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Comity and drama: current trends in cross-border insolvencies

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In November 1991, Robert Maxwell – the larger-than-life publishing magnate – mysteriously drowned alongside his yacht. Within months of Maxwell's death, his media empire had collapsed after it became clear that the enterprise was insolvent. But the company faced a major problem: although Maxwell Communications was headquartered in the United Kingdom, the majority of its assets were in the form of stock of subsidiaries in the United States, and the company's management, seeking to remain in control of the insolvency, commenced Chapter 11 proceedings for the group in the US. Fearing personal liability under UK law, the directors then commenced simultaneous insolvency proceedings for the group in the UK. It was unclear which of the two proceedings would control.

The ingenuity and flexibility of the parties and the two courts, and the creative use of the concept of comity – the recognition that one sovereign extends in its territory to the laws and decisions of a foreign sovereign – resulted in a highly pragmatic, though makeshift, solution to the conflicts

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between the two jurisdictions in the case. In a series of decisions, Judge Brozman, the US bankruptcy judge, appointed an examiner to work with the joint administrators in the UK. This cooperation between the examiner and the administrators, and Judge Brozman and Lord Hoffmann, her UK counterpart, led to the establishment of a 'Protocol' in the cases that set forth the parameters of the cooperation, and culminated in a 'Joint Plan of Reorganization' under US law and a 'Scheme of Arrangement' under UK law. Although separate documents, the Plan and the Scheme were consistent with the laws of both countries and created a single pool of assets from which creditors in the US and the UK each looked to for satisfaction of their claims. The courts also exhibited extraordinary judicial restraint when the UK administrators sought to utilise US preference law with respect to a transaction in which the UK had a greater interest, and the US courts, applying comity, deferred to UK law.

The *Maxwell* cases set off a trend that presaged an international embrace of cross-border cooperation and the application of concepts of comity in insolvency cases. In the years following the resolution of the case, a series of judicial colloquia took place,

ultimately leading to the Model Law on cross-border insolvency promulgated by the United Nations Commission on International Trade Law in 1997, and since that time there has been a proliferation of new laws patterned on the Model Law. One of these is Chapter 15 of the US Bankruptcy Code, adopted in 2005, which governs ancillary proceedings in the US.

Supporters of cross-border regimes like the Model Law believe in the doctrine of 'universalism' – that the use of a single set of rules to govern comports with the idea of 'market symmetry', or that, since markets extend across borders, the same legal rules should apply in a consistent manner from one jurisdiction to the next. Consistent legal rules, the universalists argue, make the resolution of cross-border insolvencies more efficient and more predictable.

On the other side of the discussion are 'territorialists', who dispute the feasibility and benefit of a unified approach. Territorialists question whether a local creditor would truly expect foreign bankruptcy rules to apply to its debtor counterparty and whether, in the case of a complex cross-border enterprise, it is even possible for third parties to reliably predict the jurisdiction whose law

would purportedly be applied. Moreover, they suggest that, even if parties' expectations could be known and even if a single 'home' jurisdiction could be clearly identified, debtors would simply 'forum shop' to assure application of a particular jurisdiction's rules.

As the number of cross-border insolvencies has grown in recent years, the debate between the universalists and the territorialists has become more pressing, and despite the flurry of apparent universalist sentiment around the world (20 jurisdictions now have regimes based on the Model Law), insolvency policy differs materially from jurisdiction to jurisdiction, and courts continue to struggle with the idea of allowing local insolvency principles and procedures to be overridden by a foreign jurisdiction's law. Moreover, while facially universalist laws based on the Model Law, such as Chapter 15, call for comity as the general rule, they allow for the application of local law where there is a strong local interest in applying it, which results in the principles of comity being periodically overruled by local concerns in sometimes inconsistent and unpredictable ways. Because of this so-called 'modified universalist' approach, several recent decisions in



the US and other jurisdictions appear to throw *Maxwell's* universalist legacy into some doubt, while others appear to affirm that comity and universalism continue to remain robust principles.

