

THE CROSS-BORDER INSOLVENCY OF INTERNATIONAL BANKS

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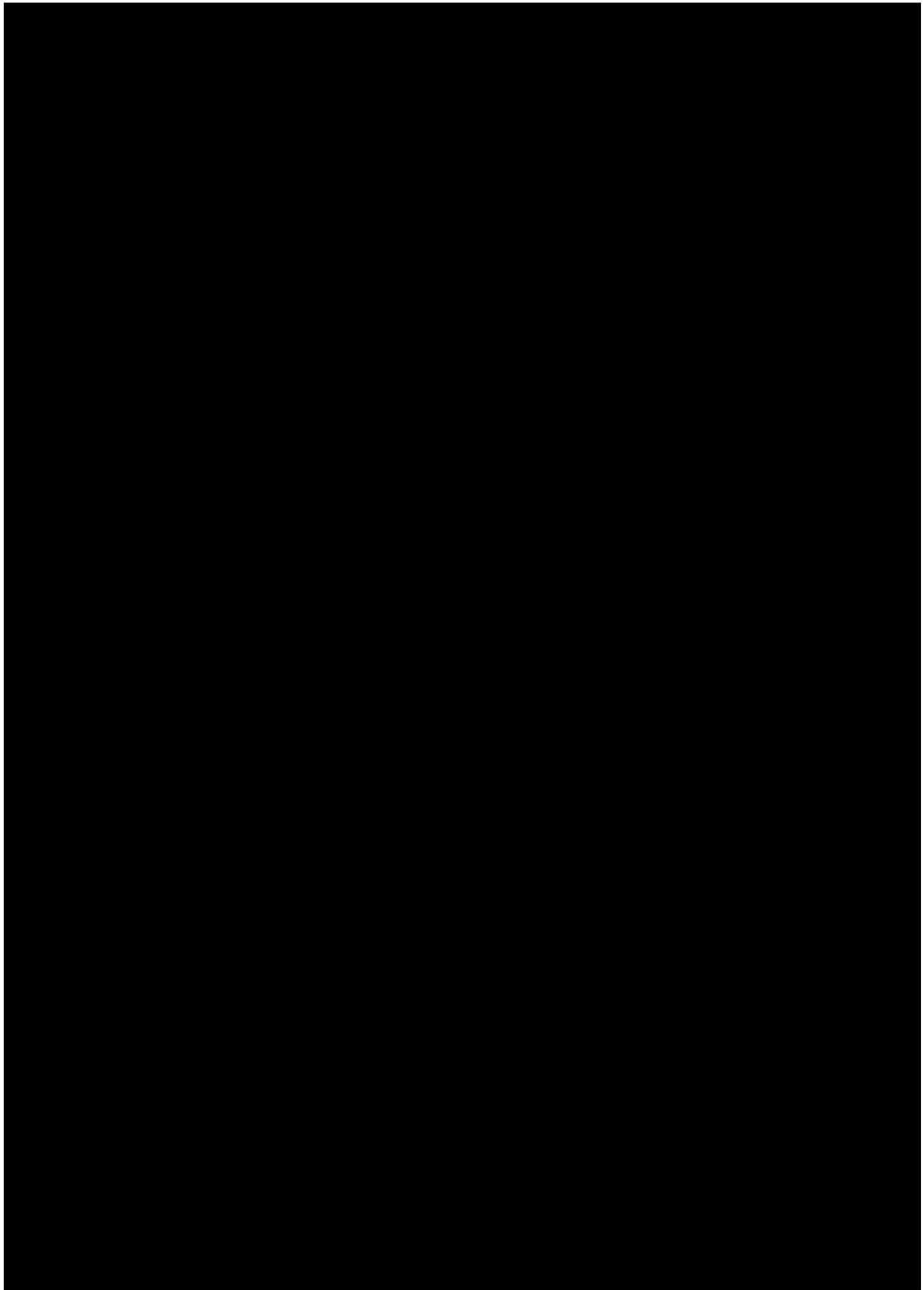


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ABSTRACT

The cross-border insolvency of international banks is magnified by the unresolved multi-jurisdictional cross-border conflicts that ensue between jurisdictions. The recent global financial crisis has shown that the big insolvency cases produce adverse consequences worldwide because of significant and complex legal issues.

