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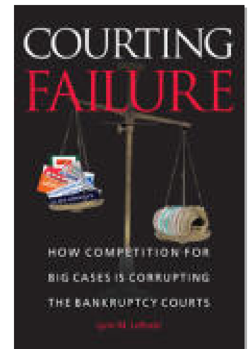

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Global and Out of Control?

"Forum shopping" for the most favorable place
to go bust seems set to flourish.

—International bankruptcy commentator John Willcox (2003)

The potential for economic harm from international forum shopping is greater than the potential for harm from domestic shopping. By choosing a different city's court within the United States the domestic shopper can gain only a different interpretation or application of the same U.S. Bankruptcy Code and Rules of Procedure. But by choosing a different country's court, an international shopper can access an entirely different set of remedies and priorities.

That potential for greater harm is held in check by the need for international recognition and enforcement of bankruptcy orders. When competing courts overreach internationally—by attempting to apply their own laws to people and events in other countries—courts of those other countries can nullify the attempt by refusing to recognize or enforce the overreaching courts' orders.

The need for foreign recognition limits what courts can offer case placers and thus moderates the competition. Competing courts tend to act more reasonably in multinational bankruptcy cases, and the potential for harm goes largely unrealized.

Unfortunately, many of the world's leading bankruptcy professionals—lawyers, judges, and academics—are trying to eliminate the recognition requirement. If they succeed, they will unleash the international system's full potential for harm. Most of these professionals are well-meaning, good-hearted idealists, working for

what they see as an improvement in the system. A few are schemers, seeking to advance themselves or their local bankruptcy courts. Under the banner of "universalism," the professionals seek to give a single court effective worldwide jurisdiction over each multinational company's bankruptcy case. Alone, that would be an improvement in the system. But to put a single court in control of a case requires some method for selecting that court. So far the universalists have proposed no method that is likely to work. If they are allowed to implement their current proposal, it will trigger an international bankruptcy court competition far more destructive than the domestic competition in the United States.

To illustrate how universalism is supposed to work, assume hypothetically that Daimler-Benz, a multinational company based in Germany, properly filed for bankruptcy in Germany. The German court would administer Daimler-Benz's assets—not just in Germany but in the United States and other countries. In accord with the general understanding that a court of one country is not competent to administer a case according to the laws and procedures of another,[1] the German court would administer the U.S. assets according to German laws and procedures. German law would control, for example, the priorities and remedies of Daimler-Benz's American employees and customers. The courts of the United States would be required to recognize orders of the German court—whether they agreed with those orders or not—and assist in enforcing them.

If, in a universalist system, Daimler-Benz could instead file in the United States, U.S. law would determine the remedies available to the company and the priorities of the company's creditors, employees, and customers throughout the world. The company's choice of the United States over Germany would provide windfall priorities to some creditors while depriving others of priorities for which they bargained and paid.

Universalists and their opponents agree that a system that allowed multinational companies a last-minute choice of law would not be viable. Parties who deal with a multinational company—particularly one already in financial difficulty—need to know what rules will govern in the event of bankruptcy.

To prevent multinational companies from changing their remedies and their creditors' priorities by the companies' last-minute venue choices, universalist laws and treaties require that each multinational case proceed in the debtor's "home country." The image of a single court—that of the debtor's home country—fairly and in good faith coordinating the worldwide reorganization of a sprawling multinational is appealing. That appeal probably explains why so many bankruptcy professionals have accepted the home country standard so uncritically. Universalist proposals incorporating it have been adopted by the European Union, the United Nations Commission on International Trade Law (UNCITRAL), and the prestigious American Law Institute, and implementation is already well under way.

In thinking that the home country standard will be sufficient to control international forum shopping, the universalists have underestimated the incentives for such shopping, the strategic nature of international bankruptcy practice, and the pressures on courts and countries to each win at least a share of the world's multibillion-dollar bankruptcy industry for themselves. The home country standard has four fatal flaws that in combination will permit almost unbridled forum shopping and encourage court competition. First, many of the largest multinational companies do not have home countries in any meaningful sense. When they file for bankruptcy, these companies each will be able to choose among the courts of two or more countries. Second, even multinational companies that do have clear, unmistakable home countries can, and already do, change them. Third, as the U.S. experience has shown, with billions of dollars of business at stake for bankruptcy professionals, competing courts cannot be counted on to determine fairly and in good faith whether they are the home court of multinationals that choose to file with them. Each will be biased in favor of its own jurisdiction. Finally, if international forum shopping and competition do—as I expect they will—run out of control, mechanisms for fixing the problem do not exist. International institutions are not strong enough to impose a solution.

In a universalist system, case placers would be free to choose the bankruptcy systems that gave them and their companies the great-

est advantage over other parties to the bankruptcy cases. The case placers could choose countries whose laws left even corrupt managers in control, barred criminal prosecutions of top managers during bankruptcy cases, lowered the priorities of hostile creditors while raising the priorities of friendly ones, or provided benefits we cannot yet even imagine. If no countries yet have such laws, aspiring bankruptcy havens will enact them.

