Beyond UNCITRAL: Alternatives to Universality in Transitional Insolvency

Alexander M. Kipnis

Follow this and additional works at: https://digitalcommons.du.edu/djilp

Recommended Citation

This Article is brought to you for free and open access by Digital Commons @ DU. It has been accepted for inclusion in Denver Journal of International Law & Policy by an authorized editor of Digital Commons @ DU. For more information, please contact jennifer.cox@du.edu,dig-commons@du.edu.

A L E X A N D E R  M .  K I P N I S

The rapid growth of international economic activity in the recent decades has brought forth a unique and formidable policy challenge. The challenge consists of reconciling two goals which sometimes compete directly with one another: creating a regime that allows economic interaction between private actors to occur with the highest possible degree of efficiency, and allowing sovereigns to ensure that the regime does not thwart their public policy to induce those sovereigns’ cooperation.

The tension between these competing goals is patently evident in transnational bankruptcies. On one hand, considerations of efficiency call for three things: \textit{ex ante} predictability, elimination of wasteful duplication of work by the courts, and incentives for optimal \textit{ex ante} allocation of resources. On the other hand, any proposed regime must be sufficiently attractive to sovereign actors for adoption, and actually become widely adopted, if it is to become a genuine international regime. To that end, it must allow sovereign actors to satisfy the needs of their own domestic public policy if they are to cooperate.

This paper discusses the need for a comprehensive system for the resolution of transnational bankruptcies. It then examines the various bankruptcy systems that are discussed in the scholarship or implemented in practice in the present day, including the various flavors of territoriality, universality, and contractualism, along with a solution predicated on the establishment of an international body for administering transnational insolvency proceedings. It further addresses the UNCITRAL Model Law on Transnational Bankruptcy and its implementation, in particular, in the United States. It discusses the advantages and disadvantages of each regime and offers thoughts on how each may be improved or tailored to suit various economic needs. The paper concludes by advocating a modified form of cooperative territoriality as an imperfect but most workable framework for an international bankruptcy regime.

---

1. Alexander M. Kipnis received his Juris Doctorate from the University of Chicago Law School and his Bachelor of Arts, with honors, from the University of California, Berkeley. He is a litigator at the law firm of Shearman & Sterling LLP, and may be reached at alexander.kipnis@shearman.com. The author acknowledges the advice and support from Hon. Diane P. Wood in the creation of this article.

A. Why a Transnational Bankruptcy System?

Transnational bankruptcy regimes have been the subject of a lively debate in recent literature. But the need for such a regime is not necessarily obvious; after all, every country that has economic activity of any global significance already has its own domestic bankruptcy laws. These laws already purport to govern situations where the bankruptcy has an international dimension; that is, when the debtor's assets or creditors are located outside the borders of the country in which the bankruptcy occurs. Why then is a global regime needed?

A global framework for bankruptcy law is necessary for largely the same reasons that domestic bankruptcy law is needed. In a world without bankruptcy law, considerable and unnecessary social costs would be imposed every time a troubled company is unable to pay its debts in full. In such a world, each creditor would have an incentive to be the first to file suit against the debtor, the first to reduce its claim to judgment, and the first to execute that judgment by seizing the debtor's assets. This race to the debtor's assets imposes two forms of social cost. First, the dismemberment of the debtor's estate may prevent the debtor's assets from being put to their highest value use. It is not uncommon that the debtor itself will already be the highest value user of the asset because the going-concern value of the debtor's business will frequently exceed the value of all the debtor's assets if sold piecemeal. Second, the "first-in-time" rule with respect to the creditors' ability to receive and execute a judgment is an inefficient way to ensure the optimal distribution of the debtor's assets. Bankruptcy law solves both problems by (1) eliminating the forced liquidation of the debtor's assets (by giving the debtor the opportunity to reorganize, at least under certain circumstances); and, (2) when liquidation is indeed warranted, by imposing a system of priority on the competing claims that is deemed more socially optimal than a simple "first-in-time" rule.

Bankruptcy on a transnational level works in a similar way. Without a comprehensive international regime, a similar problem would occur. When a debtor encounters trouble, its creditors would first look to the debtor's assets in their own country to satisfy their claims. This course of action is rational because the creditors' cost of seizing the debtor's domestic assets will be significantly

2. See discussion infra Part II.
6. At least those who choose to declare a default, instead of pursuing an alternative resolution.
8. For the purposes of this discussion, I assume a multinational debtor and multiple single-nation creditors. Accordingly, for the purposes of this section, I use terms such as "foreign," "domestic," and "abroad" in reference to the country of the creditor, not the country of the debtor.
lower than their cost of pursuing assets abroad.\textsuperscript{9} If domestic bankruptcy law operated without regard to an international regime, these creditors would then be able to force the debtor into bankruptcy in their own country (either by means of an involuntary petition or by a coercive placement into voluntary bankruptcy, such as by exercise of default and acceleration clauses) and then use the debtor's assets in that country to satisfy their claim. This is particularly true if the creditors believe that it is not worthwhile for them to participate in bankruptcy proceedings involving that debtor in foreign countries at all. Just as in the case of a domestic bankruptcy, creditors in various countries would then have an incentive to race to the assets in their home countries. This time, the incentive to rush to the assets is strengthened by the fact that the debtor's going-concern value (and its likelihood of repaying domestic debts) becomes increasingly threatened by foreign creditors' efforts to seize the debtor's assets elsewhere. This imposes the familiar social costs of unnecessary dismemberment of a going concern, which may already be putting its assets to their highest value use, and of poor ordering of distribution priorities among the competing creditors, this time on a worldwide scale.

An international bankruptcy regime would minimize those costs. It would provide a means for preserving the debtor's going concern value by instituting a mechanism that would authorize reorganization where it would maximize social benefit. It would also remove the incentives for creditors to rush to the debtor's assets in their own country by instituting a proceeding (or a set of concurrent proceedings) to authorize an orderly way for the debtor to reorganize or liquidate. It would finally provide for a distribution priority that maximizes social value, yet is mindful of disparate and, at times, mutually exclusive national policies that value certain kinds of creditors and claims over others.

B. Brief Overview of Bankruptcy Systems in Scholarship and Practice

Significant differences exist today between the substantive bankruptcy laws of various countries. Professor LoPucki\textsuperscript{10} cites a wide array of differences in priority systems alone: for example, some countries allow tort creditors to share pro rata with contract creditors; others subordinate tort claims to contract claims; and still others do not allow any tort claims which have not yet been reduced to judgment.\textsuperscript{11} Additionally, some countries treat creditors with setoff rights as secured (and therefore entitled to higher priority, at least in a reified sense), and others do not.\textsuperscript{12} Also, some countries allow employees to assert high-priority claims for wages, others do not.\textsuperscript{13}

\textsuperscript{9} Costs of pursuing assets abroad are numerous and may vary from case to case, but will usually include three similarities: the cost of unfamiliarity with the laws of the jurisdiction where the assets are located; the often-disfavored substantive status that such creditors may get as foreign creditors; and the increased cost of hiring foreign counsel, conducting foreign discovery, and collecting foreign assets.


\textsuperscript{11} Id. at 2224 (citing 11 U.S.C. §§ 502(b), 726(a) (2008)).

\textsuperscript{12} Id.

\textsuperscript{13} Id.
Beyond the differences in substantive bankruptcy laws, there are, more importantly, differences in the way that each country’s bankruptcy regime approaches situations when some of the debtor’s assets or debtors are located beyond its borders, and when a debtor that has assets within the country’s borders seeks protection elsewhere. The differences between these regimes lie in two principal areas: the degree of cooperation that the country is willing to extend to another country when the debtor with assets in the first country has filed for bankruptcy in the second; and, the degree of access that the country allows to foreign creditors when a multinational debtor files domestically.\textsuperscript{14} Five broad types of regimes of international bankruptcy are generally discussed in the literature today: territoriality, universality, contractualism, international organization, and secondary bankruptcy. Each is discussed in turn.

Under territoriality, each country in which the debtor’s assets are located has jurisdiction over the distribution of only the portion of the estate that consists of the assets located in that country.\textsuperscript{15} Accordingly, in a typical multinational bankruptcy, a multitude of concurrent proceedings in the various countries in which the debtor has assets is necessary for the resolution of the case.\textsuperscript{16}

The second regime is universality. Under universality, only one country would have jurisdiction over the entire bankruptcy.\textsuperscript{17} The courts of that country would apply that country’s substantive bankruptcy law, such as rules governing automatic stay, avoiding powers, and distribution preferences.\textsuperscript{18} All other countries in which the debtor has assets would then cooperate with the forum country, for example, by surrendering the control over the debtor’s assets to the forum country.\textsuperscript{19} In such a bankruptcy, there would only be one main proceeding, complemented as necessary by ancillary proceedings in countries in which the debtor owns assets.\textsuperscript{20}

The third regime is that of corporate-charter contractualism, which is actually a form of universality. In that regime, each firm is free to choose the bankruptcy forum country and laws to which it wishes to be subject.\textsuperscript{21} The choice would be made when the entity is incorporated.\textsuperscript{22} The selection would be specified in the corporation’s charter, which would in turn provide public notice of the corporation’s choice.\textsuperscript{23} Prospective creditors would thus receive information about the firm’s bankruptcy options \textit{ex ante}. Once made, the corporation’s choice of

\begin{footnotesize}
\begin{enumerate}
\item[16.] LoPucki, \textit{supra} note 10, at 2219.
\item[17.] LoPucki, \textit{supra} note 15, at 704.
\item[18.] \textit{Id.} at 705; see also Gilreath, \textit{supra} note 14, at 407.
\item[19.] LoPucki, \textit{supra} note 15, at 705-06.
\item[20.] LoPucki, \textit{supra} note 10, at 2220-21.
\item[21.] LoPucki, \textit{supra} note 15, at 737.
\item[22.] \textit{Id.} at 738.
\item[23.] \textit{Id.} at 737-38.
\end{enumerate}
\end{footnotesize}
bankruptcy regime cannot be revoked without overwhelming consensus of the creditors.\textsuperscript{24} Proposals that advocate such systems sometimes exempt nonconsensual creditors from the debtor’s \textit{ex ante} forum choice.\textsuperscript{25} The exemption exists to discourage firms from choosing countries with the most unfavorable tort liability laws for their bankruptcy regimes.\textsuperscript{26}

Yet another proposal suggests that an international system be used for the adjudication of transnational bankruptcy cases.\textsuperscript{27} Such a regime can be created by treaty.\textsuperscript{28} The treaty can either provide for substantive law itself, or it can have choice-of-law provisions that would determine which country’s substantive law applies to a given case. In such a system, a central adjudicative body – a world bankruptcy court – would apply the appropriate law and have jurisdiction over the debtor’s assets everywhere.