The current international regime for insolvency law is based on the presumption that it is dealing with a single company with operations in various parts of the world. In reality, this rarely happens. At present, one of the most significant legal issues is the centre of the debtor's main interests (COMI) of international banks in cross-border insolvency proceedings. International banks can have a multitude of legal entities, branches and subsidiaries that cross the globe. The interdependency of the entities of the group, the different degrees of intensity that may exist from one group to another, and the domination of one or more entities over others exemplifies the complexities of defining the COMI of the group.

As there is no statutory definition of COMI, the concept has been considered to be a vague and practically meaningless standard which different states have defined differently. The COMI of an international bank in cross-border insolvency determines which court has jurisdiction to open the main insolvency proceedings and, consequently, the law that is applicable to such proceedings. When the complexities of resolving cross-border bank insolvencies increase, the difficulty of determining the COMI is exacerbated. The ambiguity in national legal regimes over the determination of COMI has created conflicts between jurisdictions.

The issue of COMI is being addressed in national legal frameworks, specifically the two international insolvency regimes: the EU Insolvency Regulation and the UNCITRAL Model Law on Cross-Border Insolvency. The current reform of the EU Insolvency Regulation concerning the legal issue of COMI has also timely coincided with this research study. However, both regimes exclude international banks from their scope. In international bank insolvency, one significant problem of the EU Insolvency Regulation's Article 3(1) implies that the concept of COMI can be implemented only with the universality principle whereby

one court is competent to open a single set of insolvency proceedings, leading to a worldwide insolvency proceeding. The misguided belief that a specific COMI can be determined for each individual firm utilizing the single-entity approach can create adverse consequences when an international bank becomes insolvent. Moreover, the EU Insolvency Regulation does not address the COMI of group subsidiaries despite the significance of this issue. Several landmark European cases have focused on the COMI of group subsidiaries. The UNCITRAL Model Law on Cross-border Insolvency also refers to the possibility of excluding from its scope of application certain entities such as banks that are specially regulated with regard to insolvency under the laws of the enacting State. The COMI of a corporate group is developing, and arguably, the progress can assist in addressing the COMI of an international bank.

The flexibility afforded by the Model Law for domestic regimes to adopt a special provision concerning banks is a two-edged sword. The national sovereignty inherent in domestic regimes and the lack of international cooperation in respect of COMI may be detrimental to certain creditors.

Although many research studies have explored the financial and economic implications of the cross-border insolvency of international banks, no prior research studies have been conducted from an international insolvency law perspective that addresses their cross-border jurisdictional conflicts, COMI, and its related legal issues. Most of the research studies focus on the resolution of international bank insolvency but according to this research, none of them has adopted a wholistic analysis to include the multi-jurisdictional legal conflicts of international bank insolvency that has been characterized by a strong cross-border dimension. In such cases, a deeper layer of conflict further complicates an already complex situation where the insolvent entity may have establishments and assets, as well as creditors and debtors in many countries that may have conflicting laws. As a consequence, a different view is required for a research study that investigates and analyses this problem, and which affords possible solutions to resolve these conflicts in international bank insolvency.

Recent world events have shown that economic instability and uncertainty can lead to economic stagnation among domestic states. The recent European banking crises (the Eurozone crisis) and the economic repercussions of the 2008 global financial crisis have highlighted the expediency and significance of international bank insolvency and the

aftermath of jurisdictional conflicts concerning COMI and its related legal issues that have not been adequately addressed. The obstacles to international cooperation and the forsaking of national sovereignty when it overrides international objectives are the keys to resolving these multi-jurisdictional conflicts. These factors have impeded prior attempts to hold an international convention on cross-border insolvency. Only when a compromise can be reached between the ideal and the reality, can a solution be possible to resolve the multi-jurisdictional conflicts inherent in international bank insolvency and in the world.