Of course, major creditors such as banks and insurance companies would anticipate their borrowers' desire to forum shop in the event of bankruptcy and insist on contract provisions to protect themselves. Those contract provisions probably would not, however, prohibit forum shopping. Prohibiting forum shopping would protect everyone, including less sophisticated creditors, customers, landlords, employees, taxing authorities, suppliers, and others. The major creditors and their borrowers could gain more from a contract that permitted forum shopping, exploited the less sophisticated stakeholders, and split the benefits of that exploitation among the major creditors and their borrowers. When billions of dollars are at stake, there are no free riders.

Universalism's Progress

The universalist dream is more than a century old. In an article published in the *Harvard Law Review* in 1888, Professor John Lowell wrote of international bankruptcy:

> It is obvious that, in the present state of commerce and of communication, it would be better in nine cases out of ten that all settlements of insolvent debtors with their creditors should be made in a single proceeding, and generally at a single place; better for the creditors, who would thus share alike, and better for the debtor, because all his creditors would be equally bound by his discharge. . . . It is not so easy to see how this result is to be reached in actual practice.[2]

In the sixty years that followed, universalists continued to push for an international bankruptcy regime in which the decisions of bankruptcy courts in one jurisdiction would receive automatic recogni-

tion in others. In Europe, their efforts resulted in several bilateral treaties in which adjacent countries with similar bankruptcy systems agreed to recognize each other's bankruptcy proceedings.[3] In Latin America, 15 nations ratified the Bustamante Code of Private International Law, which provided for a mostly universalist bankruptcy regime among those countries.[4] But by 1948, the leading international bankruptcy scholar concluded that the push toward universalism had failed.

> Progress has been made only by negotiation between specific countries. The reason is not difficult to ascertain. A treaty-type fitting neighbor-states with a similar bankruptcy legislation, for example, cannot possibly be acceptable to countries which may be distant from each other and have entirely different legal systems. . . . [C]onclusion of a multilateral convention appears impracticable at the present time for many reasons, particularly because of the great diversity of national laws . . . .[5]

The universalists did not give up. In the five decades that followed, they negotiated convention after convention. All failed to obtain ratification. In nearly every case, the sticking point was the provision that would determine which country's courts got the cases. The earliest in this succession of failures was the Model Treaty on Bankruptcy negotiated at the Hague Conference in 1925.[6] That convention would have given jurisdiction over bankruptcy cases to a court of the country "where the statutory registered seat" of the corporation was located—essentially the country of incorporation.[7] It was not ratified by even a single country.[8]

In the mid-1980s, the International Bar Association drafted the Model International Insolvency Cooperation Act (MIICA) for adoption by individual countries. The law provided that the adopting country would recognize foreign bankruptcy proceedings in the "principal forum." When all countries had adopted the act, the result would be a worldwide universalist system. The act—which failed to specify where the "principal forum" would be[9]—was never adopted in any country.[10]

Beginning in the 1970s,[11] European Community and later European Union negotiators proposed a series of Europe-only univer-

salist bankruptcy conventions. A prominent early draft—the 1982 Common Market Draft—would have given jurisdiction to the country in which "the centre of administration of the debtor" was located. With typical British understatement, Professor Ian Fletcher, a leading commentator on international bankruptcy, found it "necessary to voice some apprehension that the correct identification of the location of a debtor's 'centre of administration' . . . may not in all cases be so straightforward as to produce total unanimity amongst the courts concerned." That uncertainty, Fletcher wrote, "could well give rise to 'positive' conflicts of jurisdiction which . . . could prove virtually irresolvable in practice."[12]

After the failure of the 1982 draft, later European convention drafts typically proposed to give jurisdiction to the court where the debtor had the "centre of its main interests." When UNCITRAL decided to propose a model law based on MIICA, its negotiators settled on the same standard. The "centre of its main interests" was at least as vague as the standard Fletcher had criticized. Universalists liked it because the vagueness enabled them to reach agreement. That did not, however, stop numerous commentators from pointing out that the "centre of [the debtor's] main interests" standard begged the question of which country should have the case and thus threatened to generate conflict rather than cooperation.[13]

Universalism in the United States

As of this writing, the U.S. government is not yet a party to any universalist treaty or convention and has adopted no universalist law. U.S. negotiators did settle on a universalist bankruptcy treaty with Canada in 1979. That treaty gave jurisdiction to the country in which the debtor had the majority of its assets. The treaty was not ratified because of "disagreements about the proper choice-of-country rule."[14]

Unable to win adoption of a universalist law or convention, the universalists asserted that section 304 of the U.S. Bankruptcy Code, which had been adopted in 1978, was such a law. Section 304 authorized the bankruptcy courts of the United States to turn over

control of U.S. assets to foreign bankruptcy courts. But the statute added:

> (C) In determining whether to grant [such] relief . . . the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—
>
> (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by [U.S. bankruptcy law].

Read literally, section 304 clearly limits authority to surrender U.S. assets to situations in which the foreign court will distribute them in substantially the same way a U.S. court would. But the universalists, many of whom were themselves bankruptcy judges, chose not to read section 304 as written. Instead, they claimed that section 304 authorized turnover of assets to foreign courts that would distribute the assets substantially differently, as long as the foreign country had a bankruptcy law "of the same sort generally as [the United States]."[15] Universalist judges, including Judge Burton R. Lifland, began surrendering U.S. assets for distribution by foreign bankruptcy courts,[16] and universalist commentators, including Professor Jay L. Westbrook, cheered them on.[17] The effect was to sporadically implement universalism in the United States, at the expense of the particular U.S. creditors whose assets were surrendered.