The fifth proposal is the system of secondary bankruptcy, which is somewhat of a hybrid between territoriality and universality.\textsuperscript{29} Under secondary bankruptcy, parallel proceedings would be instituted in each country in which the debtor has assets, in a manner similar to territoriality. The proceeding in the debtor’s home country would be deemed to be the main proceeding, while all other proceedings would be secondary. Courts administering secondary proceedings would have the authority to distribute all of the debtor’s estate in that court’s country. However, each secondary court would be required to cooperate with the home country’s court. In practice, that would mean that each secondary court would distribute only so much of the estate within its jurisdiction as is necessary for that court to preserve the law and public policy of its country. For example, if Country A’s laws give priority to employees’ back wages in bankruptcy, and Country B, which is the debtor’s “home country,” does not have such protections for employees, then Country A’s court would distribute so much of the estate as necessary to satisfy the employees’ claim, and transfer the rest to the home country. In other words, the secondary courts would only distribute the domestic portion of the estate to the minimum extent necessary to allow for the transfer of the case to the home country’s court under the principles of comity.

The final proposal is cooperative territoriality, advanced primarily by Lynn LoPucki.\textsuperscript{30} Cooperative territoriality is very similar to classic territoriality in that it provides for separate proceedings to occur in each country in which the debtor has assets. Unlike classic territoriality, however, it requires a greater degree of cooperation among the countries administering the proceeding. It is this system, with certain modifications, that I argue is the most workable of all approaches to cross-border insolvency systems.

\textsuperscript{24} There is some disagreement in the literature whether the creditors’ consent should be unanimous. Whether the system requires unanimity or supermajority, the outcome is largely the same for the comparative purposes of this paper.
\textsuperscript{25} LoPucki, \textit{supra} note 15, at 737-41.
\textsuperscript{26} \textit{See id.} at 739.
\textsuperscript{27} Gilreath, \textit{supra} note 14, at 408.
\textsuperscript{28} \textit{Id.} at 409.
\textsuperscript{29} LoPucki, \textit{supra} note 15, at 732-33.
\textsuperscript{30} \textit{See} LoPucki, \textit{supra} note 15, at 742-59.
C. UNCITRAL Model Law and Existing Transnational Bankruptcy Law

In 1997, the United Nations Commission on International Trade Law ("UNCITRAL") adopted the final draft of its Model Law on Cross-Border Insolvency. In 2005, the UNCITRAL Model Law was enacted (or its model substantially followed) in the United States, Canada, Australia, New Zealand, Eritrea, Mexico, Montenegro, and South Africa. The UNCITRAL Model Law outlines several crucial mechanisms for international cooperation. For example, it requires the adopting country to issue an automatic stay once it recognizes a foreign proceeding. It further empowers the adopting country’s court to enjoin actions, transfers, and encumbrances of the debtor’s property.

The recent adoption of the UNCITRAL Model Law in the United States has resulted in a number of changes in the American approach to transnational bankruptcy. Even prior to the law’s passage, bankruptcy law in the United States was recognized as going “further than the law of any other industrialized nation in authorizing cooperation with foreign insolvency regimes.” But there were substantial limits.

Under prior law, when a debtor filed for bankruptcy protection in another country, it also had to file in the United States. The filing was accomplished by the foreign estate’s representative (“foreign representative”) filing of a petition with the U.S. Bankruptcy Court. That case was then deemed an “ancillary case.” The foreign representative could ask the U.S. Bankruptcy Court to enjoin any action or the enforcement of any judgment against the debtor, to turn over the

32. While this paper was being prepared, the UNCITRAL Model Law was formally enacted by the United States as part of a broader bankruptcy reform that largely focused on domestic matters of consumer bankruptcy. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1501, 119 Stat. 23, 135 (2005).
34. See generally UNCITRAL Model Law, supra note 31 (containing provisions for recognition of a foreign proceeding and relief in Chapter III and provisions for cooperation with foreign courts and foreign representatives in Chapter IV).
36. UNCITRAL Model Law, supra note 31, at art. 20(1). The desirability of an automatic stay actually represents a significant substantive policy judgment by the UNCITRAL because the automatic stay is required to be imposed upon recognition of a foreign proceeding even when the implementing country’s domestic law does not provide for an automatic stay in its domestic bankruptcy cases.
37. Id. at art. 21(1)(c).
41. Id.
42. Id.
debtor’s U.S. property to the foreign representative, and to order any other appropriate relief. 43

Despite the apparent latitude in the relief afforded to foreign representatives’ petitions, there were significant practical obstacles to their success. American creditors were given plenty of grounds to oppose the foreign representatives’ ancillary petitions under Section 304. In evaluating the creditors’ opposition, courts were to be guided by a list of factors that include, inter alia, “protection of claim holders in the United States against prejudice and inconvenience” and “distribution of proceeds... substantially in accordance with the order prescribed by” American law. 44 These protections were squarely aimed at protecting U.S. creditors who (1) likely preferred the American forum, (2) have extended credit in reliance, in part, on the distribution of assets in accordance with American bankruptcy law, and (3) were also “claim holders in the United States” whose interests were required to be considered by statute. 45

Under prior law, American courts have used two conflicting approaches in evaluating domestic creditors’ opposition to §304 petitions by foreign representatives. The first emphasized comity over all other factors presented in §304(c), or, alternatively, weighed all of the §304(c) factors in light of comity. Such courts would generally deny the foreign representatives’ §304 petitions only if allowing the foreign court to handle the debtor’s U.S. assets would have violated “the law and public policy of the forum state [the United States]....” 46 Denials of the foreign representatives’ §304 petitions were rare under this approach.

The other approach was to simply weigh comity alongside the other §304(c) factors. Bebchuk and Guzmán cite In re Papeleras Reunidas as an example of a case in which this approach was applied. 47 Predictably, it resulted in the denial of the foreign representative’s §304 petition. 48 Considerations of comity were likewise jettisoned in favor of concerns than an American creditor might be treated as an unsecured creditor, rather than a lien creditor under Canadian law, despite the absence of finding that Canadian law in any way violated American public policy in In re Toga. 49 Bebchuk and Guzmán further argue that extra-statutory considerations likewise guided some American courts away from the universalist approach embraced by §304. They cite favoritism by the courts as an important concern, and specifically cite In re Lineas Areas de Nicaragua as a particularly

---

43. 11 U.S.C. § 304(b) (repealed 2005).
44. Id. at § 304(c) (emphasis added) (listing other factors such as just treatment of all holders of claims, prevention of preferential or fraudulent dispositions of property, comity, and provision of a fresh start); see also Lucian Arye Bebchuk & Andrew T. Guzmán, An Economic Analysis of Transnational Bankruptcies, 42 J.L. & ECON. 775, 783 (1999).
45. Bebchuk & Guzmán, supra note 44, at 783.
47. Bebchuk & Guzmán, supra note 44 at 784; see also In re Papeleras Reunidas, S.A., 92 B.R. 584 (Bankr. E.D.N.Y. 1988).
egregious example of such favoritism.\textsuperscript{50} In \textit{Lineas}, the court turned the assets over to the Nicaraguan bankruptcy court only on the condition that all claims of U.S. creditors were satisfied first.\textsuperscript{51} A milder example of such favoritism is the expansive reading of the "prejudice to U.S. claim holders" factor of the §304 analysis by the Second Circuit in \textit{In re Cunard}.\textsuperscript{52} Regardless of whether one considers \textit{Lineas} and \textit{Cunard} as examples of extra-statutory favoritism, as Bebchuk and Guzmán do, these cases clearly do not consider comity to be the trumping factor in §304. This interpretation largely knocked the wind out of §304's universalist sails in that it allowed cooperation with a foreign court only if American claim holders' interests were not impaired. Because, by definition, no self-interested creditor would oppose a §304 petition unless the opposition is in its interest, the consequence of this view was essentially that the court's role should be limited to rubber-stamping the creditor's choice of law.

It should be noted that even under prior law, the United States was generally considered among the countries to afford the highest degree of solicitude to foreign bankruptcy regimes even in the absence of a specific bilateral treaty.\textsuperscript{53} Bebchuk and Guzmán cite the examples of Great Britain and Japan to illustrate the point.\textsuperscript{54} In Great Britain, cooperation with most foreign regimes (other than those designated by executive order) is on an \textit{ad hoc} basis—to the extent such cooperation occurs at all.\textsuperscript{55} In Japan, until the turn of the twenty-first century, such cooperation was essentially forbidden altogether. Japanese law expressly exempted a debtor's Japanese assets from the operation of foreign bankruptcy adjudications, and limited the effects of domestic bankruptcy adjudications only to Japanese property.\textsuperscript{56} Current Japanese law is based in part on the UNCITRAL Model Law,\textsuperscript{57} but its approach is still decidedly more territorial.\textsuperscript{58} While it now

\begin{itemize}
\item \textsuperscript{50} Bebchuk & Guzmán, supra note 44, at 783; see also \textit{In re Lineas Areas de Nicaragua}, 10 B.R. 790 (Bankr. S.D. Fla. 1981).
\item \textsuperscript{51} \textit{In re Lineas}, 10 B.R. at 791.
\item \textsuperscript{52} \textit{Cunard S.S. Co. v. Salen Reefer Serv. AB}, 773 F. 2d 452, 459 (2d Cir. 1985).
\item \textsuperscript{53} Bebchuk & Guzmán, supra note 44, at 781.
\item \textsuperscript{54} \textit{Id.} at 786-87.
\item \textsuperscript{55} \textit{Id.} at 786.
\item \textsuperscript{57} \textit{Id.}
\item \textsuperscript{58} Yamamoto argues that the difference between the new Japanese bankruptcy law and the UNCITRAL Model Law is largely rooted in the fact that the UNCITRAL Model Law operates on the common-law model and gives judges a significant amount of discretion, and that Japan's modification of the law was largely limited to the extent of adopting it for the civil law model. But in reality, Japanese law makes substantive departures from the UNCITRAL Model Law that have nothing to do with the civil-versus-common law issue. For example, Japan imposes far more onerous requirements on the recognition of foreign proceedings, which include that no prejudice to local creditors must occur. Additionally, the foreign proceeding must correspond to one of the five types of bankruptcy proceedings allowed under Japanese law for recognition. \textit{Id.} These differences are probably less likely to be due to Japan's desire to limit the discretion of judges in its civil-law tradition (indeed, Japanese judges appear to have more discretion at the recognition stage than their American counterparts) than to
\end{itemize}
allows for some recognition of foreign bankruptcy proceedings, it imposes conditions that are similar to the old United States approach under the *Papeleras* line of cases.

The changes instituted by America's adoption of the UNCITRAL Model Law were profound. The old Section 304 of the Bankruptcy Code was eliminated entirely. Its provisions on foreign representatives' access to U.S. Courts were replaced with the far more expansive provisions of the UNCITRAL Model Law. First, the requirement of comity as an overriding consideration, one in light of which all other factors must be considered, was incorporated into the text of the statute. The requirement applies not only to the decision about whether to accept the foreign representative's petition at all, but also to its treatment of the petition once it is accepted, and to the treatment of the foreign representative in other U.S. proceedings that may be pending before different, non-bankruptcy courts. The new statute also expressly requires that courts consider its international origin and the need to promote its application in a manner consistent with that of other adopting countries. The sole hurdle for the foreign representative is obtaining recognition, and the burden imposed thereby is far from onerous. The requirements are limited to the following: there must exist a foreign main proceeding, the foreign representative is a person or body, and the petition is accompanied with some form of official verification of the existence of the proceeding and of the foreign representative's authority. The statute still retains the option for the United States Courts to refuse a case if it would be "manifestly contrary to the public policy of the United States," but the grounds for the refusal are written much more narrowly than previous case law allowed.

