cross-border insolvency, those efforts resulted in minimal progress. After many years of intensive study, the UN Commission on International Trade Law (UNCITRAL) promulgated the Model Law on Cross-Border Insolvency (Model Law) in 1997, and the EU passed the EU Insolvency Regulations in 2000. Finally, Protocols, which are essentially contracts between the principals in cross-border insolvencies, provide case-by-case solutions to the unique problems in this context.

These frameworks proved to have significant shortcomings, particularly in the very large cases of the last several years involving enterprise groups. The most notable example came in the ongoing Lehman Brothers insolvency. In the Lehman case, courts in the US and Britain issued contradictory orders relating to the disposition of a single set of assets. This conflict arose despite the fact that

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10 See LoPucki, 84 Cornell L Rev at 699–702 (cited in note 9).

11 This Comment will not discuss the normative debate surrounding the three approaches; it is enough to note that modified universality has carried the day, as evidenced by the Model Law, the EU Regulations on Insolvency Proceedings, and the general backdrop of Protocols. See Section II.B. For a more thorough discussion, see Bob Wessels, Bruce A. Markell, and Jason J. Kilborn, International Cooperation in Bankruptcy and Insolvency Matters 39–71, 111–12 (Oxford 2009).

12 Anne Nielsen, Mike Sigal, and Karen Wagner, The Cross-Border Insolvency Concordat: Principles to Facilitate the Resolution of International Insolvencies, 70 Am Bankr J 533, 534 (1996) (“Only a handful of international bankruptcy treaties espousing a universality-based theory have been successful, and, in these cases, the parties to the treaties usually have had close territorial ties and similar legal, economic, and cultural traditions.”).


15 “Principals” are the person(s) who control the assets of a business entity in bankruptcy—not the court or administrative body in charge of administering the case. For example, in US law, the debtor in possession or trustee either operates or liquidates the business. The nature and scope of authority of principals vary widely among legal regimes. For a comparative study, see generally Otto Eduardo Fonseca Lobo, ed, World Insolvency Systems: A Comparative Study (Carswell 2009).


17 Compare In re Lehman Bros Holdings Inc, 422 Bankr 407, 422–23 (Bankr SDNY 2010) (holding a priority provision in a swap contract unenforceable under US bankruptcy law, resulting in payment of the assets at issue to the Lehman estate, and acknowledging that the decision was in direct conflict with an earlier decision from the English High Court), with Perpetual Trustee Co Ltd v BNY Corp Trustee Serv Ltd, 2009 EWHC 1912 (Chanc July 28, 2009) (UK) (holding provision enforceable under UK law, resulting in payment to alternate investors). Though only one claim was at issue in this case, the ramifications were huge: the priority of $12 billion was at stake, with many of these claims to be made in a cross-border context. See Karen Brettell, BNY Mellon Will
all current best practices were in place to avoid such a problem: both countries adopted the Model Law, there is an expansive Protocol in place, and Lehman is being liquidated (which is a significantly less complex procedure than reorganization in the transnational context because domestic law in many countries is not designed to facilitate reorganization under the guidance of a debtor in possession). Such failures are particularly likely to occur where the "debtor" is a transnational enterprise group. This is because the frameworks in place only adequately address the individual domestic entities that make up a transnational enterprise group, without addressing the fact that the existence of the transnational enterprise as a whole relies on the connections between the disparate domestic entities. With the threat of additional cross-border insolvencies on the horizon, further examination of the current shortcomings in the framework is essential, particularly in the context of enterprise groups. Although UNCITRAL Working Group V is working to address this significant shortcoming in the current framework, current expectations are that its recommendations will manifest only in the form of a legislative guide, not as an amendment to the Model Law.

This Comment endeavors to provide a basis for future work in the area. In Section II, I describe the operative points in the existing frameworks and highlight the weaknesses in those frameworks. In Section III, I highlight a particular recent failure of the framework: the issues regarding the Dante Collateralized Debt Obligation (Dante CDO) in the Lehman bankruptcy. In Section IV, I submit two approaches that would minimize Lehman-like failures in the future: (i) greater use of substantive consolidation for the limited purpose

Appeal Lehman Ruling on Dante CDO (Reuters Feb 2, 2010), online at http://www.reuters.com/article/2010/02/02/us-mellon-bankofny-idUSTRE6113VP201000202 (visited Oct 11, 2011). Dante was a “special purpose vehicle” (SPV) in the Lehman investment structure, and it will be discussed in more detail below. Before the US ruling could be appealed, the parties settled; the UK Supreme Court affirmed the High Court’s ruling. UK rules for investors in Lehman fight (Wall St J July 27, 2011), online at http://online.wsj.com/article/SB10001424052748704471613443605664.html (visited Nov 12, 2011). Accordingly, the conflict between the two rulings was never resolved.

See, for example, Irit Mevorach, Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency, 18 Cardozo J Intl & Comp L 359, 362 (2010) (“Although international instruments for insolvency and cross-border insolvency have been devised, the issue of groups was put aside, perhaps for later consideration. The issue may have been neglected because of the complexity of the matter.”); Wessels, Markell, and Kilborn, International Cooperation at 122-25 (cited in note 11) (“The [EU Regulations require] that any legal person in any Member State must be considered separately—even if sole-shareholder or majority shareholder relationships exist between some of them— with regard to where the center of main interests is located.”) (emphasis added); LoPucki, 84 Cornell L Rev at 706 (cited in note 9) (“Writers describing universalism nearly always assume that the debtor is a single corporation conducting an independent business. Thus, they do not address the common situation in which the debtor is a corporate group.”).

See Mevorach, 18 Cardozo J Intl & Comp L at 363-64 & n 9 (cited in note 18).
of applying the center of main interest test, and (ii) insistence by courts in jurisdictions which have adopted the Model Law (Model Law Courts) that adoption of a Protocol be a prerequisite to obtaining the procedural benefits inherent in the Model Law. Section V concludes.


A. Overview

As mentioned in Section I, the three primary frameworks in transnational insolvency are Protocols, the EU Insolvency Regulations, and the Model Law. All of these acknowledge and expand on the ancient principle of comity, which has long played a role in private international law. Protocols are adopted on a case-by-case basis; as a result, they are simultaneously broader and narrower in scope than the other frameworks. The EU Regulations speak both to solely intra-EU insolvencies and to broader transnational cases where a substantial part of the enterprise is based in the EU. Finally, the Model Law aims to apply to all jurisdictions in transnational cases, but it is limited in its scope to those countries who adopt its terms.

B. Protocols

Protocols represent both the earliest foray into organizing the judicial proceedings in transnational insolvencies and the tool with the sharpest edge in

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20 In addition, the American Law Institute (ALI) promulgated guidance for insolvency proceedings involving the North American Free Trade Agreement (NAFTA) countries. Because the ALI's guidance in this area has very limited application outside of the North American context, and because this Comment seeks to focus on transnational insolvencies of a broader scope, the NAFTA principles are not discussed.