In 2001, the United States Court of Appeals for the Second Circuit dealt the universalists a major setback. In *In re Treco,*[18] Meridian International Bank, Limited (MIBL), filed bankruptcy in the Bahamas. At the time, MIBL had $600,000 on deposit in the Bank of New York. The Bank of New York had a security interest in those funds securing a debt owing from MIBL to the Bank of New York in an amount exceeding $4 million. U.S. law gives secured creditors first priority, and so if the money remained in the United States, the Bank of New York would be entitled to it. If the money were surrendered to the Bahamian court, the Bahamian court would use it to pay administrative expenses in the bankruptcy case—essentially, the fees of the Bahamian court-appointed liquidators. Bahamian law gives administrative expenses priority over

secured creditors. If the money went to the Bahamas, it was unlikely any of it was coming back. The Bahamian court had collected $10 million of MIBL assets and paid out nearly $8 million of it in administrative expenses.[19] The case was a perfect illustration of the dangers of international forum shopping and court competition.

The New York bankruptcy court ordered the Bank of New York to surrender the funds to the Bahamian court. The district court affirmed that decision on appeal. The court of appeals reversed the decision, giving the money to the Bank of New York. The court cited universalist scholars with seeming approval and disparaged territoriality as "grab law." In the end, however, it came down squarely against the universalists' interpretation of section 304. The issue, the court held, was not whether the foreign law was sufficiently similar to the U.S. law but whether the money surrendered in this case would be distributed in substantially the same way. The universalists sought to spin the decision their own way,[20] but few were buying it.

Universalism Comes in the Back Door

After more than a century of failure, the universalists suddenly won three major victories. In 1997, UNCITRAL promulgated the Model Law on Cross-Border Insolvency, which incorporates the universalists' home country concept.[21] That law has so far been adopted by only a few countries, including none of major commericial importance. But U.S. congressional leaders have already made the decision to adopt it in the United States. Since 1998, it has been included in the omnibus bankruptcy bill that has nearly been enacted several times. The UNCITRAL model law is also near adoption in England.

The second universalist victory came in 2000, when the European Union adopted the Regulation on Insolvency, which also incorporates the home country concept.[22] The EU regulation became effective in 2002. The third victory came in 2002 with the promulgation by the American Law Institute of a universalist set of

principles, "Principles of Cooperation in Transnational Insolvency Cases among the Members of the North American Free Trade Association." These principles are not themselves law, but they are recommendations to judges made by the largest and most prestigious law reform organization in the United States.

Both the EU regulation and the model law require recognition of a multinational company bankruptcy filed in a court of the company's home country.[23] Each law specifically authorizes local courts to sacrifice the rights of local creditors under local laws to the commands of home country courts.[24] Both laws are clear endorsements of universalist principles. Neither makes any attempt to explain where the "centre of [a debtor's] main interests" is located.

The EU regulation is the more clearly universalist of the two. Once the court of an EU country determines for itself that it is the debtor's home country and declares its own case the "main proceeding," the courts of other EU countries are obligated to recognize it as such. Theoretically, it would still be possible for local creditors to file a "secondary proceeding" in another country. But the secondary proceeding could only liquidate the debtor's assets in that country; it could not reorganize them. In addition, at the request of the liquidator in the main proceeding, the local court would be obligated to put the secondary proceeding on hold.[25] That could leave creditors filing secondary proceedings stranded between courts for months or years. As a practical matter, universalism is now the law in the European Union.

Despite the provision of the UNCITRAL model law requiring recognition of a main proceeding filed in another country, the U.S. promoters of the law claim it is not universalist.[26] In the law's defense, they point to provisions that would permit a parallel proceeding in the United States even after a foreign main proceeding has been recognized. But that parallel proceeding, the universalists acknowledge, would have to be brought as an "involuntary" bankruptcy.[27] What the defenders fail to mention is that involuntary bankruptcies are highly disfavored in U.S. law and notoriously difficult to initiate. The filer of an involuntary

case must meet technical requirements[28] and risk liability for damages if the filer does not succeed—including a possible award of punitive damages.[29]

Any doubts about whether adoption of the UNCITRAL model law would commit the United States to a universalist position in international bankruptcy have been rendered moot by the promulgation of the Principles of Cooperation in Transnational Insolvency Cases among the Members of the North American Free Trade Association, adopted by the American Law Institute in 2002 (the ALI principles). Professor Westbrook, a principal drafter of the principles, describes the crucial provisions as follows.

> General Principle V urges that the courts of the NAFTA [North American Free Trade Agreement] countries determine distributions from a universalist perspective to the maximum extent permitted by their respective laws. Thus, for example, the ALI Principles expressly contemplate the possibility of dismissing one or more full insolvency proceedings, so that a reorganization (rescue) plan can be adopted in the main proceeding.[30]

In other words, even if U.S. creditors succeed in initiating an involuntary parallel proceeding, the ALI principles direct the court to dismiss it. Although the ALI principles were developed in the context of NAFTA, the ALI also recommends their application "to cooperate with proceedings in non-NAFTA jurisdictions."[31] Together, the UNCITRAL model law and the ALI principles will commit the United States to international bankruptcy universalism to substantially the same extent that adoption of the EU regulation committed the Europeans.