In sum, the statute places the United States farther along the path toward universality. It eliminates any ambiguity that was caused by the conflicting interpretations of the old Section 304 in the *Culmer* and *Papeleras* lines of cases. It drastically lowers the barriers to the acceptance of foreign representatives' petitions in United States courts. Finally, the adoption of the UNCITRAL Model Law places a renewed emphasis on comity that is accorded to foreign bankruptcy proceedings.

**D. Requirements for a Desirable Transnational Bankruptcy Regime**

A successful transnational bankruptcy regime must meet two primary (and occasionally competing) criteria. First, the regime must be efficient. That is, the regime must minimize the costs it imposes on the debtors, creditors, sovereigns, and society. Second, the regime must be attractive for adoption by a significant
number of sovereigns. In other words, the widespread acceptance of the bankruptcy regime – like almost any other regime – is a prerequisite for its success in becoming a true international economic regime. I address each criterion in turn, setting forth some of the features that a bankruptcy regime should have to succeed on those criteria.

Efficiency requires that the bankruptcy process be achieved with the lowest possible cost imposed on all parties. The parties involved include the debtors themselves, ordinary creditors, special-situation creditors, and the public. A number of factors may contribute to the minimization of costs on these actors. I discuss three such factors here: (1) the degree to which the bankruptcy system ensures that the parties can predict the set of substantive rules to which they will be subject in the event of a bankruptcy; (2) the elimination of duplicative efforts by courts of multiple countries if concurrent proceedings are present; and (3) the provision of ex ante incentives for the optimal allocation of capital.

The first factor is the predictability of the system. By predictability I mean the ability to determine the exact nature of bankruptcy rules (and the nature of the forum) that will govern a particular debtor’s bankruptcy in advance of such bankruptcy. The more predictable a system is, the more likely that prospective

67. Different countries, of course, may provide different protections to the same type of person who suffers the same cost. For example, an American employee’s claim for wages may be partially protected by offering the employee a high priority in the distribution process. The same claim for wages, if made by a Mexican employee in a Mexican bankruptcy proceeding, receives a lower priority, but is not subject to a limitation on its amount as it is in the United States, even though the costs imposed on the two employees is identical. The efficiency criterion is not concerned with such differences in public policy among those countries. I do not treat these public valuations of the employee’s claim as true differences in the costs suffered by the two respective parties. I instead address this issue when I discuss the importance of allowing sovereigns to participate in the process to the extent necessary to protect their own domestic public policy. I assume throughout this paper that the value judgments inherent in the sovereigns’ public policies accurately reflect the public preferences of the society represented by that sovereign. To the extent that this is not always true – for example, in case of dictatorships or regimes that disenfranchise particular classes of constituents – the difference between public policy and that society’s value preferences will distort the efficiency of the application of the bankruptcy regime, and impose nontrivial costs that this paper acknowledges but does not include in the scope of its discussion.

68. Including the debtors’ equity holders.

69. Including both secured and unsecured contract creditors. I treat contract creditors as a distinct class of interests because such creditors ostensibly had the opportunity to bargain for credit terms. This class also includes domestic sovereign creditors (e.g. taxing entities) because, although they did not have an opportunity to bargain directly with the debtor, they are in a unique position to make rules that govern the terms of the debtor’s obligation to them and are therefore on par with (or even better off than) contract creditors in this respect.

70. Creditors who did not have an adequate opportunity to bargain for their terms of credit. The class includes not only tort victims (who are the quintessential non-consenting creditors), but also employees (as contract creditors whose bargaining power in comparison with the debtor is very weak).

71. Including the victims of any negative externalities created by the bankruptcy process. I use the term “public” to also include the sovereigns themselves in their non-creditor capacity. In particular, sovereigns’ concern about the consumption of their resources – such as judicial resources or other resources expended in the course of bankruptcy adjudication – must be given weight in any efficiency determination.
creditors will be able to accurately assess their risk. In other words, prospective creditors’ ex ante knowledge of the exact set of rules that will govern their prospective debtor’s insolvency will help such creditors to assess their exposure and will accordingly help them price credit more accurately. Conversely, ex ante predictability will also allow the debtor to insist on lower interest rates in some circumstances. In sum, ex ante information about bankruptcy rules will lead to a more efficient determination of the price of credit. The main beneficiaries of a predictable system are ordinary creditors (who can then compete effectively against other creditors by pricing credit accurately) and debtors (who can enjoy interest rates that are not artificially inflated by the lenders’ risk-averseness in an unpredictable system). It is important to note that, for the purposes of predictability, it is not critical to decide the precise substantive rules of the bankruptcy system. Efficiency gains from a predictable system are realized when the rules, whatever they are, are known in advance.

The second consideration useful to the determination of efficiency concerns the elimination of duplication of effort in the proceeding itself. To the extent that multiple sovereigns’ courts will be simultaneously involved in the proceeding, the system must ensure, as much as possible, that duplication of effort among those courts does not occur. This consideration is important for two reasons. First, judicial resources will be wasted if multiple courts are called upon to review the same issue, claim, or argument. Second, duplication of effort among different courts will increase the likelihood of inconsistent findings of law and fact by those courts. That can leave parties in the unenviable situation where compliance with one court’s order may mean the disobedience of the other, and thus also greatly compromise ex ante predictability of the system.

The last consideration concerns incentives for the optimal ex ante allocation of capital. Inefficiencies can result in a number of ways, not the least important of which is described by Bebchuk and Guzmán. In a system where disparate treatment of creditors in different countries in bankruptcy will cause those creditors to price credit differently, the debtor will, ceteris paribus, be inclined to borrow in a more creditor-friendly country because creditors from that country will be able to offer lower interest rates. To the extent that the debtor is more likely to invest in the same country as the one in which it borrows (which it may want to do for a number of reasons unrelated to bankruptcy considerations), this low interest rate may cause the debtor to invest in a country that offers a lower rate of return on the investment than is otherwise available. At first blush, the system appears unproblematic: if the debtor can obtain credit at a lower cost, and if this

72. See generally Bebchuk & Guzmán, supra note 44 (examining how territoriality generates distortions in investment patterns that can lead to inefficient allocation of capital).

73. The country may be more creditor-friendly; alternatively, it may be friendly to domestic creditors and hostile to foreign creditors. The model holds true for any bankruptcy system which enables one country’s creditors to offer better interest rates than others based solely on the fact that such creditors would be in a better predicament in a bankruptcy proceeding.

74. Among such reasons are the costs of compliance with various regulations concerning foreign investment, currency conversion, currency market fluctuations, cost of doing business over a long distance, and others.
reduction in cost provides the debtor with the best possible overall investment opportunity, then Adam Smith's invisible hand has done its job. That, however, is not the case, for this low cost comes at a price. If the creditor that offers credit at low cost obtains priority in the distribution of the debtor's asset in bankruptcy, all proceeds of the estate come at the expense of other claimants who are not entitled to the same priority. The distribution of the estate is effectively a zero-sum game: whatever the favored creditor wins, at least one other claimant must lose. The resultant cost, therefore, is borne largely by the non-privileged claimants (who lose out on the debtor's assets in the distribution of the estate) and by the debtor itself (who, in reliance on the low interest rate, decided to forego other investment opportunities that may have offered a higher return).

II. THE REGIME OF TERRITORIALITY

A. Overview

The regime of territoriality is the prevailing set of rules under which transnational bankruptcies are resolved today.\textsuperscript{75} The basic rule of territoriality states that the courts of each state in which the debtor has assets are responsible for distributing those assets — and only those assets — that are located within the territory of that state.\textsuperscript{76} For example, if a computer manufacturer has a research laboratory in the United States, an assembly plant in Taiwan, and customer support operations in India, the law and courts of the United States would oversee the distribution of the laboratory assets, the law and courts of Taiwan would handle the assembly plant, and Indian law and courts would be responsible for the customer support assets. Each of these courts would apply the domestic law of the country in which it is sitting.\textsuperscript{77} Each court would also handle claims from all of the debtor's creditors, wherever such creditors may be located, and regardless of the status of such creditors as consenting creditors (contract creditors) or non-consenting creditors (tort victims and governments).

Under a regime of territoriality, various incentives drive each country's decisions about the structuring of its own domestic bankruptcy laws. The most obvious of these incentives is to adopt laws that favor domestic creditors and disfavor foreign creditors.\textsuperscript{78} The benefits of such laws (such as encouragement of domestic economic activity and the attendant political gains for the domestic government) and their costs (such as creating inefficiencies in \textit{ex ante} resource allocation) will be explored more fully infra.

Territoriality has sometimes been derogatorily referred to as "the grab rule" because each country has the incentive to, roughly speaking, use its laws to "grab" the debtor's domestic assets for the benefit of its domestic creditors, particularly if

\textsuperscript{75} Despite the adoption of the UNCITRAL Model Law by the United States and a few others, these countries are still in the small minority. The erosion of territoriality as the dominant regime has been minor at best. \textit{See, e.g.} Bebchuk & Guzmán, \textit{supra} note 44, at 787.

\textsuperscript{76} LoPucki, \textit{supra} note 10, at 2218.

\textsuperscript{77} Including, of course, the choice-of-law rules of the forum jurisdiction. The application of those rules may naturally result in the application of substantive law that is different from the substantive law of the forum state.

\textsuperscript{78} Bebchuk & Guzmán, \textit{supra} note 44, at 780.
the debtor is foreign. But in practice, that rule has been altered to varying degrees by provisions in national bankruptcy laws that authorize cooperation with foreign bankruptcy regimes. For example, substantive American bankruptcy law takes a somewhat universalist approach in that it regards the debtor's estate, when created by a U.S. filing, to include assets abroad, and exhibits a degree of deference to foreign proceedings. Even before the adoption of the UNCITRAL Model Law, the Bankruptcy Code, for example, authorized a foreign representative to file an ancillary proceeding with the U.S. Bankruptcy Court that would enjoin any American action against any of the debtor's property if such property is involved in the foreign proceeding. It also authorized the court to turn over such property to the foreign representative. The adoption of the UNCITRAL Model Law has expanded this cooperation even farther.

It should be noted, however, that few, if any, regimes of pure territoriality exist today. Most domestic regimes blend at least a few non-territorialist elements into their framework for transnational bankruptcy resolution. But despite these nascent elements of universality, territoriality remains the dominant force in transnational bankruptcy today. Prior to the adoption of the UNCITRAL Model Law, the apparent strides toward universality made by the United States were tempered by the courts' solicitousness to the interests of American creditors at the expense of comity. It is yet to be seen how the adoption of the UNCITRAL Model Law will affect the situation. The regime of territoriality has significant advantages and disadvantages, some of which I explore below.