22 Given the expanding integration of the economic law and policy of EU member-states, the insolvency of a company that operates and has assets only in the EU is very similar to a US bankruptcy where a company has operations and assets in a number of states. For that reason, this Comment focuses on those provisions of the EU Regulations that involve assets and operations both within and without the EU.

any given case, as they are negotiated to address debtor-specific issues. Two commentators have defined Protocols as "essentially case-specific, private international insolvency treaties."\(^{24}\) That overstates the case—Protocols are more accurately seen as contracts between the various principals in an insolvency case. Like any post-petition contract that touches on issues beyond the normal operation of the debtor, that contract must be ratified by the court overseeing the debtor's administration.\(^{25}\) There are two primary reasons why definition as a "treaty" overstates the case: (i) protocols are not binding on the courts, while a treaty would be; and (ii) each principal may refuse to adopt the Protocol.\(^{26}\) However, Protocols still represent "[t]he mechanism most frequently used to establish cross-border cooperation of business enterprise groups."\(^{27}\) Protocols now touch on issues related to procedural coordination, court-to-court communication, and, in some cases, substantive issues—often in the form of limited substantive consolidation.\(^{28}\)

1. Sources of protocol provisions and the standard scope of protocol provisions.

Significant work has been done in the area of determining best practices as they relate to Protocols.\(^{29}\) These best-practice reviews focus on advocating the adaptation of the modified universalist approach to drafting Protocols and examining provisions in precedent Protocols that proved effective. I note the salient points from each below.

   a) The Cross-Border Insolvency Concordat. The International Bar Association Section on Business Law's Committee J adopted the Cross-Border Insolvency Concordat in 1996.\(^{30}\) The purpose of the Concordat is to establish best practices in the drafting of transnational insolvency Protocols where assets are distributed

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\(^{24}\) Id at 589.

\(^{25}\) See Sarra, 44 Tex Intl J at 563 (cited in note 3) ("Protocols are usually negotiated by key parties to the proceedings and then endorsed by the relevant courts with oversight of the proceedings.").

\(^{26}\) The impact of such a decision will be discussed in the context of the Lehman case. See Section III.

\(^{27}\) Sarra, 44 Tex Intl J at 562 (cited in note 3).

\(^{28}\) See id at 562–72. Substantive consolidation is an insolvency term of art, which is related to—but not necessarily the same as—the corporate law concept of piercing the corporate veil.

\(^{29}\) For a more thorough overview, see Zumbro, 11 Bus L Intl at 165–69 (cited in note 16).

in such a way that multiple main proceedings are needed.\textsuperscript{31} Ten principles are laid out in the Concordat; the principles touch both on cooperation between debtor-principals and on cooperation and communication between the various courts involved in the process.\textsuperscript{32} The Concordat’s aim of fostering inter-court cooperation was particularly influential in the development of the Model Law.\textsuperscript{33}

The ten principles of the Concordat\textsuperscript{34} are: (i) the case should be administered in as few fora as possible (in other words, there should be a “main proceeding”); (ii) non-local creditors should have equal access to the main forum, but common rulings of the main forum should be respected in ancillary fora; (iii) where there is more than one main proceeding, there should be equal information sharing between debtor-principals and creditors; (iv) where there is no main forum, payments and claims should be monitored by all parties to ensure that double payments are not made due to lack of communication; (v) ancillary proceedings should transfer remaining assets to main proceedings with minimal procedural burden; (vi) debtor-principals should be able to employ all the tools of the main forum, not merely those tools they would have access to in their home jurisdiction; (vii) the debtor-principals should be allowed to exercise the voiding—or avoidance—rules of any forum;\textsuperscript{35} (viii) ancillary fora should be able to invoke public policy limitations on the ability of debtor-principals to invoke the substantive law of the main forum if such have only a limited connection to the debtor’s primary business, and courts should acknowledge that debtor-principals are not necessarily subject to the jurisdiction of the main proceeding; (ix) reorganizations should be allowed even if all main fora do not generally allow for reorganization;\textsuperscript{36} and (x) proceedings should protect the ex ante creditor expectations.

Of those principles, vii, viii, and ix have been the most difficult to implement effectively, as they represent substantive, as opposed to merely procedural, recommendations that lead to conflicts between the substantive laws

\textsuperscript{31} See Nielsen, Sigal, and Wagner, 70 Am Bankr L. J. at 557–58 (cited in note 12); Zumbro, 11 Bus L. Int'l at 165 (cited in note 16).

\textsuperscript{32} See Nielsen, Sigal, and Wagner, 70 Am Bankr L. J. at 558–61 (cited in note 12).


\textsuperscript{34} See Concordat (cited in note 30). See also Nielsen, Sigal, and Wagner, 70 Am Bankr L. J. at 543–57 (cited in note 12) (discussing the ten principles).

\textsuperscript{35} This power, in particular, has led to significant conflict in all transnational insolvency frameworks, and it will be discussed as a specific problem. See Section II.C.3; Wessels, Markell, and Kilborn, International Cooperation at 184–85 (cited in note 11) (“The Concordat takes a controversial and somewhat confusing stance with respect to the choice of law in avoidance actions, a stance that only few later protocols would take.”).

\textsuperscript{36} This is another primary problem, particularly in the enterprise setting.
of different countries. Additionally, the commentary to the Concordat makes clear that the drafters envisioned situations similar to early transnational insolvencies, in which enterprise groups were essentially focused in a small number of jurisdictions or were not highly integrated. Nevertheless, the procedural principles of the Concordat—particularly its emphasis on information sharing and equal access—were put into practice very early. The procedural principles also generally lay the groundwork for the drafting of modern Protocols, and they were highly influential in the drafting of the Model Law.

b) The ALI Guidelines for court-to-court communication. Although the Concordat touched upon the topic of court-to-court communication, it was primarily concerned with documenting prior best practices. As noted, the Concordat’s foray into cross-court communication was novel at the time. Recognizing a need to improve further upon cross-court communication, the American Law Institute (ALI) drafted the Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (Guidelines). The Guidelines recognize that one of the most essential elements of cooperation in cross-border cases is communication among the administrating authorities of the countries involved. The Guidelines are intended to overcome the difficulties involved with court-to-court communications (particularly ex-parte communication issues) and are drafted with the intent that they be formally adopted by the courts involved before they are employed. The ALI recommends that the

37 See Concordat at Principle 1 Commentary (cited in note 30) (“In most cases, an enterprise will have its nerve center and many of its assets in one country. In the usual circumstance that country is the most appropriate forum for the administrative center of its insolvency.”). But even in highly integrated enterprise groups, significant operating decisions—and significant assets—will be located in a large number of jurisdictions.

38 See, for example, In re Evefresh Beverages, Inc, 238 Bankr 558 (Bankr SDNY 1999) (applying Concordat principles when determining whether to endorse a Protocol before the Concordat was officially adopted).


40 Terence C. Halliday, Managing Corporate Breakdowns Across National Frontiers, 2010 Norton Ann Rev of Intl Insolvency Art 7, 151 (“UNCITRAL staked its singular claim for recognition of its instrument on three grounds. It explicitly acknowledged its debt to what it had learned from prior efforts, not least from MIICA and the Concordat produced by the IBA.”).

41 The technical details of the ALI Guidelines are not explored in as much detail as the Concordat’s because the ALI Guidelines have (i) a more limited focus and (ii) are widely considered to be uncontroversial in application.