Once that commitment is in place, forum-shopping multinationals, acting in concert with DIP lenders if necessary, will choose among the courts that are plausibly their home country courts. The chosen courts will, of course, be competitive ones. Those courts will hold quick hearings, declare themselves to be the home country courts, open the proceedings, and declare those proceedings to be main. The proceedings will then be entitled to recognition in other countries. The case placer's opponents will not participate. At this stage, they probably will not yet know that the case has

been filed. If this sounds far fetched, consider this description by a leading English bankruptcy law firm describing the English system as it currently operates under the EU regulation.

> First, the hearing to open administration proceedings [in England] is generally unopposed, largely as very few people need to be notified in advance. . . . At the hearing, the debtor will address the court as to where its [centre of main interests] is located. While the debtor should put "points against" as well as "points for," it is always easier to win a match if the other team does not show up. . . . [A] judge is unlikely to second guess the company—especially if no one is arguing the contrary. Importantly, once administration proceedings are opened in [England], that decision can only be challenged in the [English] court itself.[32]

Other commentators agree that the venue decision of the first court to open proceedings is binding on other courts.[33] This is not a peculiarity of the EU system but, rather, a general principle by which courts have long operated.[34] Someone must decide who gets the case. Giving that power to the first court is hardly an ideal solution, but with no international government to take control, it is probably the best of a lot of bad alternatives.

As soon as that first case is filed, the parties will begin putting the infrastructure of a universalist bankruptcy regime in place. The court will appoint a representative, and that representative will file ancillary cases in the courts of other countries. Committees will organize at the site of the main proceeding, parties from all over the world will hire professionals to represent them at the site of the main proceeding, the court will enter first-day orders, and new lenders will rely on those orders by supplying the debtor with new working capital. The case will grow roots where it was filed, making challenges to that venue virtually impossible to win. At the conclusion of the case, the court's decision will be entitled to automatic recognition in other countries.[35]

Forum Shopping in a Universalist System

All the case placer need do to forum shop in a universalist system is make a plausible argument that the chosen court is at the "cen-

tre of [the debtor's] main interests."[36] The chosen court will do the rest, pondering the issues and then solemnly concluding that the debtor is indeed correct.

The plausible argument can be based on the presence in the chosen country of any of these four attributes: (1) incorporation (registered office), (2) headquarters, (3) administrative employees and operations, and (4) assets. Each of these attributes has, at various times and places, been considered the most appropriate basis on which to fix the location of a multinational company.

1. *Incorporation.* Bankruptcies filed in the country of incorporation are routinely recognized and deferred to in much of the world today. When companies such as Tyco, Global Crossing, and Fruit of the Loom "move" offshore to defeat U.S. taxation, what they in fact do is incorporate offshore. When a court refers to a company as a "Delaware corporation" or a "Bahamian corporation," what the court means is that the company is incorporated in Delaware or the Bahamas.

Both the UNCITRAL model law and the EU regulation state that "the debtor's registered office . . . is presumed to be the centre of the debtor's main interests." In this context, "registered office" simply means the country of incorporation; no real office is involved. The center of a corporation's main interests is presumed to be in the country of its incorporation.

If incorporation is the debtor's only contact with the forum country, the argument may not be plausible. The presumption is rebuttable. It logically follows that in the weakest case, the presumption can be rebutted. That weakest case is the one in which incorporation is the only contact. The first case to interpret this provision of the EU regulation was that of BRAC Rent-A-Car International, Inc., a former subsidiary of the Budget Rent A Car group. The London High Court of Justice was faced with these facts.

> [The debtor] is incorporated in Delaware and has its registered address in the United States. However, that is not an address from which it trades, and it has never traded in the U.S. Its oper-

> ations are conducted almost entirely in the UK. . . . It has no employees in the US, and all its employees work in England . . . apart from a small number in a branch office in Switzerland. [BRAC] is . . . in Chapter 11 administration in the US.[37]

The English court reached the only plausible conclusion. The center of BRAC's main interests was in England. But add even a little trading in the United States, and the Delaware bankruptcy court might easily claim the case.

2. *Headquarters.* In defending the "centre of main interests" test, Professor Jay L. Westbrook, the leading American universalist, analogizes it to the "principal place of business" test used for various purposes in the United States.

> [T]he principal place of business standard in one formulation or another is commonplace throughout American law—state and federal—and is found elsewhere as well. That sort of standard has produced some litigation, but I am unaware of any widely held view that it is so imprecise as to be impractical or to maim any important legal objective.[38]

The case law to which Westbrook refers, however, holds that a company's principal place of business is at its headquarters, as opposed to the place where it has the bulk of its assets or operations. A court could easily hold isolated corporate headquarters to be the center of a corporation's main interests. Westbrook himself as much as endorsed this interpretation when he wrote that England was the "center of gravity" of Maxwell Communications, even though the great bulk of Maxwell's assets and operations was in the United States.[39]

3. *Administrative employees and operations.* The failure of Bank of Commerce and Credit International (BCCI) was one of the major financial scandals of the twentieth century. BCCI was founded by Saudis, incorporated in Luxembourg, and operated in numerous countries through subsidiaries. For most of BCCI's existence, its headquarters were in London along with most of its central administration. Before BCCI filed for bankruptcy, the firm

moved its headquarters, including nearly all of its top managers, to Saudi Arabia. (The firm's top executives apparently felt they would be more comfortable dealing with the world's criminal courts from their home country.) BCCI's central administrative operations remained in London. BCCI filed for bankruptcy in Luxembourg, and the Luxembourg proceeding was recognized as a main proceeding throughout the world. (Some countries, including both the United States and England, recognized the Luxembourg proceeding but did not fully cooperate with it. Both the United States and England kept some BCCI assets for their local creditors.)