79. Id. at 777-78.
80. 11 U.S.C. § 541(a) (2007) (defining estate to includes assets “wherever located and by whomever held”); Bebchuk & Guzmán, supra note 44, at 781-82 (recognizing that “wherever located” language generally understood to encompass assets abroad). A well-publicized recent example of this view surfaced in the case of Yukos Oil Company (“Yukos”), an energy firm in the Russian Federation. The Russian government, apparently in retaliation for the support of public criticism of President Putin by Yukos’ CEO, claimed that Yukos was liable to the Russian for $27 billion in back taxes and penalties. The validity of that tax bill remains disputed. Yukos, predictably, was unable to come up with the money, whereupon the Russian government sought to seize and sell Yuganskneftegaz (“YNG”), Yukos’ most valuable production asset, at a public auction. YNG is a production facility located in Yugansk, Russia. At that time, Yukos filed for Chapter 11 in the Southern District of Texas, seeking to use the automatic stay to enjoin the auction. While the bankruptcy court was unable to order the Russian government not to conduct the auction, its temporary restraining order successfully prevented various investment banks from participating in the deal. Yukos’ U.S. filing therefore resulted in a U.S. injunction that applied to purely foreign assets. Yukos was ultimately unsuccessful in preventing the sale of YNG (which was ultimately purchased by a state-run Russian oil firm, Rosneft, using alternate financing and a shadowy intermediary), and its Chapter 11 petition was subsequently dismissed. But the case is nonetheless remarkable in that Yukos, a Russian company with almost no U.S. contacts, was able to obtain an injunction from an American court that applied to its purely Russian assets. In re Yukos Oil Co., 320 B.R. 130 (Bankr. S.D. Tex. 2004).
81. See Bebchuk & Guzmán supra note 44, at 782.
83. Id. at § 304(b)(2).
84. Gilreath, supra note 14, at 405.
85. Bebchuk & Guzmán, supra note 44, at 787.
B. Advantages of Territoriality

Territoriality offers three distinct advantages as a regime of international bankruptcy. First, it is significantly more predictable and flexible than the other regimes discussed in this paper. Second, despite the multiplicity of proceedings in multiple countries that are necessary in a regime of territoriality, the costs of such proceedings are contained because each country’s court is dealing only with domestic assets and applying domestic laws. Third, it allows local creditors to litigate in a closer and more convenient forum than they would be able to under a regime of universality. I explore each advantage in turn.

First, territoriality offers the most predictable and flexible regime of all. Territoriality is predictable because the identity of the court that will decide the disposition of a particular asset, and the law that the court will apply in its decision, are both determined from knowing a single piece of information: the location of that particular asset. That information is ascertainable at a fairly low cost, particularly for real and tangible personal property.

There also exists international agreement on standards for determining the location of intangible property, such as bank accounts, franchises, and leases. Accordingly, whenever a creditor relies on the debtor’s assets in extending credit, the location of those assets will, ex ante, enable the creditor to know the bankruptcy regime with which the creditor would need to contend. A universalist regime, on the other hand, would not offer such certainty, for both the reviewing court and the applicable law would be determined in accordance with criteria which are hard to evaluate ex ante. Under one view of universality, the debtor would have wide latitude of countries in which it could file. In other words, if the debtor were to desire to avail itself of the automatic stay requirement of a particular country, it would file in that country, whose bankruptcy regime would then govern the entire proceeding. Such arrangement makes it impossible to predict either the forum of the substantive law that will govern the bankruptcy.

Under a more common view of universality, the debtor would file in its “home” country. That poses a number of problems of its own, not least of those being that many multinational companies are formally separated into discrete entities, each in a different “home country.” In such a bankruptcy, the debtor, having many “home countries” thanks to the geographic diversity of the debtor’s entities, would have the ability to file wherever it chose. From the standpoint of predictability, such a regime is untenable. Alternatively, each of the debtor’s entities could file in its own “home country.” This view of universality still does not confer any advantages over territoriality. If these proceedings were to become consolidated into one at some point after filing, the determination of the country of forum and of applicable law is often far from clear. If the individual proceedings were to remain in their own countries, the resulting arrangement would be little different from territoriality, except that the jurisdicational lines would run along the boundaries of national entities rather than purely along the location of assets.

Yet another regime — corporate-charter contractualism, similar to that

---

86. LoPucki, supra note 15, at 743-44.
advocated by Robert Rasmussen—purports to kill two birds with one stone. Corporate-charter contractualism appears predictable at the outset; after all, the applicable bankruptcy regime is stated right in the corporation’s charter. But its application is more difficult in practice. While large creditors with experience in multinational lending are likely to have both the knowledge and the experience necessary to lend under regimes different from their own, the same may not be true for smaller creditors, particularly if the debtor’s bankruptcy regime choice is not a commonly encountered one. While the identity of the overall regime to be applied to the case is abundantly clear, the subjective intrinsic predictability of that regime (arising from the fact that the rules of the regime are likely unknown and practically unknowable to smaller creditors) leaves much to be desired. Such uncertainty will raise these smaller creditors’ cost and reduce competition among creditors, resulting in a less efficient outcome. The other claimed advantage of corporate-charter contractualism is that of flexibility, in that the parties are free to choose their own bankruptcy regime. This freedom would result in the optimal regime for the parties, not only because they would choose the regime that is best for them, but also because bankruptcy regimes would become a commodity and individual countries would compete with each other to deliver the best one. But in practice, this is highly unlikely to work to the advantage of anyone but the debtor and the largest creditors. Smaller creditors are again left at a disadvantage. This is necessarily so because most large international firms have only a few major creditors (with whom they can negotiate fairly easily about their regime choice) but a myriad of smaller ones (whose numerosity raises transaction costs for negotiations with them to the point of impossibility). Thus, from the standpoint of smaller creditors, such a system would be neither predictable nor flexible. Accordingly, territoriality affords both predictability and flexibility, and does so better than universality.

The second advantage conferred by territoriality is that individual domestic proceedings do not tend to be overly costly in comparison to a large, consolidated international case. First, each court is concerned only with applying its own domestic law, and need not make time-consuming and labor-intensive inquiries into the laws of other countries. Second, each court is concerned only with assets and claims that arose in their domestic jurisdiction, greatly reducing the number of parties, adversary proceedings, and evidentiary hearings that are needed to resolve the parties’ rights. Even compared to a single multinational consolidated proceeding, the duplication of efforts—which, to some degree, is inevitable whenever multiple proceedings exist—is not likely to impose significant additional costs, at least to the extent that most of the hearings about individual claims and assets would not be duplicated because each would occur in its home country.

The third advantage of territoriality is that it affords all creditors a local forum. Unless the creditor’s claim exceeds what the creditor would receive under domestic law, the creditor never needs to assert its claim in a foreign country. Some creditors’ claims can likely be satisfied in full—or close to full—solely with

87. Rasmussen, supra note 7, at 32-35.
88. LoPucki, supra note 15, at 739.
the domestic assets of the creditor. The remaining creditors will be fewer in number and will incur a lower total cost in asserting their claims in foreign countries. It is worth noting that both private and public costs would be spared in such case. Private costs savings come from creditors who no longer need to assert their claims in a foreign country. Public savings occur from judicial resources, which are saved when individual courts have to conduct fewer evidentiary hearings, deal with fewer parties, and can avoid the labor-intensive task of analyzing foreign law.

C. Disadvantages of Territoriality

A transnational bankruptcy regime based on territoriality exhibits three principal weaknesses. First, it results in waste caused by duplicative efforts across multiple jurisdictions. Second, it encourages strategic ex ante behavior by debtors and creditors that creates significant negative externalities, and is therefore inefficient. Third, even in the absence of strategic behavior, territoriality still provides wrong ex ante incentives for capital allocation, resulting in the debtors’ assets not being put to their highest value use. Each of these weaknesses is discussed in turn.

The first weakness of territoriality is also its most obvious one: when proceedings are launched in multiple jurisdictions simultaneously, each jurisdiction—though responsible only for assets within its reach—will inevitably be required to make findings that are duplicative of those made by other jurisdictions in the parallel proceedings. For example, whenever a creditor asserts a claim in more than one country, the existence of the claim—even if based on the same transaction or occurrence—may have to be separately determined under the laws of each country. Parallel proceedings in multiple countries are likely to result in another and more powerful flaw in the final resolution: if each country allocates only the domestic assets of the debtor, it will often be forced to split those assets from the debtor’s foreign assets. This can result in piecemeal liquidation of assets that ought to be treated as integral. This piecemeal treatment will frequently significantly lower the liquidation value of the debtor’s assets.

The second disadvantage of the system of territoriality is that it creates opportunities for strategic behavior by debtors and creditors. Here, debtors and creditors have an ex ante incentive to choose the location of the debtor’s assets to secure the most favorable treatment to themselves. Thus, in a purely territorial regime (such as the regime that existed in Japan until the turn of this century), if Country X is friendly to tort creditors and Country Y is not, the debtor (and any large unsecured lender of the debtor, which may ordinarily be forced to share in the proceeds of the debtor’s estate with the tort victims) will have an incentive to ensure that the debtor’s assets will be located in Country Y and not in Country X. Such behavior is inefficient because Country Y may not provide the debtor with the best return on its assets, and because tort victims in Country X will go undercompensated for their cost. Moreover, the disparity among various countries’ systems, in the absence of cooperation between those countries, provides opportunities for strategic behavior that is even more harmful. On the eve of bankruptcy, the debtor (alone or in collusion with one or more creditors) may move assets to a jurisdiction that would benefit them the most. Assets are thus
moved beyond the reach of the domestic creditors, who are left to choose between taking a reduced share of the debtor’s estate or braving the waters of a foreign proceeding.

The final disadvantage is explored fully in the Bebchuk and Guzmán model. In essence, territorialist systems will create an inefficient market interest-rate distortion when they are present in the world economy alongside universalist regimes. This occurs because territorialist systems tend to favor domestic creditors over foreign ones. Such preference may occur either explicitly or implicitly. An example of an explicit preference would be the one present in the United States before the adoption of the UNCITRAL Model Law, such as one expressed in Lineas Areas de Nicaragua, where the court insisted that the claims of American creditors must be satisfied in full before the claims of all other creditors would be satisfied at all. Implicit preferences are generally not as egregious, but the costs that they impose are equally real. These preferences include both the substantive limitations on the rights afforded to the foreign representatives in the countries’ domestic law, and the simple fact that it is generally much costlier for foreign creditors to pursue their claims. Regardless of the cause and manner of preference of domestic creditors over foreign, the outcome is the same: ceteris paribus, domestic creditors stand a higher chance of being paid on their debt than foreign creditors in a bankruptcy proceeding in a territorialist system. The distortion occurs because universalist systems do not have the same preference for domestic creditors; indeed, universalist systems will hang their domestic creditors out to dry when a foreign bankruptcy proceeding is initiated. As a result, domestic creditors in territorialist systems are more likely to be paid back than domestic creditors in universalist systems. Domestic creditors in territorialist systems are consequently more likely to be able to offer lower interest rates because of their lower risk exposure. Debtors will thus be more likely to borrow in territorialist systems over universalist systems. Creditors in territorialist regimes will look to the debtor’s assets to satisfy their claim, generally through some combination of an express grant of a security interest, the setting of various default triggers in the loan agreement that relate to the state of the debtor’s assets, some prohibition on the movement of the debtor’s assets abroad, or some other mechanism of expressing the creditor’s reliance on those assets. The debtor will accordingly be limited (at least to some degree) to keeping its assets and investments in the territorialist country. This is inefficient because the debtor’s assets may be able to be put to better use abroad. There is another inefficiency which Bebchuk and Guzmán overlook: over time, the territorialist country will become oversaturated with investment capital, which will eventually further decrease the return on that investment capital, and which will further increase the opportunity cost to the

89. See Bebchuk & Guzmán, supra note 44, at 794-98.
90. In re Lineas, 10 B.R. at 791.
91. Relatively, of course. This paper acknowledges that even universalist systems generally have a public-policy exception to their deference to foreign bankruptcy proceedings. But the contrast with territorialist systems is illustrative, in that territorialist systems will actively protect their domestic creditors, whether explicitly or implicitly, while universalist systems will generally assume a hands-off approach, unless an issue of public policy is involved.
debtor of not investing in a universalist country. It must be noted that the disparity in the debtor’s cost of capital between the territorialist and universalist regimes cannot be attributed to territoriality winning the “competition” for investment capital between the two types of regimes. Rather, the surplus enjoyed by debtors and creditors in the territorial regime is actually a negative externality that comes directly from the pockets of universalist-regime creditors who do not have a way of recouping their investment when a territorial-regime debtor files for bankruptcy.