44 See id; Zumbro, 11 Bus L Intl at 166–67 (cited in note 16).
Guidelines be adopted in concert with a Protocol;\textsuperscript{45} in that sense, the Guidelines have been successful, as they have been adopted wholesale "by no fewer than 18 separate Judges in twelve bankruptcy courts."\textsuperscript{46}

c) The European Communication and Cooperation Guidelines. Most recently, the European Communication and Cooperation Guidelines for Cross-Border Insolvency (European Guidelines)\textsuperscript{47} have been proposed as a supplement to the EU Insolvency Regulations in an effort to assist the application of the EU Regulations in transnational cases involving more than one main case.\textsuperscript{48} Such guidelines were necessary because European Protocol practice is less developed than US Protocol practice (that is, practice involving cases in which at least one principal is located in the US).\textsuperscript{49} The European Guidelines contain eighteen principles for court-to-court communication that are specifically tailored to the EU context, and they contain principles for communication and coordination with the European Court of Justice (ECJ). However, notwithstanding their EU-centric nature, the European Guidelines have influenced Protocols involving enterprise groups that include European operations but whose primary operations are elsewhere.\textsuperscript{50}

2. Expanding the scope of Protocols to address transnational enterprise groups.

Protocols have expanded significantly in scope over the last twenty years. The early Protocols focused on situations where, even if the insolvency was transnational in scope, the principal assets of the enterprise were focused in one

\textsuperscript{45} See Zumbro, 11 Bus L Intl at 167 (cited in note 16).

\textsuperscript{46} Leonard, 17 J Bankr L & Prac at 624 (cited in note 43).


\textsuperscript{48} See Zumbro, 11 Bus L Intl at 167 (cited in note 16).

\textsuperscript{49} See Wessels, Markell, and Kilborn, International Cooperation at 189 (cited in note 11). This is due, in part, to the fact that the use of Protocols is generally more problematic in civil law countries because of the lack of specific statutory authority to communicate with other courts and to adopt a Protocol. See Leonard, 17 J Bankr L & Prac at 622 (cited in note 43).

\textsuperscript{50} See Zumbro, 11 Bus L Intl at 167 (cited in note 16) (noting that the Lehman Protocol, while generally modeled on ALI and Concordat principles, also included elements of the European Guidelines). This could be seen as part of a bid to make the principal of Lehman Brothers International more likely to sign on to the Lehman Protocol. If that was the desired outcome, it was unsuccessful.
or two jurisdictions. The Protocols in those cases dealt generally with the rights of parties asserting claims against the debtor: where creditors could file certain types of claims; choice of law issues that could be agreed upon by the parties (as opposed to choice of law issues requiring a judicial determination); certain intra-group settlement procedures; and so on. They involved only a limited number of principals, and they did not purport to address issues of substantive law. Although the Protocols were considered groundbreaking at the time of their first use and led to the development of the Concordat (which influenced the drafting of the Model Law), the scope of early Protocols was entirely inadequate to address the "particularly vexing problems" of transnational entities.

By contrast, more recent Protocols seek to address issues of a more substantive nature, in addition to the traditional issues regarding court-to-court communications and equal access. In particular, Protocols have attempted to define the law of the case respecting avoidance actions and priority schemes (particularly respecting tort claims) between third party creditors; the applicable choice of law for certain classes of claims or classes of assets; and, perhaps most importantly, limited substantive consolidation for the purposes of settling intra-group liabilities. In particular, the emphasis on limited substantive consolidation and attempts to predetermine certain choice-of-law issues represent an attempt to work through the issues relevant to transnational insolvencies involving enterprise groups. Indeed, many of these evolutions are...

51 See, for example, the Protocol in In re Maxwell Communications Corp, 170 Bankr 800, 802 (Bankr SDNY 1994); Final Supplemental Order Appointing Examiner and Approving Agreement Between Examiner and Joint Administrators, In re Maxwell Communications Corp, No 91 B 15741, 1992 Bankr LEXIS 2582 (Bankr SDNY Jan 15, 1992). Maxwell had nearly four hundred subsidiaries in the UK, the US, and Canada, and it was organized as a UK-based holding company. However, 80 percent of Maxwell's assets were tied to US subsidiaries. See Zumbro, 11 Bus L Intl at 163 (cited in note 16). See also In re Evefresh Beverages, 238 Bankr at 566 (cited in note 38) (operating assets only in the US and Canada); In re Nakash, 190 Bankr 763, 766 (Bankr SDNY 1996) (an insolvent Israeli bank under Israeli receivership with US assets).

52 See generally Zumbro, 11 Bus L Intl 157 (cited in note 16).


54 See Zumbro, 11 Bus L Intl at 162 (cited in note 16).


57 See Jay Lawrence Westbrook, Priority Conflicts As a Barrier to Cooperation in Multinational Insolvencies, 27 Pa St Intl L Rev 869, 877 (2009).

58 See Sarra, 44 Tex Intl L J at 566–72 (cited in note 3). For example, the Lehman Protocol calls for orderly settling of all intra-company claims with minimal judicial involvement and, importantly, cancels intra-creditor claims below a certain threshold amount. These broad "Protocol powers" were endorsed by Judge Peck in In re Lehman Bros Holdings Inc, 404 Bankr 752 (Bankr SDNY 2009).
similar to the proposals of the UNCITRAL Working Group V, which is focused on addressing shortcomings in the Model Law as it relates to transnational insolvency.


Protocols have proven to be incredibly powerful tools in cross-border insolvencies. However, they suffer from two very basic—yet extremely potent—flaws, which limit their usefulness in transnational insolvencies involving enterprise groups: (i) hold-out principals, and (ii) territorial disagreements regarding substantive law.

a) Hold-out principals. First, although Protocols' utility may be obvious to most parties, they essentially remain optional, private contracts between the various principals. In the traditional Protocol context, where there are only a limited number of principals, the transaction costs involved with drafting a Protocol are minimal, particularly in light of the Concordat and ALI Guidelines. Accordingly, holdout concerns are minimized; it is likely that all of the involved principals will eventually sign on to a Protocol.

However, as the Lehman case demonstrated, where an enterprise that is truly worldwide in scope enters insolvency, a large number of principals will be involved. Moreover, where liquidation—instead of reorganization—is at issue, some principals may decide that the terms of the Protocol are unfavorable, in part because liquidations are zero-sum games: the creditors will not have any opportunity to recover their claims based on the future operations of the company, so anything in a Protocol that might reduce current recoveries will be fought with more vigor. In the Lehman insolvency, the administrator for Lehman Brothers International Europe (LBIE) refused to sign the Protocol, citing concerns over how intra-company claims were to be handled, certain attempts at determining choice of law analysis, and whether the Protocol could, in fact, be effectively used in certain jurisdictions (particularly Singapore, where many swap transactions were based).59

b) Territoriality concerns. The Concordat and ALI Guidelines clearly adopt a modified universalist stance toward the conduct of transnational insolvency.60 But these compilations of best practice cannot overcome basic differences in the substantive law of forum jurisdictions. For example, Protocols that seek to allow


recognized principals to employ the transaction avoidance principles of all jurisdictions (following the seventh Concordat principle) often purport to grant a substantive right that would not otherwise exist because transaction avoidance principles vary widely between jurisdictions. Protocols that acknowledge "public policy" exceptions to the application of any particular provision lend themselves to significant uncertainty: after all, divining the public policy of a large number of jurisdictions—all with different legal systems, systems of priority in insolvency, and constituency concerns—involves significant difficulty and uncertainty. This is particularly true given that the insolvency systems in many jurisdictions are far more heavily tilted toward a fast liquidation than the US system, which often favors going-concern sales or reorganizations.