Elpida Memory, Inc., a Japanese technology manufacturer, filed a reorganisation proceeding in Japan in February 2012. Soon thereafter, the company sought recognition of that proceeding under Chapter 15 in the Delaware Bankruptcy Court. Elpida's foreign representative requested approval to sell or licence certain patents located in the US pursuant to the company's Japanese bankruptcy plan. Although the Tokyo District Court had already approved the transaction, the US Bankruptcy Court held the deal had to be postponed while the company presented evidence to satisfy the requirements of the 'business judgment' standard under US law. "Comity," the court noted, "is not the end all be all of the statute."

Less than two months after the *Elpida* decision, a New York bankruptcy judge analysed a similar set of facts in *Fairfield Sentry*. *Fairfield Sentry* was a British Virgin Islands registered feeder fund that suffered huge losses as a result of the Madoff Ponzi scheme. In July 2009, a court in the British Virgin Islands had granted an order

to wind up *Fairfield Sentry*, an order which required the sale of its assets. In contrast to the *Elpida* court, the US judge in *Fairfield Sentry* stressed the importance of comity to a cross-border insolvency regime, and declined to review the sale.

Elpida and *Fairfield Sentry* appear to be somewhat at odds philosophically, even if the results are not contradictory. After all, following the presentation of evidence, the *Elpida* court approved all the transactions that implicated Elpida's US assets and eventually did grant comity to Elpida's Japanese plan of reorganisation. The apparent difference in approach between the Delaware and New York courts may have been based more on circumstances than on a philosophical difference between the judges.

Still, a very recent decision by the Second Circuit Court of Appeals has cast doubt on the ability of Chapter 15 to carry out its universalist objectives. In December 2013, that Court held in *Drawbridge v. Barnett* that an Australian debtor could not have its foreign proceeding recognised under Chapter 15, and thereby gain access to the US court system to pursue claims in the US, because it did not have any assets in the US. Although the Model Law does not require a party to have assets

in the jurisdiction in which he seeks relief, the court in *Drawbridge* held that Section 109 of the Bankruptcy Code (which requires that a party own property in the US to be eligible to be a debtor) does impose such a requirement on a foreign entity seeking relief in the US. US courts have been willing to grant Chapter 15 recognition to debtors with only nominal assets in the US, but, in *Drawbridge*, the court felt constrained by the plain text of Section 109. Nevertheless, perhaps in acknowledgement of the effect that the decision would have on the goal of universalism, the Second Circuit took the unusual step of instructing the clerk of the Court to forward a copy of the decision to Congress. In addition, in a recent case in another circuit, a bankruptcy court has strongly disagreed with the Second Circuit's conclusion.

The US is not the only jurisdiction that is grappling with the appropriate role of comity in multinational insolvencies. For many years, it seemed universalism was firmly established under English law. A recent testament to this trend was the *Cambridge Gas* case, in which a court held that a UK bankruptcy court need not be bound by the stringent jurisdictional rules that can interfere with comity in an



ordinary civil case under English law. However, in *Rubin*, a 2012 decision by the Supreme Court of the United Kingdom, the holding of *Cambridge Gas* was expressly rejected. *Rubin* held that certain foreign insolvency orders – those imposing monetary liability on a UK resident – are to be treated the same as all other foreign civil orders; that is, subject to the requirement that personal jurisdiction exists over the liable party. Nearly 20 years after *Maxwell*, the UK high court has seemingly retreated somewhat from its wholehearted embrace of the principles of comity as applied in

insolvency cases.

Elsewhere in the world, universalist principles are taking a firmer hold. Canada has generally been willing to grant comity to US bankruptcy proceedings, and recent cases, such as the *Lightsquared* case and the *Hartford Computer* case, suggest that this trend continues unabated. Recent decisions in Singapore, Hong Kong, and South Africa all reveal a broadening enthusiasm for universalist ideas among a growing coalition of nations which recognise the importance of advancing objectives of international cooperation and a unified distribution

of assets.

The role of comity in a cross-border insolvency proceeding remains unsettled in many jurisdictions, including in the US. In the US, decisions continue to surprise despite Chapter 15's promise of 'greater legal certainty'. Meanwhile, while some non-US jurisdictions appear increasingly committed to universalism, in others the results are less predictable. Though universalism continues to be the prevailing trend in cross-border insolvency, it no longer seems quite as consistently 'universal' as it was once hoped to be. ■