III. THE REGIME OF UNIVERSALITY

A. Overview

Until the recent times, universality remained a regime that was largely the ideal advanced by academics, but unimplemented by policymakers. Even some proponents of non-universalist systems see universality as an overarching goal, with their proposed systems being merely an interim solution. The recent times have seen varying forms of strides toward universality, with the adoption of the UNCITRAL Model Law by some countries, with the passage of UNCITRAL-influenced universalist laws in others, and with varying degrees of built-in universality, unrelated to the UNCITRAL Model Law, in the domestic regimes of still others. With these exceptions, universality still remains largely a theoretical rather than practically-implemented system.

The central premise of universality is deceptively simple. Under universality, one country – say, the debtor’s “home country” – would be responsible for administering the debtor’s bankruptcy. The home country would exercise control over the debtor’s assets located both within and outside its borders. To the extent that the home country would be unable to directly reach the debtor’s foreign assets under the traditional principles of jurisdiction, the courts of the countries where such foreign assets are located would turn those assets over to the home country’s court to enable it to administer the bankruptcy on a global level. There would be a single proceeding, and all creditors, wherever located, would be required to assert their claims in that proceeding. The judgment of the home country’s court would have worldwide effect, and any assets previously located beyond the home country’s reach would be rendered under its control by the foreign courts’ cooperation. Each home country would apply its own substantive law to the adjudication of the bankruptcy, with the possible exception, under some proposals, of establishing the parties’ pre-bankruptcy rights. No proceedings would occur in countries other than the home country, except to the extent

92. Rasmussen, supra note 7, at 17.
93. LoPucki, supra note 10, at 2217.
94. See also Bebchuk & Guzmán, supra note 44, at 786-87.
95. Bebchuk & Guzmán, supra note 44, at 778.
96. LoPucki, supra note 10, at 2216.
97. Bebchuk & Guzmán, supra note 44, at 782.
98. Gilreath, supra note 14, at 407.
100. Gilreath, supra note 14, at 407-08.
necessary to establish the cooperation of those countries with the home country.\footnote{LoPucki, \textit{supra} note 15, at 699.}

This idyllic proposal is recognized, even by its proponents, as unworkable in the current world circumstances and incompatible with the notion of sovereignty.\footnote{LoPucki, \textit{supra} note 15, at 734; LoPucki, \textit{supra} note 10, at 2220-21.} Desire to protect sovereignty leads countries—even those with universalist leanings—to adopt limits on their cooperation with foreign proceedings, much like the United States did before the adoption of the UNCITRAL Model Law, and continues to do today.

Other flavors of universality have been proposed, notably by Professor Westbrook. Westbrook’s proposals\footnote{LoPucki, \textit{supra} note 10, at 2221-23.} include (1) both those based on a single body of international substantive bankruptcy law\footnote{\textit{Id.} at 2221.} and those based on national laws,\footnote{\textit{Id.} at 2221.} (2) both those applied by a single new international bankruptcy court\footnote{\textit{See id.} at 2221-22.} and those administered by an existing national court;\footnote{\textit{Id.} at 2222.} and (3) both those universally applicable to all creditors and those which would apply universality to large, sophisticated creditors and non-universalist rules to small, unsophisticated creditors.\footnote{\textit{Id.} at 2222 (citing Donald T. Trautman, Jay Lawrence Westbrook & Emmanuel Gaillard, \textit{Four Models for International Bankruptcy}, 41 \textit{Am. J. Comp. L.} 573, 579 (1993)).} For all their variance in the choice of substantive law and the choice of forum, “pure” universalist proposals have one common defining trait: a single court administers the bankruptcy, and all other courts participate only to the extent necessary to empower the “lead” court to complete its task, or to the extent necessary to protect their own vital national interests in a manner consistent with comity.

\textbf{B. Advantages of Universality}

Advantages of universality are plentiful and oft-cited. First, a single forum for resolving all disputes relating to the bankruptcy is cost-effective. Second, the outcome of the bankruptcy proceeding would not be influenced by something as fortuitous (or as manipulable) as the placement of the debtor’s assets on the eve of the bankruptcy. Third, there would be no opportunity for forum-shopping because each debtor would file in its home country, a fact that would be known to all potential creditors in advance and would thus promote consistency and predictability.

Universality is cost-effective for three independent reasons. First, having a single court and a single trustee manage all of the debtor’s assets will eliminate the transaction costs that would otherwise be incurred by having multiple courts and multiple representatives.\footnote{LoPucki, \textit{supra} note 15, at 707-08.} Second, the coordinated management of the debtor’s estate will prevent the debtor’s piecemeal liquidation, preserve its going-concern value, and maximize the distributions to all creditors in the event of liquidation.\footnote{\textit{Id.} at 706-07.}
Third, universality results in an efficient choice between liquidation and reorganization. Without universality, creditors in countries with high asset-to-claim ratios would not have an incentive to push for reorganization, while creditors in countries with low asset-to-claim ratios would have an incentive to encourage those risks. The combination of a single point of estate management, preservation of the debtor’s going-concern value (when efficient), and efficient choice of liquidation versus reorganization thus contributes to the cost savings of universality over other regimes.

The outcome of a bankruptcy proceeding under universality, moreover, would not be affected by the particular placement of the debtor’s assets. While the location of an asset provides an easy and predictable way to ascertain the nature of the bankruptcy regime that will govern its liquidation, that location itself is both fortuitous and easily manipulable. That is particularly true for intangible assets that can be easily moved across national borders, such as bank accounts. Under universality, the location of the asset would not matter, as its distribution would in any case be governed by the law of the “home country.”

Finally, universality also discourages other kinds of strategic behavior, such as forum-shopping by debtors. This advantage is most pronounced when there exists a mix of universalist and territorialist regimes around the world, and the debtor seeks to file in a universalist regime that is different from its home country. The recent bankruptcy of the Yukos Oil Company, where the Russian corporate debtor forum-shopped itself into a Texas bankruptcy court (which, by statute, had jurisdiction over all of Yukos’ assets “wherever located”) by depositing a few million dollars in the account of its counsel, Texas-based Fulbright & Jaworski, is an illustrative example of such behavior. While Yukos had good reasons to seek bankruptcy protection in the United States, rather than its native Russian Federation, the encouragement of such forum-shopping on a global scale would

---

111. Id. at 707. LoPucki correctly notes that it is generally the estate representatives (such as trustees and debtors-in-possession), not the creditors, who control the decision about whether the firm should reorganize or liquidate, and that Westbrook incorrectly assumes it to be otherwise. Id. However, discussion of creditors’ incentives is nonetheless important here because creditors can generally argue in a bankruptcy proceeding for either reorganization or liquidation. Creditors may further exercise their leverage – at least in the United States – by voting to reject a reorganization plan. See 11 U.S.C. § 1126 (2008).

112. This scenario would not pose a problem under United States substantive law, because of laws governing fraudulent transfers and voidable preferences (11 U.S.C. §§ 544, 548 and the Uniform Fraudulent Transfer Act) and because, even if the debtor were to circumvent those laws by transferring money to its own bank account abroad, the money would not be lost by the estate because the estate includes all of the debtor’s assets “wherever located.” 11 U.S.C. § 541(a) (2008). But in a more territorialist country (whose domestic bankruptcy law does not purport to govern the debtor’s assets abroad, such as Japan before the recent reforms), or one whose fraudulent conveyance laws are less robust, it is easy to imagine how assets could be moved to other countries with no recourse for domestic debtors other than asserting their claim in the foreign country.


116. Such as its (probably well-founded) belief that it would not be treated fairly by a Russian
have disastrous consequences for the predictability of bankruptcy systems. If every debtor that perceived unfairness in its domestic system were able to file abroad merely by transferring a few assets to a friendlier country, it would be impossible for creditors to predict, *ex ante*, the nature of the regime that they would be subject to. Universality discourages such behavior because it leaves bankruptcy proceedings to the debtor's home country, and consequently makes asset placement irrelevant for the choice of law that governs their distribution.

The advantages of universality, if realized, render universality a more efficient system that cuts administration costs and discourages harmful strategic behavior by debtors and creditors. It is precisely these advantages that have made universality the choice system in the academia. But the practical adoption of universality presents grave complications, which I explore below.

**C. Disadvantages of Universality**

For all of its theoretical superiority, the problems inherent in any practical implementation of a regime of universality are fatal to its success. First, a universalist regime would have to find a way to determine the "home" country of every debtor in a consistent, predictable, and permanent way. Second, such a regime would have to provide for fair treatment of multinational debtors that have national subsidiaries under varying degrees of control by the debtor's "home office," if such a home office indeed exists. Third, universality imposes grave costs on local creditors of multinational debtors when such creditors become forced to defend their interests in a distant court applying unfamiliar substantive law.

Universalists concede that it is impossible to establish a system that would determine, *ex ante*, the "home country" of each debtor. A "we know it when we see it" approach, which universalists claim is sufficient for the vast majority of cases, is unacceptable, and is at any rate insufficient for some of the best-known transnational bankruptcy cases in recent history, including Maxwell Communications Corporation and BCCI. Most universalist-leaning regimes, including the UNCITRAL Model Law and the European Union Convention on Insolvency Proceedings, set the default rule that the country of incorporation is the "home country" for the purposes of insolvency proceedings. But this
DENV. J. INT’L L. & POL’Y

The presumption may be overridden by a contrary showing in both regimes;\textsuperscript{1} the end result is an intense fact-based inquiry, which destroys any hope of predictability that may have existed had the default rule just been left alone. A per se rule, which would conclusively set the country of incorporation as the home country, is hardly the solution either. First, if combined with the sort of an automatic-stay provision encountered in the United States, a debtor’s filing in one country will prevent creditors from seeking home-country determination elsewhere, thus essentially allowing the debtor to unilaterally choose which country will determine its home country (and thus effectively allow the debtor to choose its own country).\textsuperscript{1} Second, it would encourage debtors to choose regimes for their incorporation that may have little to do with their actual economic activity, which would place an enormous burden on creditors – particularly small, local creditors – to acquire information about the regimes of far-away countries. Worse, it will encourage debtors to change their home state on the eve of bankruptcy,\textsuperscript{2} suddenly forcing their existing creditors to assert their claims in a brand new system.\textsuperscript{3} The incentives for this brand of forum-shopping are considerable, and various countries – such as Bermuda, Luxembourg, and Cayman Islands – may well emerge as possible international bankruptcy havens.\textsuperscript{4} These eve-of-bankruptcy moves are fairly common in contemporary practice,\textsuperscript{5} and once the venue is thus chosen, its change is highly unlikely.\textsuperscript{6} Third, it provides little

\textsuperscript{1} Model Law, supra note 31, at art. 16(3); European Insolvency Convention, supra note 119, at art. 3(1).