These problems are particularly troublesome when a Protocol purports to organize proceedings involving both civil and common law jurisdictions. Courts in civil law jurisdictions meticulously scour their civil codes for authorization to engage in any practice, but because Protocols frequently interact with rules limiting ex parte communications and communications between courts, civil law courts have found their authority to endorse Protocols lacking. As discussed above, many of the most beneficial aspects of Protocols require the approval of the involved courts. Thus, if a civil law jurisdiction is important to insolvency proceedings involving a transnational enterprise group (and such a jurisdiction almost always will be), this basic problem can significantly limit the beneficial nature of Protocols. This resulting limitation is particularly true because the effectiveness of Protocols relies on the participation of all primary principals, and if one principal is unable or unwilling to sign on, communication and cooperation even between signatories to the Protocol will diminish. This reliance on complete participation is essential because lack of cooperation will make reorganization of the transnational enterprise essentially impossible. Without cooperation between “liquidation-focused” jurisdictions and “reorganization-focused” jurisdictions, when the liquidation-focused jurisdictions order the sale of assets that would be necessary to the survival of the enterprise group as a whole, the entire group could be forced into liquidation.

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62 Problems that arise from the concept of public policy exceptions will be discussed in more detail in connection with the Model Law. See Section II.C.3.
64 See Flaschen and Silverman, 33 Tex Int'l L J at 593–94 (cited in note 23) (citing the Nakash Protocol as the first Protocol to overcome the difficulties imposed by civil law regimes).
65 See id.
C. The Model Law

The Model Law is widely heralded as the greatest achievement in the development of transnational insolvency law and solidifies the primacy of modified universalism.\(^{66}\) The text was adopted by UNCITRAL in 2007, and it has since been adopted by eighteen countries, including several countries that are particularly important in the global economy.\(^{67}\) However, notably absent from the list of adopting countries are the majority of the EU countries,\(^{68}\) Brazil,\(^{69}\) and, perhaps most importantly, China.\(^{70}\) In connection with the promulgation of the Model Law, UNCITRAL has also released guidance on crafting domestic insolvency law that will function within the international framework,\(^{71}\) as well as a practice guide on cross-border insolvency that emphasizes the interplay between the Model Law, domestic law in non-adopting countries, and Protocols.\(^{72}\) Most recently, Working Group V has pre-released

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\(^{68}\) As discussed below, the EU countries have their own framework, but the interaction between the EU Regulations and non-EU countries is unclear, at best.

\(^{69}\) For a discussion of whether adoption of the Model Law would be appropriate for Brazil, which is emerging as an important player in the world economy, see Fernando Locatelli, *International Trade and Insolvency Law: Is the UNCITRAL Model Law on Cross-Border Insolvency an Answer for Brazil*, 14 L & Bus Rev Am 313, 344–45 (2008) (concluding that Brazil’s current emphasis on territoriality in cross-border insolvency cases may be hampering its competitiveness in the global economy). For a general discussion of the current law on transnational insolvency in Brazil, see Paulo Fernando Campana Filho, *The Legal Framework for Cross-Border Insolvency in Brazil*, 32 Houston J Int'l L 97, 149–51 (2010) (noting Brazil’s current territorialism and arguing for a need to move toward modified universalism).

\(^{70}\) For a general discussion of China’s insolvency law, see Rakhi I. Patel, *A Practical Evaluation of the People’s Republic of China’s 2007 Enterprise Bankruptcy Law*, 10 UC Davis Bus L J 109, 115–16 (noting that “the 2007 law remains without a comprehensive cross-border bankruptcy proceeding to assist foreign companies as the law requires that debtors have a domicile in China,” but that the law “makes an effort to recognize foreign bankruptcy proceedings and provides that foreign parties may apply to the People’s Court for recognition and enforcement of a bankruptcy judgment made in a foreign court that involves debtor property located in Mainland China”). In that sense, China’s law is actually closer to the modified universalist framework than Brazil’s, though still with serious drawbacks.


some guidance on the treatment of enterprise groups in insolvency.\textsuperscript{73} I will briefly explain the most salient points and shortcomings of the Model Law as it relates to enterprise groups,\textsuperscript{74} and I will note the insufficiency of Working Group V’s recommendations.

1. The Model Law’s operating framework.

Ian Fletcher states that “[t]he four cornerstones of the Model Law can be represented by four primary concepts: Access, Recognition, Relief, and Cooperation.”\textsuperscript{75} The Model Law purports to accomplish those goals by facilitating: (i) recognition of foreign proceedings; (ii) information sharing between involved courts and involved principals; (iii) equal access to all involved courts for all principals, as well as for all parties with claims against a debtor; and (iv) organization of cases where multiple main proceedings are taking place involving a single debtor.\textsuperscript{76}

The Model Law contains a variety of built-in limitations on its scope. First, Article 2 states that only certain kinds of foreign proceedings should be recognized: to be recognized, a proceeding must be a collective proceeding under the supervision of a judicial or administrative process (meaning that all of the debtor’s assets, and all claims against those assets, are on the table) and it must be pursuant to a law relating to insolvency (not merely pursuant to general creditor-debtor laws).\textsuperscript{77} Additionally, Article 2 limits the scope of which principals are entitled to access: only foreign representatives receive the benefits of the Model Law. Some interpretations of this language could lead to the conclusion that “debtors in possession”—in other words, the management of the company that was in place before the petition was filed—would not qualify.\textsuperscript{78} However, given the importance of US proceedings in most transnational insolvencies, the US’ strong public policy in favor of allowing debtors in possession to remain in control of companies even if they are in


\textsuperscript{74} The Model Law has received significant scholarly attention, so a full discussion of its application outside of the enterprise group context would be duplicative and unnecessary here. For a discussion of the Model Law’s application outside of enterprise groups, see Fletcher, \textit{Insolvency in Private International Law} at 443–57 (cited in note 33).

\textsuperscript{75} Id at 453.

\textsuperscript{76} See id.

\textsuperscript{77} See id. These points have been subject to some litigation; in particular, parties will often dispute whether a proceeding is “collective” or “under a law relating to insolvency.” See, for example, \textit{In re Betcorp Ltd}, 400 Bankr. 266, 295 (Bankr. D Nev 2010) (holding that Australian winding-up procedure qualified as a foreign main proceeding).

\textsuperscript{78} See Fletcher, \textit{Insolvency in Private International Law} at 455–56 (cited in note 33).
liquidation,\textsuperscript{79} and the US’ wholesale adoption of the Model Law, such an interpretation is implausible.