At the time it filed for bankruptcy, BCCI had neither its headquarters nor its registered office in England. But if a firm identical to BCCI were to file in England today—away from its place of incorporation, its headquarters, and the bulk of its assets—an English court's decision that England was the firm's home country would be more than plausible. The location of the central bureaucracy that holds a far-flung firm together is arguably the most substantial presence that a firm can have in a country.

The Delaware bankruptcy court seems to have proceeded on that basis in the Lernout & Hauspie case, discussed in chapter 7. Lernout & Hauspie's headquarters were in Belgium, and the firm was incorporated there. After the firm filed parallel proceedings in Delaware and Belgium the Delaware court sought to take control of the main issue in the case: the priority of Stonington Partners' stock fraud claim. None of the three American courts that reviewed the case even suggested that the U.S. court should defer to the Belgian court simply because Lernout & Hauspie was both headquartered and incorporated in Belgium.[40] Instead, the U.S. Third Circuit Court of Appeals pressured the Delaware bankruptcy court to negotiate with the Belgian bankruptcy court, an approach that begs the home country question.[41]

4. *Assets.* Some large public companies consist principally of hard, tangible assets. An oil exploration company may own hundreds of millions of dollars worth of properties. Those properties may or may not be producing, and even if they are producing, the production may be managed by others. The assets may actually be

the company. The same might be true of a shipping company, such as Global Ocean Carriers (discussed in chap. 7), that owns ocean-going vessels. A court where the assets of such a company were located could plausibly hold its country to be the home country, even if the place of incorporation, headquarters, and central operations were elsewhere.

In fixing so vague a standard for venue, the universalists undoubtedly imagined courts proceeding in good faith to determine the best application of the standard to the facts of the particular case. But in a world where a single big bankruptcy case can bring more than a billion dollars in fees to the bankruptcy professionals of a locale, such imaginings are naive.

Is the Home Country That of the Corporation or the Group?

Nearly all multinational companies are corporate groups, not single corporations. The largest are often composed of hundreds of corporations. For example, General Motors is a group consisting of over 500 corporations.[42] Some of those corporations operate independent businesses, others are integral parts of the group's main automobile manufacturing businesses, and the rest are somewhere in between.

In deciding whether the members of these groups should be treated as a single debtor in applying the home country standard, the universalists are on the horns of a dilemma. On the one hand, putting a single court in control of the debtor's worldwide business is the very point of universalism. The basic premise is that reorganization or liquidation of a business requires coordination that only a single court can provide. That suggests that universalism should apply to corporate groups, not corporations, and the search for the "centre of main interests" should be for the center of the group's interests.

Instead, both the EU regulation and the UNCITRAL model law direct that the search be for the home countries of individual corporations, not corporate groups. Thus a British Court held that a

Swedish corporation that owned a subsidiary with an establishment in England did not have an "establishment" in England—its subsidiary did. [43] A leading commentator states flatly that "international jurisdiction according to the Regulation must exist for each of the concerned debtors with a separate legal entity."[44] It follows that when the corporations of a group have different home countries, the bankruptcy of the group's business will be split among numerous courts.

The problem cannot be solved merely by providing that all members of the group should file in the home country of the group. To see why, reconsider my example of the corporate group commonly referred to in the United States as Daimler-Chrysler.[45] The German parent corporation of that group, Daimler-Benz Corporation, owned subsidiaries that made automobiles in dozens of countries. One of those subsidiaries was Daimler-Chrysler Corporation, which manufactured automobiles in the United States and in turn owned sub-subsidiaries that manufactured automobiles in about a dozen other countries. One of those sub-subsidiaries was Chrysler De Mexico, S.A., which manufactured automobiles only in Mexico.[46] All of these corporations were members of the same corporate group. If a universalist law required reorganization in the home country of the group, that probably would mean reorganization in a German court. That in turn would mean the affairs of Chrysler De Mexico, S.A.—a corporation that did business with Mexicans in Mexico—would have been adjudicated by a distant court in a different language. That German court would have administered German remedies and applied German priorities to relationships principally among Mexicans. For the German court to administer Mexican remedies and priorities to the affairs of the Mexican subsidiary would not be an option. As previously noted, all commentators agree that the bankruptcy court of one nation could not competently administer the bankruptcy laws of another.[47] In this example, the only sensible solution would be to permit Chrysler De Mexico, S.A., to reorganize in a Mexican court under Mexican law.

Generalizing on the point, the sensible solution to the corporate

group problem is to administer economically integrated group members together in the home country of the integrated group while administering economically independent group members separately in the home countries of the members. But to make the separation, one needs exactly what one cannot have in a world of forum shopping and court competition—unbiased courts that would exercise broad discretion to reject inappropriately filed cases.