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CHAPTER 1: INTRODUCTION

Chapter Overview

In 2008, the collapse of numerous large complex financial institutions in national regimes was a significant factor in the global financial crisis. The recent collapses of these international banks¹ and attempts to find solutions to prevent these collapses, arguably occurred too late.

In 2002, the G10 Contact Group on the legal and institutional underpinnings of the international financial system examined the resolution of internationally active banks and acknowledged the importance of the cross-border dimensions of their multi-jurisdictional activities.² The Report's Appendix A: Cross-border Aspects of Insolvency stated that one aspect of the cross-border dimension is:

The functioning of existing insolvency regimes in international cases and the treatment of various cross-border issues that may arise in such insolvency proceedings.³

¹ For the purpose of this thesis, the common definition of bank as a 'credit institution' is accepted with no distinction between the functions of banks. The Organisation for Economic Co-operation and Development (OECD) and the European Union's First Council Directive of 12 December 1977 defines a 'credit institution' as an "undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account." See European Union First Council Directive 77/780/EEC of 12 December 1977 on the co-ordination of the laws, regulations, and administrative provisions relating to the taking up and pursuit of the business of credit institutions; European Union First Council Directive 77/780/EEC of 12 December 1977, First Banking Directive, Article 1; Organisation for Economic Co-operation and Development (OECD), Glossary of Statistical Terms. <<http://stats.oecd.org/glossary/index.htm>> at March 8, 2010. The definition of 'cross-border bank' should 'include any bank which either is active itself in multiple jurisdictions or is part of a group and through its various group members, is active in multiple jurisdictions.' Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border Bank Group, March 2010, 3. Indeed, the characteristic functions of banks include being the primary source of direct and standby credit, and to provide the liquidity which is necessary to operate an efficient economy, and connect government fiscal policy with the banking system. The role of banks is unique as only banks can perform all of these functions.¹ See Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border Bank Group, March 2010, 8. The interrelationship between these characteristics distinguishes banks from all other financial institutions. See E. Gerald Corrigan, 'Are Banks Special?', *Federal Reserve Bank of Minneapolis:1982 Annual Report Essay* viewed at <<http://www.minneapolisfed.org/pubs/ar/ar1982>a.cfm>> on January 28, 2011.

² Bank of International Settlements, Report of the Contact Group on the Legal and Institutional Underpinnings of the International Financial System, Appendix A: Cross-border Aspects of Insolvency, *Insolvency Arrangements and Contract Enforceability*, Appendix A: Cross-border Aspects of Insolvency, (December, 2002), A1.

³ *Ibid*, A5.

Although more than a decade has passed since this report, the cross-border conflicts that arise when international banks collapse, still remain the same. The purpose of this study is to investigate the critical issues prevalent in the cross-border conflicts between jurisdictions when an international bank becomes insolvent, and subsequently, to discover possible solutions at this most critical time when the world is still experiencing economic problems and instability.

The introductory chapter is structured as follows:

The introduction explains the background of and justifications for the research.

The second section discusses the objectives of the research and includes the major question to be addressed in this study: What are the critical issues that need to be addressed in the cross-border insolvency of international banks?

The third section discusses the significance of the research study in consideration of the 2008 global financial crisis.

The fourth section examines the theoretical framework that structures the research study.

The fifth section lists the research methodology which includes legal and international insolvency law literature, and their methodologies.

The sixth section discusses the limitations of the research.

1.Introduction

The purpose of this thesis is to find the most appropriate understanding possibly leading to a solution in respect of the conflicts between national legal systems in international bank insolvencies and specifically, in respect of COMI (the centre of the debtor's main interests). The insolvency of large, complex financial institutions (LCFIs) amongst other issues is complicated by the problem of deciding the home country⁴- the centre of the debtor's main interests. This has been considered to be a vague standard which has remained elusive in its interpretation and meaning; hence, it has been given different interpretations by states.