Most importantly, the Model Law draws a distinction between “main” and “non-main” proceedings. Foreign main proceedings are the focal point of the Model Law; generally, the substantive law of the foreign main proceeding should guide the disposition of the debtor’s assets.\textsuperscript{80} Article 20 of the Model Law provides for a stay over all claims relating to a debtor when a foreign main proceeding has been identified—essentially tying the hands of the domestic court that recognizes the main proceeding. In order to qualify as a foreign main proceeding, “the proceeding should be taking place in the State where the debtor has the centre of its main interests.”\textsuperscript{81} The center of main interests (COMI) test purports to gauge where a business conducts its primary operations.\textsuperscript{82} The Model Law introduces a rebuttable presumption that the debtor’s registered office is the center of main interest,\textsuperscript{83} but the COMI concept, particularly in the US, is a very fact-intensive inquiry. Courts in the US, applying the principal place of business test that forms the bedrock of jurisdictional law in that country,\textsuperscript{84} do not hesitate to find that a COMI is in a place other than that of registration.\textsuperscript{85} Other courts rely more heavily on the Model Law’s “site of registration” presumption.\textsuperscript{86} These competing standards lead to the possibility of conflicting rulings on the COMI issue, and because courts will only recognize as a main proceeding cases based in the location of a business’s COMI, the COMI determination is at the heart of the Model Law framework.

Foreign non-main proceedings may be opened in any place where the debtor has an “establishment,” which is “any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.”\textsuperscript{87} Importantly, neither definition includes jurisdiction based

\textsuperscript{79} See, for example, A. Mechele Dickerson, Privatizing Ethics in Corporate Reorganizations, 93 Minn L Rev 875, 932 (2009) (explaining that the US bankruptcy code evinces a normative decision that management—either original management or management installed by primary creditors pursuant to contractual rights after default—is in the best position to guide an organization through reorganization, even a liquidating reorganization).

\textsuperscript{80} See Fletcher, Insolvency in Private International Law at 454–57 (cited in note 33).

\textsuperscript{81} Id at 457. See also Model Law, Art 2(b) (cited in note 13).

\textsuperscript{82} See Fletcher, Insolvency in Private International Law at 457 (cited in note 33).

\textsuperscript{83} Model Law Art, 16(3) (cited in note 13).

\textsuperscript{84} See Hertz Corp v Friend, 130 S Ct 1181, 1185–86 (2010).


\textsuperscript{86} As I discuss in more detail in connection with the EU Regulations, most European courts have turned the ostensibly rebuttable presumption into a nearly controlling presumption.

\textsuperscript{87} Model Law, Art 2(f) (cited in note 13).
solely on the transitory presence of assets, although Article 28 allows for limited jurisdiction in such cases to facilitate the disposition of all the assets of the debtor.

Upon the recognition of either a main or non-main proceeding, Model Law Courts may grant any relief appropriate for ensuring the proper treatment of the foreign proceeding. Article 21(1) includes an illustrative list of relief, which includes a stay on proceedings or execution of assets, an evidentiary process, or the grant of "any additional relief that may be available to" an office holder appointed under the insolvency law of the enacting state. As Fletcher notes, the final provision, in particular, may lead to situations where a principal may be able to exercise greater powers under the law of the enacting state than it would have been able to exercise under the insolvency laws of its own state. This is particularly true in the areas of evidence—especially discovery—and the exercise of avoidance powers. Accordingly, it is probably the provision most likely to lead to the exercise of the public policy exception because it is bound up in determinations of substantive law.

The Model Law does not purport to alter the domestic insolvency regimes in enacting jurisdictions, and it provides for a public policy exception where recognition of a foreign proceeding or a grant of access to domestic courts would violate a fundamental public policy of domestic insolvency law. However, the Legislative Guide makes clear that the public policy exception should be interpreted quite narrowly, particularly in light of Article 8 of the Model Law, which provides that "[i]n the interpretation of the present Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith."
It is important to note that the Model Law has no reciprocity requirement. In other words, countries that adopt the Model Law will recognize the proceedings of non-adopting countries.\footnote{But some enacting states have included reciprocity requirements: South Africa, Argentina, Mexico, Romania, and the British Virgin Islands. Mund, 28 Wis Ind L J at 335–36 (cited in note 21).}

2. The application of the COMI standard as it relates to transnational enterprise groups.

As noted above, the COMI standard is the driving force in the Model Law, as the determination of the foreign main proceeding essentially guides the remainder of the proceeding. However, the Model Law currently speaks only to individual debtors—it makes no provision for enterprise groups.\footnote{See Westbrook, 76 Am Bankr L J at 8–10 (cited in note 60).} In the enterprise group context, then, operating subsidiaries with varying places of registration are likely to have different COMIs under a traditional Model Law analysis, particularly in Model Law Courts that employ a strong presumption that a debtor's COMI is its place of registration. When combined with the willingness of courts following the US model to give greater consideration to operating realities, there are likely to be conflicting COMI findings with respect to certain members of the enterprise group, and those findings may have little to do with economic realities. One possible solution would be simply to allow enterprise groups to elect a COMI in the incorporating or registering documents, which would at least allow for certainty—and certainty, the argument goes, is worth the forum shopping price one pays.\footnote{See Susan Johnston and John Han, \textit{A Proposal for Party-Determined COMI in Cross-Border Insolvencies of Multinational Corporate Groups}, 16 J Bankr L & Prac 811, 814 (2007).} Additionally, with respect to jurisdictions whose COMI analysis turns on the place of incorporation or registration, forum shopping is still readily available because reincorporation on the eve of insolvency is feasible.\footnote{Id.} But this analysis of forum shopping understates the difficulties faced in reincorporating or reregistering companies.\footnote{There are tax, regulatory, and contractual issues that come into play here that are outside the scope of this Comment.} Thus, the COMI issue remains a sticking point in the enterprise context.

3. The “public policy” exception.

In essence, the public policy exception serves as a check on the kinds of relief a Model Law court will grant. The Legislative Guide makes it clear that the public policy exception should be read in conjunction with Article 8's clear
statement that the overall aims of the Model Law—harmonization of transnational insolvency proceedings—should be narrow in scope.\textsuperscript{101} In the US, the public policy exception has been sparingly employed.\textsuperscript{102} However, as discussed in connection with the Lehman case study, a US court has found that a violation of the US prohibition against ipso facto provisions would prevent the court from respecting principles of comity.\textsuperscript{103} The court's discussion of such specific public policy incongruities sidesteps the fundamental conflict that exists between domestic insolvency systems that support reorganization and those that do not. This fundamental conflict has never been specifically analyzed, and it remains the "elephant in the room" of the public policy exception's relation to enterprise groups. For example, would a US court recognize a UK ruling that stripped assets located in the US from a UK subsidiary (where the US had recognized the UK proceeding as a foreign main proceeding), if those assets were necessary to the reorganization of an enterprise group with its COMI in the US? On this point, the public policy exception and COMI determinations as they relate to enterprise groups clearly conflict, and the current framework provides no resolution.


Recognizing the shortfalls in the Model Law respecting transnational enterprise groups, when Working Group V commenced work respecting enterprise groups in insolvency generally, it also considered the insolvency of transnational enterprise groups.\textsuperscript{104} Most importantly, Working Group V considered whether substantive consolidation provides the answer to the "Group COMI" question, but it ultimately abandoned the idea.\textsuperscript{105} Accordingly, "the Working Group eventually focused on facilitating coordination and cooperation between courts (and representatives) handling insolvency proceedings against different members of an enterprise group."\textsuperscript{106} In essence, the Working Group recommendations amount to provisions that have proven successful in Protocols involving court-to-court communication in large-scale

\textsuperscript{101} The Legislative Guide states: "The Model Law preserves the possibility of excluding or limiting any action in favour of the foreign proceeding, including recognition of the proceeding, on the basis of overriding public policy considerations, although it is expected that the public policy exception will be rarely used." Legislative Guide at 311 (cited in note 71).