\textsuperscript{2} LoPucki, supra note 15, at 723. (citing Nakash v. Zur, 190 B.R. 763, 767-69 (Bankr. S.D.N.Y. 1996)) (holding that the creditor violated the automatic stay by filing an involuntary petition against the debtor in Israel).

\textsuperscript{3} This problem cannot be privately solved by contract alone. If the contract were to trigger an automatic default and acceleration with the debtor’s change of incorporation, such contract (and the accelerated amount) would then simply become a claim in the bankruptcy proceeding in the new country. It can only be solved either by law that would refuse to give effect to a change of incorporation that is done less than a certain time before the filing, or by a requirement that would empower the creditor to assert the claim in the old country of incorporation and that would require the court of the new country to cooperate.

\textsuperscript{4} As already occurs with respect to different venues in the United States. LoPucki notes “rampant forum-shopping” by U.S. debtors and that over half of all U.S. filings occur in venues other than those that universalists would identify as the proper venue. LoPucki, supra note 15, at 720-21; see also Theodore Eisenberg & Lynn LoPucki, Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations, 84 CORNELL L. REV. 967, 968 (1999).

\textsuperscript{5} LoPucki, supra note 15, at 721 (citing also the danger that these countries will have a disproportionate role in setting distribution priorities and other substantive rights for debtors everywhere in the world).

\textsuperscript{6} Id. at 722 (citing examples of Amdura, Baldwin United, Continental Airlines, Evans Products, Memorex, Michigan General, Tacoma Boatbuilding, and the Wickes Companies).

\textsuperscript{120} See GORDON BERMANT ET AL., CHAPTER 11 VENUE CHOICE BY LARGE PUBLIC COMPANIES: REPORT TO THE JUDICIAL CONFERENCE COMMITTEE ON THE ADMINISTRATION OF THE BANKRUPTCY SYSTEM 7 (1997); Eisenberg & LoPucki, supra note 123, at 1000; Lynn LoPucki & William Whitford, Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies, 1991 WIS. L. REV. 11, 24-26 (1991) (noting that these cases are said to “grow roots” immediately upon moving to the new venue as executives make decisions and parties hire counsel, making it “unthinkable” to move a case within mere weeks).
guidance on the treatment of the many multinational corporations that operate not as single units but as corporate groups whose loosely-controlled subsidiaries are incorporated in a number of countries. This is a larger problem with universality, to which I now turn.

Great difficulty exists in determining the regime that should govern international corporate groups. Alternatives include treating each legally distinct entity in the group as having its own home country, treating the entire corporate group as having a single home country (which may or may not be that of the corporate parent), and treating the troubled entities as a single unit that has its own home country (which may be determined on some basis other than the country of incorporation). Each is fraught with problems. LoPucki cites a simple yet illustrative example of a corporate group consisting of an American parent (which is not financially troubled) with Canadian and French subsidiaries (both troubled), with the Canadian subsidiary conducting the bulk of its operations through a non-troubled German subsidiary. Under the view that treats each entity as having its home country, the proceedings should take place in Canada and France; under the view that treats the entire group as having a single home country, the United States is the appropriate forum; an alternate view would disregard the Canadian entity’s state of incorporation and would instead require it to proceed in Germany due to the fact that the bulk of its assets is located there. The resulting dilemma is that any approach that requires the proceeding to be consolidated in a single country will risk inefficiency by also implicating the solvent members of the corporate group that would have been better off continuing in operation without liquidation or reorganization, and by altering wholly-domestic relationships between solvent subsidiaries and their domestic creditors. On the other hand, any approach that allows the exclusion of solvent members from the bankruptcy proceedings by allowing the proceeding to be commenced in multiple forums will defeat the aims of universality, exclude important assets from the bankruptcy estate, risk destroying the going-concern value of the debtor, and encourage strategic asset-shifting among corporate group members. Moreover, universality allows corporate groups to further manipulate their bankruptcy regime by means of a staggered filing; that is, having some of the group’s entities file before others. The proceeding, if consolidated at all, will be consolidated in the home country of the first-filing subsidiary, not in the parent’s country because the subsidiary’s

128. LoPucki, supra at note 15, at 724.
129. Id.
130. Id at 717-718.
131. Id. at 718-20 (citing the bankruptcy of Bramalea Limited, whose Canadian bankruptcy filing had precisely this effect on the relationship of its solvent American subsidiaries with their domestic creditors); see generally R. GORDON MARANTZ, The Reorganization of a Complex Corporate Entity: The Bramalea Story, in CASE STUDIES IN RECENT CANADIAN INSOLVENCY REORGANIZATIONS 1, 30 (Jacob Ziegel ed., 1997) (detailing the Bramalea story).
132. See LoPucki, supra note 15, at 720.
country’s court will already be on the way in resolving the case.\textsuperscript{133}

Third, universality imposes grave costs on local creditors. Under universality, a debtor is required to file in its “home country” which, as we have seen, may be quite different from the country in which the bulk of its economic activity takes place. For example, a small British company that sells auto parts on credit to the British automaker Jaguar, may suddenly find itself having to defend its interests in Delaware, and assert its priority under the U.S. Bankruptcy Code, if the Ford Motor Company, the current corporate parent of Jaguar, were to file for bankruptcy there. Different substantive priorities and different treatment of similar claims in different countries makes the \textit{ex ante} pricing of credit impossible without accurate information about substantive foreign law. In many cases, the mere fact that the debtor actually has a foreign “home country” is not immediately apparent to creditors. Even in cases where it is apparent, smaller creditors will still be disadvantaged because they cannot accurately evaluate their risks and exposure under foreign bankruptcy law, and thus cannot price their credit accurately.

The combination of these practical problems is fatal to the ability of universality to realize its potential. While a universalist world would, in theory, be more predictable, no universalist system proposed to date has been able to overcome the hurdle of resolving the threshold questions about the home country of the debtor or about the prejudice that occurs to domestic creditors. As a consequence, universality remains an unworkable system.

\textbf{D. Corporate-Charter Universality}

A more promising universalist proposal is advanced by Rasmussen.\textsuperscript{134} Under his proposal, each debtor would have the ability to choose its bankruptcy country – that is, both the forum and the law, with the sole requirement that the forum apply \textit{lex fori} (law of the forum) – to which its bankruptcy would be subject.\textsuperscript{135} The country would then function as the “home country,” and administer the proceeding in accordance with the principles of universality.\textsuperscript{136} The debtor’s choice would be made at incorporation, changeable only with the consent of the creditors, and publicly available to any prospective creditor \textit{ex ante}.\textsuperscript{137} This approach, in essence, bypasses the most dangerous component of universality, which is the determination of the debtor’s home country for bankruptcy purposes. As a result, it would eliminate strategic behavior by debtors, eve-of-bankruptcy reincorporation, and other tactics that undermine the integrity of universality. Moreover, it would abandon traditional choice-of-law principles and give the debtor and its creditors more flexibility in choosing the debtor’s bankruptcy regime, unhampered by considerations of country of incorporation, country of headquarters, and country of the majority of assets.

\begin{footnotesize}
\begin{itemize}
\item 133. \textit{id.} at 723.
\item 134. Rasmussen, \textit{supra} note 7, at 32-35.
\item 135. \textit{id.} at 32.
\item 136. \textit{id.} at 27.
\item 137. \textit{id.} at 5.
\end{itemize}
\end{footnotesize}
Rasmussen’s regime is less objectionable than traditional universality for those reasons. Nonetheless, its flaws are considerable. In addition to problems already enumerated, the system will impose extreme costs on nonconsensual creditors of the debtor, such as tort victims. Debtors – particularly those prone to tort liability – will have an incentive to choose the country that is as hostile to plaintiffs as possible for their bankruptcy home. As a result, tort victims will be systematically undercompensated and will, as a class, effectively bear the cost of any efficiency gains that may be passed on to the debtor and other creditors. A possible solution is proposed by Rasmussen himself: have each country that has tort creditors conduct “fairness hearings” before requiring its domestic tort creditors to go to the debtor’s home country. But the cure is just as bad as the disease. While tort victims will benefit, the overall predictability of the system would suffer. A German creditor, for example, would have to adjust the terms of its credit to a debtor that elected France as its bankruptcy regime based on the debtor’s potential tort liability in the United States. Moreover, the solution will not work if the country where the debtor faces tort exposure is also a country where it does not have many assets, because in the absence of foreign courts’ cooperation, the seizure of the debtor’s assets is essentially the only leverage that the tort country’s court has against the debtor.

IV. AN INTERNATIONAL REGIME?

A minority of commentators – notably Westbrook – advocate the use of an international body to resolve transnational bankruptcies. In such a system, an international court would have exclusive jurisdiction over all transnational bankruptcy cases. Under various versions of the proposal, the international bankruptcy court would apply either the domestic law of the debtor, or a new body of substantive international bankruptcy law. Both the international bankruptcy court and any possible substantive law would be created by convention or treaty. Domestic courts of individual countries would participate in the process only to the extent necessary to enforce the judgment of the international bankruptcy court (for example, ordering that assets be seized and turned over to the international bankruptcy court).

Proponents of such an international system claim two overriding advantages. First, a purely international system would be the model of predictability and uniformity. There would never be any guesswork about the forum that would take control of the proceedings because only one such forum would exist. Moreover, under the version of the proposal that favors creating a single body of substantive

138. See LoPucki, supra note 15, at 739-40 (citing Goldberg v. Lee Express Cab Corp., 634 N.Y.S. 2d 337, 338 (Sup. Ct. 1995) as an example of the length to which some debtors go, ex ante, to limit their tort liability). In Goldberg, the court noted the common practice of taxicab companies to create a separate corporation for each taxicab, thus making the rest of the taxi fleet immune from any possible tort judgment against an individual single-cab subsidiary. Id.
139. Rasmussen, supra note 7, at 35.
141. Id. at 2292-93.
142. See id. at 2292-93.
law, every creditor, large or small, would know exactly its prospects in a potential bankruptcy proceeding, and would thus price its credit accurately. Instead of being forced to learn dozens of foreign regimes, as under universality, creditors would only need to know one.

The second claimed advantage is that the international nature of the regime would be fair to all creditors and debtors, regardless of their national origin. No court would have to decide the allocation of costs between “domestic” and “foreign” creditors because all creditors would, in a sense, be equally “foreign” to an international body. Similarly, substantive law would eliminate any built-in bias in favor of “domestic” and against “foreign” creditors. Composition of the court can easily be set in such a manner as to minimize or eliminate any possibility for favoritism.