The European Union Insolvency Regulation⁵ and the UNCITRAL Model Law on Cross-border Insolvency,⁶ for example, have not provided a clear and precise definition. This has created uncertainty and given rise to disputes between parties over the legitimacy of proceedings in a specific jurisdiction.⁷ This definitional deficit has added to the confusion in international insolvency processes, legal regimes, and insolvency law. The COMI of a multinational bank in a cross-border insolvency situation determines which court has jurisdiction to open the main insolvency proceedings and, consequently, the law applicable to govern such proceedings.⁸ When the complexities of resolving cross-border bank insolvencies increase, the difficulty of determining the COMI is exacerbated. The ambiguity in national legal regimes over the determination of COMI has created conflicts between jurisdictions.

International bank insolvencies are distinguished from a number of other multinational corporate insolvencies in that 'legal and regulatory systems are unprepared to deal with the consequences of such failures'.⁹

⁴ See Irit Mevorach, 'The Home Country of a Multinational Enterprise Group Facing Insolvency', 57(2) (2008) *International and Comparative Law Quarterly* 427 where she states that 'There is no ready made home country concept of a multinational enterprise group. Cross-border insolvency models have not provided an answer for the question of jurisdiction in cases of international corporate groups.'

⁵ *European Union Insolvency Regulation, No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002) [hereinafter Insolvency Regulation].

⁶ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997).

⁷ Ian Fletcher, 'Maintaining the Momentum: The Continuing Quest for Global Standards and Principles to Govern Cross-Border Insolvency' (2007) 32 *Brooklyn Journal of International Law* 767, 781.

⁸ Michel Menjuq & Reinhard Dammann, 'Regulation 1346/2000 on Insolvency Proceedings: Facing the Companies Group Phenomenon', (2008) 9(2) *Business Law International* 145.

⁹ Douglas W. Arner & Joseph J. Norton, 'Building a Framework to Address Failure of Complex Global Financial Institutions' (2009) 39 (1) *Hong Kong Law Journal* 95.

‘In the past few decades the world has experienced a number of banking crises which have heightened the awareness and understanding of the causes, problems and potential risks and costs connected with the insolvency of banks and other financial institutions. However, many of the recent insolvencies of financial institutions have also been characterised by a strong cross-border dimension. In such international insolvency cases, where the insolvent entity may have establishments and assets, as well as creditors and debtors, in many countries, a further layer of complexity is already added to a complex situation.’¹⁰

‘The paradigmatic problem of transnational operators confronting multiple national laws and its solution of a single uniform law is ageless’.¹¹ It is ageless and has not yet been resolved because, although banking markets have expanded internationally, regulation has remained largely the domain of domestic jurisdictions.¹² Furthermore, because ‘insolvency laws differ greatly from country to country’¹³, this compounds the challenge to resolve the conflicts arising from them expediently.¹⁴ The failure of LCFIs, and the lack of international and domestic mechanisms to address these¹⁵ insolvencies, has resulted in systemic failures and economic collapse.¹⁶

There are also conflicts between national legal systems in the resolution of a cross-border bank issue when national sovereignty overrides international cooperation. In 2009, the International Monetary Fund (IMF) proposed a framework for the resolution of cross-border banks to the G20. The proposal stated that, most importantly, when regulators are faced with the insolvency of a multinational bank that is within their own jurisdiction, they tend to favour creditors of branches or subsidiaries located within their own jurisdiction.¹⁷ Since many systemically important banks operate globally, an uncoordinated application of

¹⁰ Ibid, A5.

¹¹ Ibid.

¹² Rosa M. Lastra, ‘Cross-Border Bank Insolvency: Legal Implications in the Case of Banks Operating in Different Jurisdictions in Latin America’ (2003) (March) *Journal of International Economic Law* 79, 80.

¹³ Ibid, 81.

¹⁴ Ibid, 81.

¹⁵ Arner & Norton, above n9, 100.