\textsuperscript{102} For a detailed analysis, see Mund, 28 Wis Intl L. J at 340–48 (cited in note 21).

\textsuperscript{103} See In re Lehman Bros Holdings, 422 Bankr at 412. See also Section III.

\textsuperscript{104} See Mevorach, 18 Cardozo J Intl & Comp L at 369–70 (cited in note 18).

\textsuperscript{105} See id at 409; Enterprise Group Guide at 65–67 (cited in note 73).

\textsuperscript{106} Mevorach, 18 Cardozo J Intl & Comp L at 415 (cited in note 18).
enterprise groups. As such, they added little to the substantive framework of the Model Law, and they are more similar to the Concordat or ALI guidelines. One potential improvement that may result is that Model Law Courts in civil law countries will see the Enterprise Group Guide, integrated as it is with the Model Law, as implicit statutory authorization to engage in practices in which they were unwilling to engage in before, such as communication with courts handling the insolvencies of related entities in the enterprise group. However, that is a limited benefit, at best.


It is apparent from the above analysis that Working Group V has essentially waved the white flag—at least for the time being—on addressing head-on the problem of enterprise groups, even though it acknowledges that such groups are “the most common form of business model.” Indeed, the Working Group’s recommendations simply reaffirm the application of Model Law principles to enterprise groups, without purporting to suggest particular methods for getting around the vexing problems inherent in the structure of those groups. Many of the problems encountered can be attributed to problems of entity law generally, not to transnational concerns. Accordingly, Model Law Courts faced with the insolvency of enterprise groups continue without guidance on many of the most important issues in transnational insolvency.

D. The EU Insolvency Regulations

The EU Insolvency Regulations went into force in 2002, and they apply to all members of the EU except Denmark. Commentators widely agree that their primary provisions were animated by the same modified universality considerations that have driven the development of Protocols and the Model Law. Indeed, the primary difference between the EU Regulations and the Model Law is the operative framework of the EU Regulations: specifically, the European Court of Justice (ECJ) has authority to issue rulings that bind all participating jurisdictions, which allows for harmonization on many of the

109 See id.
points of law—particularly, determination of COMI issues—when the domestic courts applying the EU Regulations come to inconsistent results. The decisions regarding the EU Regulations by the ECJ have proven persuasive to courts seeking to interpret domestic versions of the Model Law. Thus, to a certain extent, the EU Regulations serve to harmonize all transnational insolvency law involving large enterprise groups. Because most transnational enterprise groups are likely to have assets in a European jurisdiction, EU courts are likely to apply EU Regulations law even in cases that involve non-EU jurisdictions, and EU courts are obliged to apply the EU Regulations to enterprises when the EU court determines the COMI is in an EU jurisdiction.

The foregoing discussion is particularly significant in light of the fact that the ECJ’s decision in Eurofood IFSC Ltd draws a bright-line rule for COMI issues: in the absence of overwhelming evidence to the contrary, a business’s COMI is its site of registration or place of incorporation. While this bright-line rule allows for a significant degree of control by the parties, it simply cannot account for the reality that, in a business enterprise group, a subsidiary registered in the Cayman Islands for tax purposes is likely to be controlled by an operating company elsewhere. Put another way, current law under the EU Regulations simply does not allow for any degree of substantive consolidation to determine a COMI for business enterprise groups that reflects their economic reality. This is in contrast to the willingness of US bankruptcy courts to consider more broadly the COMI of the entire enterprise group. Therefore, the potentially unifying application of the EU Regulations may lead to conflict with US interpretation of the Model Law, and that conflict will lead to uncertainty and forum shopping.

112 See, for example, the Eurofood case, where the ECJ issued its authoritative determination that COMI, under the EU insolvency regulations, must be determined as of the date of the insolvency petition. Eurofood IFSC Ltd, Case 341/04, 2006 ECR I-3813 (2006).

113 See, for example, In re Betcorp, 400 Bankr at 289 (discussing the ECJ’s Eurofood decision to determine the COMI, under Chapter 15, of a company undergoing an administrative winding-up in Australia); In re Ran, 607 F3d 1017, 1020–21 (5th Cir 2010) (discussing the connection between the EU Regulations and analyzing EJC decisions in the Chapter 15 context).

114 See Mion, 13 New Eng J Intl & Comp L at 24 (cited in note 110) (“In today’s global economy a foreign creditor is probably unable to disregard the orders of a European Court since he/she is likely to have assets or business in Europe and the company’s officers from time to time might travel there.”).

115 See id.

116 See id.


119 See Mion, 13 New Eng J Intl & Comp L at 24 (cited in note 110).
E. Concluding Observations about the Existing Framework

The foregoing discussion makes clear that the current framework is woefully ill-equipped to handle insolvencies involving transnational enterprise groups. A high degree of conflict and uncertainty respecting the application of the COMI principle to enterprise groups persists, even though Protocols, the Model Law, and the EU Regulations all rely on a determination of COMI for their procedural mechanisms.

Even if COMI can be accurately determined, substantive issues, which are subject to vague public policy exceptions under the order-recognition regimes of those frameworks, remain intractable. These include transaction-avoidance mechanisms; priority schemes; the ability of former management to continue operating the debtor as debtors-in-possession; the ability to engage in discovery and other evidentiary issues that implicate the treatment of claims and valuation of business assets; and, most fundamentally, business rescue or restructuring regimes, in contrast to liquidation regimes. The main tools to address these substantive issues are Protocols that include negotiation and arbitration provisions aimed at settling substantive disputes, particularly substantive disputes relating to intra-enterprise obligations. But such Protocols may be ignored by principals seeking to maximize the return to their domestic creditors.\(^{120}\)

III. THE CONSEQUENCES OF FAILURE: THE LEHMAN/DANTE CASE STUDY

Discussion of the shortcomings of the current framework would be needless if the framework was capable of producing generally coherent results. Unfortunately, in the Dante CDO case the shortcomings of the current framework all led to the worst conceivable result: a third party holding assets in a custodial capacity was ordered to dispose of the assets in two different, irreconcilable ways by courts in the UK and the US.\(^{121}\) The amount of money

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\(^{120}\) This, of course, involves a serious public choice issue: principals will always seek to maximize the return to their domestic parties, so that the domestic parties seek that principal when a future debtor enters insolvency. For a discussion of some of the public choice issues inherent in bankruptcy practice, see generally Lynn M. LoPucki and Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a “Race to the Bottom”*, 54 Vand L Rev 231 (2001) (evaluating empirical evidence that indicates that bankruptcy fora may encourage forum-shopping by engaging in a race to the bottom). In the US, the US Trustee’s Office, which acts as trustee in liquidation proceedings, serves as a hedge against this kind of parochialism. The same cannot be said of many other jurisdictions, where administrators are appointed by creditor’s committees. For a comparative study of the appointment process for debtor-administrators, see generally Lobo, *World Insolvency Systems* (cited in note 15).