As a result of the corporate group problem, the EU regulation began to unravel almost as soon as it went into effect. In May 2000, Daisytek, Inc., a U.S.-based company with about $400 million in assets, filed for bankruptcy reorganization in Dallas, Texas. Later, Daisytek's 14 European subsidiaries filed for bankruptcy administration in England.[48] One of the 14, Daisytek-ISA Limited, was a holding company that owned the other 13. Three of the other 13 were German companies, and one was French. That is, the three German companies operated only in Germany, and the French company operated only in France. The English court—the High Court of Justice in Leeds—nevertheless held that England was the center of main interests for each of the 14 corporations. The court gave as its explanation that various aspects of the businesses of the German and French companies were controlled from England.

German commentators reacted to the English court's decision in Daisytek "with surprise and—to say the least—with anger."[49] In France, the commercial court set up a challenge to English jurisdiction by authorizing a competing main proceeding for the French subsidiary. A French appellate court reversed the commercial court's ruling, correctly saying that it violated the EU regulation.[50] The regulation requires that when an EU member state opens a main proceeding—here the proceeding in England—the courts of other countries must recognize it.[51] The decision of the court that initially gets the case is final.[52]

Notice that if creditors of the German and French subsidiaries of Daisytek had filed against those subsidiaries in Germany and France before Daisytek filed their cases in England, the German

and French courts could have determined their countries to be the home countries. The English court would have been bound by those findings. In the context of international court competition, the effect of the EU regulation is the opposite of its intent. The effect is to give the case to the country that grabs first.

The ruling in Daisytek was not an isolated instance. An English commentator described how an English court took jurisdiction over the case of Enron's Spanish subsidiary.

> Enron Directo was a Spanish company with Spanish operations and Spanish employees, and most of its day-to-day operations were performed in Spain. However, some of its strategic decisions were taken in London at Enron's European headquarters and certain board meetings were held in London. Accordingly, the argument was that the debtor's head office functions were in London. At the unopposed hearing, the UK court accepted that as being the test for [centre of main interests] and opened UK administration proceedings.[53]

In another case, an Italian court ruled that Italy was the center of main interests of a Dutch subsidiary of an Italian firm, Cirio Del Monte. The objective was apparently to protect the Dutch subsidiary against a Dutch creditor in circumstances where a Dutch court would not have done so.[54] In the Parmalat bankruptcy, an Italian court is battling with an Irish court over the bankruptcy of Eurofoods, the Irish subsidiary of Parmalat. Because the two courts have entered conflicting orders, the Irish Supreme Court has passed the case along to the European Court of Justice in Luxembourg.

The competition for cases generated by Europe's attempt at universalism makes the Luxembourg court's task a virtually impossible one. If that court rules—as it probably must—that the decision of the first court to hear the case is binding on later courts, it will be a green light for court competition. As one commentator summed up the European experience with universalism:

> We are now nearly 18 months into the Regulation and decisions have been made which were not contemplated on 31 May 2002. The long arm of the Regulation has reached further than was

> anticipated. There can be no doubt that, as far as the Member states are concerned, they have handed control over the affairs of companies with their registered office in their jurisdiction to whichever Member State the proceedings are opened in.[55]

The problems of the rest of the world under the UNCITRAL model law will be worse. Both the EU regulation and the UNCITRAL model law adopt the universalist "centre of main interests" test. But the European Union has a viable government structure that can order and coordinate a retreat from its universalist regulation. The rest of the world does not.

It is worth noting that the corporate group problem is easily solved in a cooperative territorial system. A cooperative territorial system is one in which each country's courts administer the assets located in the country and authorize a representative to cooperate with representatives appointed in foreign proceedings.[56] In a cooperative territorial system, once cases were filed and representatives appointed in each of the countries involved, the representatives could meet to determine whether cooperation could increase the total recovery of the group. In most cases, the answer would be no, because the group was compartmentalized by country prior to bankruptcy. If the answer were yes, the negotiators should be able to reach agreement for the simple reason that they could share the increase in recovery among them. The circumstances of KPNQwest illustrate how cooperative territoriality would work.

> The KPNQwest group owned cables in Europe and across the Atlantic Ocean, the main ones being in the form of rings. For example, one ring ran through Germany, France, Belgium and The Netherlands, connecting major cities in these countries. However, the part of the ring that was situated in Germany was owned by a German subsidiary, the part of the ring situated in France by a French subsidiary, and so forth. When the Dutch parent company, KPNQwest N.V., went into bankruptcy many of the subsidiaries had to enter insolvency proceedings as well. Interestingly, the KPNQwest N.V. bankruptcy was one of the first to fall under the scope of the Regulation since it was adjudicated on 31 May 2002, the date on which the Regulation entered

> into force. However, the trustees of the Dutch bankruptcy did not hold any powers with respect to bankrupt subsidiaries in other member states, and it proved to be very difficult to coordinate the sale of the rings. As it turned out, the KPNQwest group disintegrated and it is likely that the proceeds of the sale of the assets were much lower than they would have been if the enterprise had been sold as a whole.[57]

Universalism failed KPNQwest. In a cooperative territoriality regime, insolvency proceedings would have been initiated and a representative appointed in each of the involved countries. Those representatives would have had the power—subject to whatever creditor and court approvals were required under the laws of each country—to join in a common sale effort. Each would realize that he or she faced a choice: join in the common sale effort within the time constraints of the market and share in the proceeds of the common sale or conduct a separate sale of the assets located in the country. Each representative would be free to take the course it believed would produce the greatest distribution for those claiming in the country's insolvency case. By contrast, in a universalist system, creditors must concern themselves not only with the desirability of the common sale but also with which court will conduct it. It might be in a group of creditors' interests to oppose an advantageous sale by the court of a country that would accord the particular group of creditors a low priority. In a cooperative territorial regime, venue would never be an issue. Venue with respect to any particular asset would be in the courts of the country that had power over the asset by sovereignty.