The international organization regime, however, is even less of a workable solution than universality. If the regime administered by an international organization is to be any more predictable than universality, there must exist a single body of substantive law that the international organization would apply. To allow domestic laws to remain applicable to transnational bankruptcies under such a scenario is to invite the same uncertainty and manipulation as universality would allow (minus, of course, the choice of the forum itself). Even if the international bankruptcy court were to have its own criteria for determining the identity of the debtor’s “home country,” debtors can still re-incorporate, move their headquarters, or shift assets as easily as they can under universality. Accordingly, we are left with a system that would create both a forum and a body of substantive law to resolve transnational insolvencies.

Regrettably, the very reason why an international solution to transnational bankruptcy is needed is also the reason why an international body of substantive bankruptcy law cannot work: nations have vastly differing economic priorities. National decisions about economic priorities are influenced by a host of factors, ranging from development objectives, to attraction of foreign capital, to moral judgments. These unique economic priorities become expressed in national bankruptcy systems. In the present day, these systems exhibit a dizzying array of diverse choices about the scope of the estate, claim recognition, class treatment, creditor priority, available remedies, and just about all other aspects of bankruptcy proceedings. It is this rich diversity of policy choices on the global scale that makes transnational bankruptcy so unpredictable and a uniform regime desirable. It is also this diversity that will prevent any consensus with respect to substantive law. Consensus has been elusive even in fairly closely-knit geopolitical units such as the European Union, whose members – save perhaps for the recent arrivals from the former Eastern Bloc – are largely well-established, industrialized, powerful economic players in a similar stage of development. If substantive consensus

143. See LoPucki, supra note 10, at 2224-25.
144. See European Insolvency Convention, supra note 119, at art. 4(2) (explicitly leaving questions of substantive law - such as scope of estate, treatment of assets, powers of debtor and liquidator, effects of bankruptcy on debtor's current obligations, recognition of claims, distribution of assets, ranking of claims, and others - to the domestic law of the state that is administering the bankruptcy)
cannot be achieved in Europe, there is little hope that a consensus on substantive law can be had on a global scale. Without consensus, the regime cannot take hold and will die in one of two ways: it can attempt to be substantively comprehensive, but secure the ratification of only a few countries that share the same economic priorities; or, it can attempt to secure broader participation at the expense of substantively meaningful provisions. Either way, a comprehensive regime that would govern substantive issues—such as scope of estate and priority of claims—is currently impossible on a worldwide scale.

V. COOPERATIVE TERRITORIALITY AND BEYOND
A. Overview

Professor LoPucki proposes a regime that she calls cooperative territoriality to govern transnational insolvency proceedings. The system is not flawless; however, with some adjustments, this approach is the most practically workable paradigm of all that are presently discussed in the literature.

Cooperative territoriality is similar to classic territoriality. Under cooperative territoriality, separate and coequal bankruptcy proceedings occur in each country in which the debtor has assets. The court of each of those countries would administer those assets, and only those assets, that are located within that country. Lex fori would govern the substantive issues in each proceeding. Two critical differences would distinguish the regime from classical territoriality, however. First, cooperation among courts would reduce administrative costs and reduce wasteful duplication without compromising the participating countries’ sovereignty. Second, disputed claims would be litigated in a single forum with binding effect on all other countries.

The first form of cooperation that LoPucki proposes concerns the process of filing and allowing claims. Under classic territoriality, a creditor that wants to have access to the debtor’s assets worldwide would need to file its claim in each country in which the debtor has assets. Under LoPucki’s proposal, the creditor would only file in one country. The claim would be automatically deemed allowed in each country in which the bankruptcy proceeding is pending, unless the trustee in such other country objected to the allowability of the claim based on local substantive law. The creditor would then have a choice of whether to press for the allowance of the claim in that foreign court, or simply give up and focus its attention elsewhere.

The second form of cooperation that LoPucki proposes concerns litigating disputed claims. Two alternatives exist for such process. Under the first possibility, a creditor would litigate its disputed claim in its home country. The

146. See id. at 742.
147. See id.
148. Id. at 742-43.
149. See id. 742.
150. See id. at 753-55.
151. See id. at 750-55.
152. See id. at 754-55.
judgment of that court would then become binding on all other courts that are administering the bankruptcy around the world. The second alternative would require the litigation of disputed claims in each country in which they are disputed. LoPucki naturally favors the first alternative, but recognizes that the courts' current reluctance to always give effect to foreign judgments will likely impede the chances of this approach taking hold.\textsuperscript{153} I will now explore advantages and disadvantages of the LoPucki proposal and propose modifications that will likely improve the system's chances for success.

**B. Advantages**

The LoPucki approach captures all advantages of classic territoriality.\textsuperscript{154} First, cooperative territoriality is eminently predictable. The regime that will govern the distribution of a particular asset is governed by the law of the place where that asset is located. The complicated and unpredictable process of ascertaining the debtor's home country is eliminated from the equation. Second, it allows local creditors to litigate in a close, convenient forum, and be governed by domestic law, rather than being illogically forced into a distant forum to litigate a purely domestic dispute. Like classic territoriality, it is also superior in its treatment of global corporate groups. It treats each national entity of a global corporate group as a separate debtor, and thus conforms to the expectation of creditors who were dealing with that particular entity.

It also adds some advantages of its own. It takes the most efficient aspect of territoriality – the cost savings arising from each court's ability to focus solely on domestic assets and laws – and it enhances it with the cooperation requirement. If a large multinational debtor has thousands of claims filed against it in bankruptcy, and the majority of those claims are uncontested, the fact that such claims will be allowed globally represents significant cost savings in relation to the existing regime. Even if the filing of a claim is a largely automatic process in each individual court, the expense involved in filing such claims separately, multiplied by thousands of creditors and hundreds of cases, can be considerable. Moreover, the automatic allowance of such claims will not significantly increase the expenditure of judicial resources in the allowing countries because, by hypothesis, these claims are uncontested. The automation of the process is thus a laudable step forward.

Cooperative territoriality also reduces (but does not eliminate) incentives for strategic asset placement by debtors who want to avoid tort liability in a particular country. By allowing easy cross-recognition of claims among the various national estates created by the concurrent proceedings, no portion of the debtor's assets would be inaccessible to the debtor's creditors. The process would be aided even more greatly if automatic recognition of the judgments determining claim amount could be secured in the bankruptcy context. However, even without automatic recognition, cooperative territoriality represents an improvement over the status quo.

\textsuperscript{153} See id. at 755-56.

\textsuperscript{154} See id. at 751-53.
Similarly, cooperative territoriality neutralizes some (but not all) incentives that, under the model proposed by Bebchuk and Guzmán, cause inefficient allocation of capital. The model predicts that in a world with a mix of territoriality and universality, disproportionate and socially inefficient investment would occur in countries that have adopted territoriality. That is so because creditors in territorialist countries stand a better chance of being repaid in bankruptcy and will thus be able to offer more competitive interest rates, and debtors will consequently be more likely to borrow and invest in territorialist countries. Cooperative territoriality addresses this shortcoming in several ways. First, as already stated, it partially erodes some of the barriers to recovery that creditors in universalist countries will have. That is, when a creditor from a universalist country must assert its claim, such a creditor need only file a proof of claim in its home country’s court for the claim to automatically be allowed in all countries in which the debtor has assets. Such a creditor need not face the cost of filing its proof of claim in dozens of countries, nor establish the allowability of the claim in each country. Of course, when the claim is objected to, the debtor must still choose between defending and forfeiting it. However, that process is no worse than current practice. Secondly, if a mechanism is adopted by which the allowance of a disputed claim by one country can be made binding on others, the costs associated with such litigation would dramatically decrease. Under current practice, the debtor would have to file each proof of claim independently and only then respond to objections on a country-by-country basis.

C. Disadvantages

The LoPucki proposal is not without flaws. First, some of the disadvantages of classic territoriality, such as the high cost of multiple concurrent proceedings, are plainly inherent in cooperative territoriality. Second, as already stated, it does not completely eliminate the built-in incentives in territoriality that cause inefficient allocation of capital. To be sure, cooperative territoriality is likely to fare far better than conventional territoriality in those respects, but any regime that allows for differing likelihoods of recovery by creditors based on their location will, to a degree, have the same effect.

The LoPucki proposal does not so much introduce disadvantages that did not exist in the world of classic territoriality, as it fails to resolve the questions that it raises. LoPucki, for example, proposes the automatic allowance of claims in all countries once they have been allowed in one country. But also, she urges that debtors be able to prevent such automatic allowance by merely filing an objection. Consequently, any efficiency gains that automatic allowance would bring would become obliterated as the exception swallows the rule. In the following section, I propose a solution to the automatic-allowance dilemma that will likely streamline the process, save costs, and still allow each country full control over decisions that affect its sovereignty.

Another flaw with the LoPucki system is that it recognizes that debtors will

155. See Bebchuk & Guzmán, supra note 44, at 789-90.
156. See discussion infra Part V. D.
have an incentive to shift their assets to countries that will shield them from various types of creditors, yet does not propose a system to address this problem beyond a vague suggestion that the countries might cooperate with one another to prevent this from occurring. I propose a comprehensive system to resolve this issue, and I also discuss it in the next section.

D. Proposed Improvements

I propose several modifications to the LoPucki proposal that, if implemented, will increase the potential of cooperative territoriality to be an efficient means to streamline the process of transnational insolvency. These modifications may be adopted by way of treaty or convention.

First, I propose a modification in the process of allowing claims. Claims allowed in the creditor’s domestic courts should be conclusively presumed allowed in all other counties’ courts, with only two enumerated exceptions. The first such exception can occur if there exists an international agreement that a particular kind of claim is not allowable. For example, suppose that there came into existence an agreement stipulating that punitive damages are never allowable in any transnational bankruptcy case. In such a scenario, the creditor’s domestic court would disallow the creditor’s claim for punitive damages in the first instance. The second exception would occur if the allowance of the claim is against an express law of the country that is asked to allow the claim. The second exception should be construed extremely narrowly, and individual countries would be permitted to disallow claims only in the existence of a specific law that prohibits such allowance. For example, suppose there were no international punitive damage agreement, as there was in the previous hypothesis. Suppose further that the creditor’s country allowed punitive damages. Finally, suppose that the country in which a substantial chunk of the debtor’s assets is located does not have punitive damages in its tort law. Under my proposal, the second country would be required to allow the creditor’s claim because although it does not permit punitive damages in tort, it does not have an explicit rule banning the inclusion of foreign punitive tort damages in bankruptcy. If the second country decided to pass a law banning punitive damages from other countries from being included in bankruptcy, then it would be permitted to disallow them. This requirement goes a step past ordinary principles of comity. Under conventional comity, the second country would be permitted to disallow the punitive damage claim if it conflicted with a fundamental policy of the second country. This standard, although well-established, falls short of offering predictability. The deciding court often has to determine what public policy is, often in the absence of explicit legislative guidance. It then has to decide whether the proposed action will violate that public policy. Under the “comity-

157. Such an agreement is not merely an academic possibility. Many countries do not allow punitive damages at all. Even others, such as the United States — where punitive damages are jokingly referred to as a national pastime — grant punitive damages only a very low priority in domestic bankruptcies. See 11 U.S.C. § 726(a)(4) (2008) (listing punitive damages as a low priority in liquidation); see generally Menard-Sanford v. Mabey, 880 F.2d 694 (4th Cir. 1989) (holding that, in the bankruptcy that followed the Dalkon Shield IUD litigation, the court had equitable power to disallow or subordinate punitive damages).
plus" proposal, the court's discretion would be far more limited. No court would ever be required to make pronouncements of public policy. The allowance or disallowance of the claim would be predictable with a simple look at the country's statute dealing with the allowance of specific claims. If the allowance of the claim is not expressly prohibited, then it must be allowed, even if the underlying claim does not exist according to the country's domestic law, and even if the country's public policy opposes such claims. Moreover, each country would have a perfectly safe way to preserve its sovereignty by disallowing claims that it finds inappropriate: all it would have to do is pass an explicit law to that effect. If France, for example, decides that punitive damages are the province of les Américains litigieux, it is perfectly free to outlaw the allowance of foreign punitive damages by its domestic courts. Otherwise, it is free to continue to prohibit punitive damages in its domestic courts but allow them when it administers a portion of the estate of an American debtor with American liabilities.