\(^{121}\) See note 17.
involved with the Dante CDO case pales in comparison to the financial cost of conflicting rulings that could result if BP, for example, decided to file for bankruptcy protection in an effort to address unknown—and potentially overwhelming—obligations from the Gulf disaster. In this section, I explore the failings of the current framework in the context of the Dante CDO case.

A. Lehman and the Dante CDO

This Comment has alluded to the scope and complexity of the Lehman Brothers bankruptcy, but only a simplified explanation of Lehman's structure and the Dante CDO itself is necessary here.\(^{122}\)


The main Lehman holding company was incorporated in the US with operating subsidiaries in numerous countries. However, operating subsidiaries notwithstanding, cash flowed freely within the company under a highly integrated cash management system. Accordingly, while there were intra-company debts, these debts were essentially illusory, and they simply represented the bookkeeping necessary to comply with regulatory and taxation authorities. Similar systems are common in large, multinational enterprise groups.\(^{123}\) In addition to largely illusory intra-company debts, there were elaborate systems of cross-collateralization and intra-company guarantees of debts to third parties. The ultimate effect was to ensure that Lehman's creditors were not limited to the assets of single subsidiaries, unless a subsidiary was established as a special purpose entity (or bankruptcy remote vehicle, as the case may be).\(^{124}\)

Judge Peck, the judge in charge of the LBHI proceedings in the US, issued an early order allowing the enterprise to continue operating under its pre-petition cash management system; however, the order did not prohibit the assets from being frozen by the laws of other jurisdictions.\(^{125}\) The cash management

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\(^{122}\) All explanation of the basic Lehman framework in this Section is drawn from the following sources: McDonald and Robinson, *A Colossal Failure of Common Sense* (cited in note 3); *In re Lehman Bros Holdings*, 2008 WL 4902202 (explaining cash management system); *In re Lehman Bros Holdings*, 422 Bankr 407 (holding the priority swap provision at issue in the Dante CDO unenforceable); Tatiana V. Tkachenko, *Lehman Brothers' Bankruptcy Proceedings: The European Perspective*, 2010 Norton Ann Rev Intl Insolvency 304.

\(^{123}\) See Tkachenko, 19 J Bankr L & Prac at 586–87 (cited in note 5).

\(^{124}\) “Special purpose entities” or “bankruptcy remote vehicles” are subsidiaries established to hold certain assets that have a different risk portfolio than a company’s normal asset portfolios or are otherwise specialized assets. They are also widely used as entities for cash-management or tax sheltering purposes. The details of special purpose vehicles are unimportant to this discussion.

\(^{125}\) *In re Lehman Bros Holdings*, 2008 WL 4902202 at *2–3.
system—and, by extension, the operation of the entire enterprise—was managed by a corporation whose COMI was undeniably in the US; but because COMI analysis focuses on the place of incorporation and operation of each member of the enterprise individually, multiple foreign main proceedings were filed, including, importantly, the main proceeding for Lehman Brothers International Europe (LBIE), which controlled most of Lehman’s European assets.126

Recognizing a need to coordinate proceedings, the various Lehman principals engaged in negotiations toward a Protocol of unprecedented scope.127 Most importantly, the Protocol included provisions that served to limit the scope and targets of avoidance actions and intra-company claims.128 But those provisions led to the principals of LBIE and Lehman Brothers Japan (LBJ) refusing to sign the Protocol, which greatly diminished the Protocol’s benefit.129 Additionally, LBIE’s refusal to sign on to the Protocol angered Judge Peck, who stated in court that “[t]he position that’s being taken by LBIE appears to be getting in the way of a global initiative.”130

The precise results of the refusal of LBIE and LBJ to sign on to the Protocol are probably unknowable. The most likely result is higher negotiation and litigation costs relating to information sharing and intra-company claims, and those figures are very likely to be significant. More generally, the failure demonstrates the potential inability for a Protocol to handle a large-scale transnational enterprise insolvency adequately.

2. Dante and the failure of the Model Law/EU Regulations framework.

The Dante case illustrates several of the shortcomings of the Model Law framework. Indeed, neither the UK nor US courts even discussed the application of the Model Law to the issue at hand, probably because the Model Law was outside of what proved to be the very narrow reach of the existing

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127 See Zumbro, 11 Bus L Intl at 164 (cited in note 16); Tkachenko, 2010 Norton Ann Rev Intl Insolvency at 315 (cited in note 122) (“Unlike mostly bilateral protocols in the past that have been between states of common law jurisdictions . . . , this Protocol has sought to coordinate insolvency proceedings among multiple common law and civil law jurisdictions in various continental European countries and, for the first time, several countries in Asia.”).
129 Id at 318 (“The US operations of Lehman Brothers and the UK and European Lehman Brothers’ entities in administration are now being dealt with through separate legal procedures as if they are no longer part of the same group,” quoting LBIE’s principal.).
130 Potkewitz, Lehman Bankruptcy Hits Stumbling Block (cited in note 59).
framework as it relates to enterprise groups. Nominally, the parties in interest were not subject to the Model Law provisions, because the special purpose vehicles (SPVs) in the Dante program were not themselves in liquidation—only the enterprise entities subject to its cross-collateralization provisions were in liquidation. Specifically, the Dante provision was linked to a bankruptcy filing by LBHI, the main US holding bank.

"Dante" was the name of a Lehman SPV program, whose assets included a variety of derivatives contracts. A third-party custodian, Bank of New York Mellon, held legal title of Dante’s assets and had disbursement responsibilities. The contracts setting up the Dante vehicle had choice-of-law clauses, which stated that UK law was to apply to any dispute or interpretative question.

The Dante program was supposed to be “bankruptcy remote” from the main Lehman holdings. In other words, the guarantee network itself was somewhat independent from the overall cash management system of the enterprise. Nevertheless, the catastrophic nature of Lehman’s collapse pulled in most of Lehman’s SPVs, and the Dante entities were no exception. At issue in both the UK and US litigation was a contract provision that shifted payment priority upon the bankruptcy of certain members of the enterprise group. The UK high court found that the provision was enforceable, while the US court found that the provision violated the bankruptcy code’s prohibition against ipso facto clauses; the opposing rulings led to inconsistent recoveries (in the UK litigation, the noteholders recovered, while Lehman recovered in the US litigation). The prohibition against ipso facto clauses is considered a fundamental public policy of US bankruptcy, which is why the court declined to honor the UK court’s decision and the UK choice of

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132 See id.
133 See In re Lehman Bros Holdings, 422 Bankr at 413.
134 Perpetual Trustee Co Ltd, 2009 EWHC 1912.
136 Id.
137 See In re Lehman Bros Holdings, 2008 WL 4902202 at *2; In re Lehman Bros Holdings, 422 Bankr at 411.
139 In re Lehman Bros Holdings, 422 Bankr at 412. The court also held that various exceptions in the bankruptcy code did not apply; that discussion is not relevant to this Comment. Ipso facto clauses are clauses that give specific economic consequences to insolvency.
law provision in the contract. While the public policy analysis in the Dante case was done under a comity analysis instead of under the Model Law, fundamental public policy analysis is similar under both the comity and Model Law lenses.