Changing Home Countries

The indeterminacy of the home country standard and the intractability of the corporate group problem are alone enough to doom universalism. But universalism has a much bigger problem with which to grapple. However universalists define a multinational's home country, the multinational can change it.

To illustrate how easily multinationals can change their loca-

tions, Fruit of the Loom—which filed for bankruptcy in 1999—had most of its operations in the United States as late as 1995. That year it closed six U.S. plants and laid off more than 3,000 workers.[58] The company moved that production to its own plants in the Carribean and Central America.[59] Then, shortly before filing bankruptcy, Fruit of the Loom incorporated a new holding company in the Cayman Islands and transferred the stock of itself and its foreign subsidiaries to that holding company.[60] These changes converted Fruit of the Loom from a clearly American company to a truly multinational one.

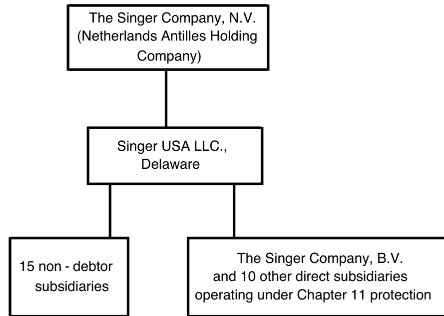
Singer, N.V., a firm that began as the U.S. manufacturer of the Singer sewing machine in 1851 and quickly became a U.S.-based multinational, provides another example. When Hong Kong–based Akai bought Singer in 1989, the new owner changed Singer's place of incorporation to the Netherlands Antilles and its headquarters to Hong Kong. By the time Singer filed for bankruptcy in 1999, three-quarters of its employees were in Asia, Europe, Africa, or the Middle East. By whatever standard one applied, Singer was no longer an American firm.

Singer wanted, however, to reorganize in the United States. Shortly before filing in the New York bankruptcy court, Singer hired a CEO in New York and declared New York its headquarters. But even after the New York court assumed jurisdiction over Singer's worldwide operations, Singer remained concerned whether the courts of other nations would recognize the U.S. proceeding and enforce the plan against "numerous international creditors who might assert that they were not subject to U.S. jurisdiction."[61] The problem was that Singer's parent company, Singer, N.V., was still a Netherlands Antilles company.

To solve the problem, Singer's advisers came up with this strategy.

> Singer filed a motion seeking authority to create a new wholly-owned U.S. subsidiary of Singer NV, Singer USA LLC (Singer USA). After Singer USA was formed, the proposal was to transfer all of Singer NV's assets (Singer NV's equity interests in its subsidiaries) to Singer USA and to cause Singer USA to guarantee all of Singer NV's liabilities. Thereafter, Singer NV's sole

asset would consist of its equity interest in Singer USA, resulting in a simplified corporate structure as follows:



> The next step would be for Singer USA to file its own chapter 11 petition, thus bringing Singer USA within the protection of the U.S. bankruptcy court. The final step was to propose a chapter 11 plan of reorganization for Singer USA that eliminated Singer NV's equity interest and issued 100% of the new equity in Singer USA to Singer USA's creditors, i.e., the holders of the obligations of Singer NV that Singer USA had guaranteed.[62]

Stripped of the legalisms, Singer's strategy was to replace the Netherlands Antilles corporation with a newly minted U.S. one and bankrupt the new corporation immediately. The New York bankruptcy court confirmed Singer's plan, and it appears that no one challenged it elsewhere.

Like an immigrant applying for U.S. citizenship, Singer became an American company. Singer's purpose was to file bankruptcy in the United States. Under both the EU regulation and the model law, changing home countries in anticipation of bankruptcy is fair game. The court determines the home country of a multinational company based on the company's characteristics at the time of bankruptcy.[63] Neither law contains any provision prohibiting changes in those characteristics on the eve of bankruptcy or authorizing the court to ignore such changes. Some commentators take the position that the court should "ignore the steps taken purely to avoid the appropriate jurisdiction."[64] But so subjective a limit would play into the hands of competing judges, who could determine the subjective issue of intent in their own personal interests.

Numerous examples in this book have already shown the ease with which multinational companies can change their places of incorporation and the locations of their headquarters. The locations of assets and operations are more difficult to change. But even the multinational's center of assets and operations can be changed—without moving any assets or operations.