The most obvious criticism of this proposal comes from the fact that debtors will have a tremendous incentive to shift assets on the eve of bankruptcy to countries that will shield them from undesirable exposure. However, this problem can be addressed by adopting a set of international principles of fraudulent transfers. Current law relies on the creditor's domestic court to make the determination that a fraudulent transfer has been made, and on the foreign court to enforce it under the principles of comity. The incentive for the foreign court not to grant comity to the fraudulent transfer judgment of the domestic court is too great, particularly if the transfer was made to avoid liability under a law that is repugnant to the foreign country.

I propose that an international system governing fraudulent transfers be adopted by convention or treaty. The agreement would set uniform guidelines for what constitutes a fraudulent transfer. It would not need to delve into whether the fraudulent transfer ought to be permissible if it is made to avoid liability under some repugnant law because each country would have independent ability to disallow claims based on such liability. The agreement need not even define the standards for intent to defraud; it could merely treat all transfers made within a certain time before filing as fraudulent and thus avoidable. The agreement, accordingly, would not need to make substantive determinations on subjects that divide the international community, and would thus be likely to be widely adopted.

Suppose, as earlier, that France abhors punitive damages in tort. Suppose further that France imposes civil fines for the display of Nazi memorabilia, while the United States opposes such fines on free-speech grounds. Under my proposed agreement, United States and France would not need to negotiate with each other about the substantive merits of either punitive damages or fines for Nazi

158. LoPucki suggests a system of cooperation among countries to prevent the problem of "fleeing assets" but does not present a concrete proposal. See LoPucki, supra note 15, at 758-59. Instead of ad hoc cooperation, which is the essence of LoPucki's treatment of the subject, I propose a system of per se rules that would conclusively determine transfers to be avoidable.

displays. Both could agree to uniform principles under which each would render assistance to the other under a fraudulent transfer convention—such as, for example, treating all transfers made within six months before filing as conclusively fraudulent. If the United States is opposed to the Nazi fines, it can then disallow them at the local level by passing a law that prevents the allowance of, for example, all claims based on liability for the content of commercial speech, with the necessary exceptions such as fraud, unfair competition, trademark infringement, or securities liability. Conversely, if France is opposed to punitive damages, it can keep them out of its courts by passing a law that bans the allowance of all extra-compensatory damages.

This modification to the cooperative territoriality proposal offers greater predictability than the LoPucki proposal, which permits for the disallowance of claims on ordinary “public policy” grounds. At first blush, the modification would appear to be labor-intensive: each country would have to come up with a list of claims that it would want disallowed. However, the process is effectively a one-time commitment. Once implemented, the courts’ decision about the allowance of claims becomes as simple as determining whether the claim is expressly prohibited from being allowed. The political branches of the government will thus be charged with determining what, in essence, is a decision of foreign policy. The courts’ decisions will thus be both more predictable and more responsive to political reality.

The second criticism is that the “comity-plus” requirement will simply allow the political branches to block cooperation instead of the courts. In other words, instead of courts refusing to extend comity, it would be the political branches of the government that would prohibit the allowance of claims. The criticism is partially deserved; however, my proposal still allows for far greater cooperation than is possible in the status quo. Typically, it is the political branches that are responsible for a country’s foreign policy. They are thus in the best position to bargain with other countries about the substantive rules governing allowance and disallowance of claims. It will thus be far easier for political branches to permit greater allowance of claims than it is for courts under the current principles of comity. Courts strive to follow precedent and will not declare that public policy has changed overnight. Political branches, on the other hand, are free to fashion foreign policy, bargain for greater allowability of claims, and create domestic laws in accordance with the country’s economic needs.

In sum, my first proposed improvement consists of the following parts. First, I propose a further automation of the claim allowance process. A claim filed in one country would be disallowed only if it either (a) is internationally agreed to be an impermissible claim, or (b) if its allowance is expressly against the domestic law of the country, which is asked to allow it. Otherwise, the claim becomes automatically allowed in all countries in which the debtor’s bankruptcy is pending. Second, I propose an international (if minimalist) system of cooperation on fraudulent conveyances that would deter debtors from transferring assets to countries that disallow claims that are based on the debtors’ actual or potential liabilities.

My second proposal deals with claims where the liability is not disputed but
the amount is. For example, suppose that a United States trustee rejects an
executory contract that the debtor had with the creditor. The contract is deemed
breached and the creditor becomes entitled to money damages, whose priority is
that of a general unsecured creditor. In the United States, the breach is deemed
to have occurred at the time that the petition is filed. But suppose that in Japan
the breach is deemed to have occurred at the time that the trustee chose to reject
the executory contract. Suppose further that, under the applicable provisions of the
Uniform Commercial Code, the creditor is entitled to expectation damages, but
under Japanese law, the creditor is entitled only to reliance damages. Suppose that
as the result, the creditor's claim under the U.S. law is $3 million, while under
Japanese law it is only $2 million. Suppose further that the debtor is a Japanese
company with some U.S. assets and that the creditor is American. Finally, suppose
that Japanese courts have declared that it is a matter of vital public policy to only
allow reliance and not expectation damages in breach of contract cases, taking this
out of the realm of decisions where comity might be extended. LoPucki suggests
that it would be desirable to have the Japanese court enforce the full $3 million, but
that is unlikely, unless the creditor makes a showing in the Japanese court that it is
entitled to the full amount it seeks.

It is of course desirable to have a single court determine the amount of the
claim. But for Japan to allow the United States' courts to channel an extra million
dollars to an American creditor is to accept a decision which violates its vital
public policy, which is counter to its sovereignty, and which it will not do under
the principles of comity. Accordingly, alternative ways must be found to address
the problem.

I propose that the excess $1 million be treated as if it were a separate claim
that is allowed by the U.S. but disallowed by Japan. The burden would be on
Japan to pass a law that would prohibit the allowance of all contract damage claims
in excess of what is recoverable under the reliance measure. The American
creditor would then establish its claim in the United States, obtain a separate
finding on the recoverable amount under the reliance measure, and take that
reduced claim to Japan. The creditor would then have to assert its claim for $1
million in the United States alone.

The above proposal should be viewed in light of the aim of cooperative
territoriality—that no country should be required to apply the substantive law of
another country. I propose that the only exception to this principle should be to
allow the court to conform its judgment to standards that would be acceptable in
the foreign country. Such departures should be kept to an absolute minimum. For
example, domestic courts can easily decide what would be the proper amount of
damages, if the date of breach were later rather than sooner, if the measure of
damages were reliance rather than expectation, or if the award excluded punitive
damages rather than included them. Domestic courts can then decide the issue
based on domestic law, and make separate auxiliary findings that would then be

161. See id.
binding on the foreign court. The sole foreign laws that domestic courts would then have to apply are the foreign laws governing the allowability of foreign claims. Knowing that in advance, all countries can enact such laws in a manner that would be most conducive to easy and predictable interpretation by foreign courts. Moreover, foreign courts of different countries may use each other’s interpretations of such laws as precedent.

Under both of my proposals, one question remains: what priority should be given to the residual amount of the claim that is not allowed in the foreign court? In the first example, if the French government’s claim for fines for Nazi paraphernalia is disallowed by the United States, should France be allowed to give it higher priority in its domestic proceeding? Conversely, should the U.S. creditor be allowed to increase the priority of its claim for $1 million of contract damages that it would not get under the Japanese measure of reliance? My answer to that is that no special priority should be given in domestic proceedings to such claims. In the simple examples that I provided, higher priority may not present an issue. But imagine a proceeding where the debtor files in dozens of countries, some of which allow the claim and some of which do not. How does one set the threshold about the elevation of the claim’s priority domestically? By the number of allowing countries? By their percentage of the total? By the amount or percentage of assets based therein? In any event, the elevation of domestic priority of such claims is likely to cause more problems that it would solve. But if elevated priority is in fact granted (and domestic political pressures may well end up dictating such a result), such priority must be granted based on clear and explicit criteria and numerical thresholds that would allow ex ante predictability of the claim’s fate.

VI. CONCLUSION

Having established a need for a transnational bankruptcy system, we have turned to a brief survey of various regimes in scholarship and practice. We examined the regime that begins to show signs of widespread adoption – the UNCITRAL Model Law – and concluded that, while an improvement over prior law, it does not provide the most efficient resolution to the problem.

We then examined the various theoretical frameworks on which a transnational bankruptcy regime may be based. We looked at classic territoriality, and concluded that it offers a moderately predictable system, and it is fair to local creditors who are allowed to litigate their claims in a local forum. But our praise for the regime was tempered by three strong reservations: that it is too costly, that it provides incentives for harmful strategic behavior, and that it causes inefficient allocation of capital in borrowing and investment decisions. We acknowledged that territoriality is largely the rule in the status quo, but we hesitated to embrace it because of its drawbacks.

We then looked at universality and explored the advantages that make it so appealing to many academics. The idea of a single proceeding in a single country that would dispose of the entire case, without the costly duplication of effort, seemed attractive. Equally attractive seemed the promise of universality to eliminate forum-shopping by debtors (who would be forced to file in their home country) and the elimination of their ability to escape justice by moving assets around. But we were then forced to reject universality because in reality, it would
create more insidious forms of forum-shopping than it would prevent, and collapse into complete unpredictability with respect to the outcomes that it delivers. Moreover, universality cannot adequately deal with a world economy dominated by corporate groups that are compartmentalized by country, and cannot adequately protect the interests of local creditors whose only avenue for protecting their interests in a purely domestic dispute would be to litigate in a foreign forum. Accordingly, universality was not the answer. Neither was corporate-charter universality, a close cousin of classic universality, because while it addressed many of universality's flaws, it could not provide adequate treatment for tort creditors. Further, it was likely to reduce competition in the credit market by imposing disproportionate costs on smaller creditors. We then briefly examined and rejected a solution based on the creation of an international bankruptcy court as practically unworkable.

Finally, we looked at cooperative territoriality. We concluded that cooperative territoriality captured all of the advantages of classic territoriality and reduced many of its drawbacks. We examined the model proposed by Lynn LoPucki and concluded it to be workable with several modifications. Finally, we explored those modifications – specifically a streamlining of the claim allowance process based on a "comity plus" model, a fraudulent transfer agreement, and a two-step process for allowing claims whose amount is disputed – and concluded that, while far from flawless, the modified cooperative territoriality approach was likely to work best for transnational insolvency proceedings.