Many of the successes and failures of the transnational framework in the context of the Lehman bankruptcy are likely to be unknowable. The Lehman Protocol, signed by Judge Peck, gave the administrator of LBHI broad authority to settle claims without further accounting by the court. It is impossible to know precisely what impact the Protocol’s provisions had on negotiation of various intra-company claims and how those negotiations interplayed with the court proceedings involving third-party creditors. Similarly, the Lehman case has not progressed far enough to know the litigation and transaction costs resulting from the failure of Lehman’s US broker-dealer, LBJ, and LBIE to sign on to the Protocol.

We do know the concrete consequences that resulted from application of the same public policy analysis that permeates application of the Model Law: conflicting rulings. Though the Dante case itself ultimately settled out of court due to pressure from the UK and US courts, similarly conflicting rulings could happen in the future.

What is remarkable about the failures in the Lehman case is that, despite its massive scope, all the pieces of the transnational insolvency framework were in place, and yet the failures still occurred. The US and UK have both enacted legislation implementing the Model Law and have similar legal systems. Lehman is in liquidation; there are no concerns about preserving enterprise value on a going-concern basis and no conflicts between domestic insolvency systems that generally do not contemplate reorganization and those that do. There was no conflict between tort creditors and financial creditors. For those reasons, the failures in the Lehman case are instructive on what could happen if, for example, BP were to file for insolvency protection to handle certain aspects of the Gulf disaster.

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140 See id at 417–18 (noting that courts will not adhere to the principle of comity where doing so would violate a fundamental public policy in the US bankruptcy code).
141 See id at 416. See also Section II.C.
The primary purpose of this Comment is to explain the current framework of transnational insolvencies, identify the most glaring weaknesses, and demonstrate the resulting problems. In this section, I briefly propose two approaches courts working within the current framework should employ in order to minimize the potential for conflicting court rulings and inefficiencies resulting from the failure to adopt Protocols under certain circumstances. These proposals are designed to lead toward a “new lex mercatoria” for the most important issues of transnational insolvency.\(^\text{144}\)

A. Greater Use of Substantive Consolidation for the Limited Purpose of Applying the Center of Main Interest Test

As discussed in connection with the Model Law and EU Regulations, the primary weakness in the current framework is its failure to account for corporate enterprise groups that have operating assets in multiple jurisdictions but have highly integrated structures. Under those circumstances, multiple main proceedings will be opened—one for each portion of the enterprise group with operating assets sufficient to justify the opening of a proceeding. This has two inevitable results: (i) COMI determinations for each operating subsidiary do not adequately account for the centralized cash-management systems of integrated groups; and (ii) conflicting COMI determinations with respect to operating subsidiaries are likely, as some jurisdictions (following the US example) will account for actual operations, while other jurisdictions (following the European example) will employ a presumption that the place of incorporation or registration is the COMI of the corporate group.

In order to get around this problem, courts should take a cue from US bankruptcy law. Under US law, the insolvency proceedings of corporate enterprise groups are procedurally consolidated into one proceeding.\(^\text{145}\)

\(^{144}\) New lex mercatoria is an evolving legal philosophy dealing with private international law generally, and it argues that the current private international law framework does not adequately account for the business needs of transnational commerce. Interestingly, the development of new lex mercatoria theory has focused on the commercial dealings of solvent companies, even though all dealings of solvent companies occur in the shadow of insolvency. The exploration of the potential application of new lex mercatoria theory to transnational insolvency is not the subject of this Comment. For a description of new lex mercatoria theory, see generally Klaus Peter Berger, *The Creeping Codification of the New Lex Mercatoria* (Kluwer L Intl ed 2d ed 2010).

Additionally, in circumstances where the individually incorporated entities are, in fact, incapable of being unwound from the main operating company, courts will employ *substantive* consolidation.\(^\text{146}\) In those circumstances, intra-company transfers are ignored, the assets of the entire enterprise group are considered together, and priorities among the third-party creditors of the various subsidiaries are blended. Full substantive consolidation in the transnational insolvency context would be both impossible and undesirable because substantively consolidating proceedings that are governed by different substantive laws is difficult even where the laws are closely related. However, for the purposes of determining the COMI of a transnational business enterprise group, conducting a hypothetical substantive consolidation—that is, taking a look at the entire enterprise—would allow courts to open fewer main proceedings. Based on combined transaction structures and operating assets, courts could open main proceedings only in those locations where a main proceeding is truly necessary to maximize the value of the enterprise as a whole and to accommodate differences in substantive law.

This limited proposal differs significantly from the full substantive consolidation considered (and rejected) by Working Group V because I do not argue that, after consolidation for purposes of determining COMI, the walls separating the various enterprise groups should be pulled down. Instead, I use the concept of substantive consolidation in order to shine a light on what the true COMI of various constituents in the corporate enterprise actually are. Such an approach not affect priorities in payment or grant new substantive rights, and would preserve the expectations of creditors by ensuring the application of the insolvency law where the debtor-enterprise actually does business, as opposed to the various insolvency laws of disparate cites of incorporation where the creditors’ money eventually lands.

B. Insistence by Model Law Courts That Adoption of a Protocol Be a Prerequisite to Obtaining the Procedural Benefits Inherent in the Model Law

 Currently, many provisions of the Model Law and EU Regulations anticipate that various principals will seek to enter Protocols. However, Model Law Courts, until now, have not *required* that principals do so in order to obtain the benefits from the Model Law and EU Regulations.

I propose utilizing the public policy exception broadly in this instance. The public policy of all domestic insolvency regimes is the maximization of value. Although domestic regimes contain differences respecting the disbursement of

\(^{146}\) Id.
that value, all constituents—creditors, employees, and communities—benefit when insolvency proceedings maximize the size of the pie. Protocols are designed to work in concert with the provisions of the Model Law and EU Regulations, as well as with general principles of comity, in non-EU jurisdictions that have not enacted the Model Law in order to maximize value, mainly by limiting needless transaction costs. Thus, refusal to enter a Protocol serves a blow to the overall value of the business enterprise—a reality made clear in the Lehman case.

Accordingly, courts, acting under the public policy exception, should refuse to recognize principals who have failed to give adequate cause for refusing to enter Protocols. This would allow Model Law Courts, as well as courts working under more general principles of comity, to leverage the Protocol process to maximize the value of the entire enterprise group. Importantly, this proposal acknowledges the emphasis that Working Group V has placed on Protocols as the only feasible way to coordinate and control large-scale transnational enterprise insolvencies.

V. CONCLUDING REMARKS

Significant progress has been made in the theory and practice of transnational insolvency in the last twenty years. But as globalization continues to lead to integrated transnational enterprise groups, the potential for insolvencies similar to Lehman will continue to grow. Accordingly, the current frameworks must continue to evolve. The proposals of Working Group V may lead to improvement, but they fall short of allowing for a logical liquidation or reorganization proceeding for distressed transnational enterprise groups. Therefore, courts will need to continue to employ their own creativity in addressing these issues. By engaging in a hypothetical substantive consolidation to provide more “teeth” to the COMI analysis and by utilizing the public policy exception to force otherwise recalcitrant principals to sign on to Protocols, the courts will be able to handle more effectively the difficult questions that arise in this context.