Corporate groups can accomplish that through acquisitions and divestitures. For example, a firm with principal assets in England that wished to reorganize in the United States could arrange for its acquisition by a previously unrelated firm already headed for U.S. bankruptcy. In most cases, the English firm would be insolvent and its stock would have only a nominal value, making the "acquisition" mostly a paper transaction. Alternatively, a U.S. parent that would be pulled into the English bankruptcy by its larger English subsidiary could spin off the subsidiary by distributing its stock to the parent's stockholders. If the English subsidiary were insolvent, the transaction would have no economic substance; the stock would be canceled in the bankruptcy case anyway. But distributing that worthless stock before bankruptcy would split the group, leaving the parent with a clear entitlement to file in the United States.

Groups could change their centers by strategically dissolving subsidiaries. For example, the center of Chrysler De Mexico's main interests would be in Mexico. But if that corporation were dissolved before bankruptcy, Chrysler De Mexico's assets would be owned by the much larger, U.S.-based Daimler Chrysler. Despite Daimler Chrysler's acquisition of the Mexican assets, the bulk of Daimler Chrysler's assets and operations would still be in the United States. If Daimler Chrysler then filed bankruptcy in the United States the assets formerly owned by Chrysler De Mexico would be administered in that bankruptcy—in the United States, according to U.S. law.

The case of Derby Cycle Corporation, first discussed in chapter 6, provides an example of how a firm can forum shop by changing the location of the bulk of its assets. Derby Cycle was the manufacturer of Raleigh and Diamondback bikes. At the time its managers arrived at the offices of the firm's U.S. bankruptcy lawyers,

Derby was operated from England, and the group's principal assets were in the Netherlands.[65] The lawyers conceived an integrated plan by which Derby first sold the Netherlands assets for about $120 million and distributed the proceeds to creditors. The managers then put the U.S.-incorporated parent company—whose remaining assets were concentrated in the United States—into bankruptcy in Delaware.[66] The managers availed themselves of Delaware's lax sale procedures to sell the remainder of the company to themselves for $40 million—leaving more than $100 million in debt unpaid.[67] By selling the Netherlands assets first, Derby made itself an American company.

In attempting to deal with the corporate group problem, the ALI principles recommend that the courts immediately begin allowing subsidiaries from anywhere in the world "to file for insolvency in the parent's home country, even if they would not ordinarily be allowed to do so, so they can be reorganized on a group basis."[68] The principles leave no doubt that they intend the court to apply the law of its own country to the reorganization or liquidation of those subsidiaries.

If the courts take this principle seriously, it will open the floodgates to international forum shopping. Parent corporations are often "holding companies" that have no assets other than the stock of their subsidiaries. No matter what attributes determine the center of a holding company's main interests, the holding company can easily change them. Hiring a single employee, for example, fixes the location of the holding company's workforce. Moving the corporate records to the Bahamas and placing them under the control of that single employee there makes the Bahamas the holding company's principal place of business. Under the ALI principles, such a simple ruse would entitle the entire group to file in the Bahamas.

Global and Out of Control?

In combination, the inherent ambiguity of the "centre of its main interests" test, the uncertainty over whether the relevant unit is the corporation or the group, and the ability of both corporations and

corporate groups to quickly and easily relocate make forum shopping easy in a universalist system. Because the chosen court can apply its own law to people and events throughout the world and its decisions will be entitled to worldwide recognition, the benefits international shoppers can gain will far exceed the benefits that drive rampant shopping in the United States. The universalist meltdown has already begun in the European Union.

Provided one's own money is not at stake and one is not put off by the corruption of the world's bankruptcy judges, the dynamic of adjustment will be interesting to observe. In the initial stage, participants in the system—governments, courts, professionals, executives, creditors, and other stakeholders—will develop strategies for seeking individual advantage. Debtors will forum shop, creditors will seek to ally with them, and courts will compete for cases. Countries will change their laws to advantage their courts in the competition. Eventually, the minus-sum nature of the game will become apparent, and there will be calls for reform.

Theorists will then repeat the debates that are now occurring with respect to forum shopping and court competition in the United States. Three resolutions seem possible. First, the system may backtrack by adopting an international bankruptcy convention grounded in cooperative territoriality. That seems unlikely. For that to occur, a lot of important people would have to confess error and recommend reversal of a course they themselves set.

Second, the universalists may seize on the chaos they themselves caused as an excuse for forcing the countries of the world to "harmonize" their laws. *Harmonization* is a euphemism for forcing commercially less important countries to adopt the remedies and priorities of the commercially more important countries. (Some Machiavellians may have endorsed universalism in the first place hoping it would lead to this forced harmonization.) That harmonization would be painful for people in countries that would be forced to change the basic rules of their economic cultures—for example, elevating secured banks to priority over employees. Such harmonization would greatly reduce the incentives for forum shopping. But it would hardly eliminate the international competition

for cases. Harmonization has already taken place among the states of the United States, but domestic forum shopping and court competition still flourish here.

Third, the advocates of court competition may prevail, leaving multinational companies free to chose the courts in which they will reorganize or liquidate and the law that will govern the rights of their creditors and other stakeholders. As a condition of lending, large creditors and stakeholders will demand a say in their borrowers' choices of bankruptcy courts. Responding to market forces, the competing countries and their courts will adopt rules and practices that heap advantages on the case placers. The losers will be the corporate outsiders who have no means of controlling their debtor's choice of courts: tort victims, employees, suppliers, customers, other stakeholders with small interests, and—as with every strategy game—the less sophisticated players.