¹⁶ Ibid. See also Financial Crisis Inquiry Commission Report, United States of America, *Final Report of the Commission on the Causes of the Financial and Economic Crisis in the United States*, Official Government Edition (January 2011), 52, David Darrell Evanoff & George G. Kaufmann (eds), *Systemic Financial Crises: Resolving Large Bank Insolvencies*, (World Scientific Publishing Co. Pty Ltd, 2005), 35 Rosa M. Lastra, *Central Banking and Banking Regulation* (London School of Economics and Political Science (September 1, 1996) 1996), 82-84 which describes bank runs.

¹⁷ Ibid.

resolution systems will make it very difficult to limit contagion and place the financial burden of bank resolutions on shareholders and creditors.¹⁸ In addition, the legal frameworks of many jurisdictions fail to sufficiently facilitate coordination of actions in respect of an insolvent bank. In the context of an international bank, the overlapping responsibilities of various national supervisory authorities, and difficulties in discerning these responsibilities, are magnified.¹⁹

The implications of a cross-border insolvency framework for an international bank are also influenced by the legal and regulatory difficulties of conflicting jurisdictional approaches and national systems of specific banking laws.²⁰ Furthermore, within the national systems of law, principles and rules from private international law have been expanded to include multilateral schemes for resolving cross-border insolvency problems. In practice, private international law has created many of the choice of law problems²¹ concerning jurisdictional issues such as resolving the multi-jurisdictional conflicts in international bank insolvencies and in respect of COMI.

The divergent approach between jurisdictions has resulted in restrictive regulation²² that may adversely affect the development of an international legal framework for bank insolvencies and create uncertainty in determining COMI. The recent international financial crisis illustrated the complex problems and regulatory difficulties that are faced by banks operating in different jurisdictions. Ackerman argues that internationally integrated markets intensify links between jurisdictions that infiltrate and cross many borders. This is exemplified by the fact that half of the foreign assets held by US investors originate in Europe, and the share of EU investments in US equity is almost 40 percent.²³ The impact of this integration is that both the EU and US jurisdictions are impacted upon when these investments collapse. There is also the discrepancy between the globalisation of financial operations and the lack of global approaches to deal with the insolvency of international banks. To date, attempts to

¹⁸ International Monetary Fund Legal and Monetary and Capital Markets Departments, *'Resolution of Cross-border Banks – A Proposed Framework for Enhanced Coordination'*, International Monetary Fund, June 11 2010, 3.

¹⁹ Ibid.

²⁰ George G. Kaufmann (ed.), *Market Discipline in Banking: Theory and Evidence* (Elsevier Limited, 2003), 101.

²¹ Michael J. Whincorp & Mary Keyes, *Policy and Pragmatism in the Conflict of Laws* (Dartmouth Publishing Ltd, 2001), 188

²² Ibid.

²³ Josef Akerman, 'The Global Financial System and the Challenges Ahead', 35 (2011) *Fletcher Forum of World Affairs* 127, 129.

address the legal issues, such as the determination of COMI arising in multinational bank failures, have not been as successful as anticipated.

1.4 The Objectives of the Research

This major issues of this research arise from and involve international insolvency law. The cross-border conflicts of international bank insolvency arise from the difficulty of applying traditional doctrines of international insolvency law to deal adequately with jurisdictional conflicts prevalent in these cases. As this thesis focuses specifically on jurisdictional conflicts concerning COMI and its related legal issues, the effects of banking and diverse national banking regulations in the resolution of international banks are beyond the scope of the research. The resolution of international bank insolvency is alluded to in Chapter 2, Part 2 to provide the context for the Icelandic banking crisis. Political and economic influences are alluded to for further clarification, but are not the major focus of the issues examined that involve issues of international insolvency law.

International insolvency regimes and the law on which they are based continue to show significant weaknesses because jurisdictional conflicts continue to occur. The regimes of the EU Insolvency Regulation and the Model Law adopt a single-entity approach but lack rules for corporate groups,²⁴ which is impractical in a multijurisdictional insolvency. Furthermore, these regimes include provisions that allow the exclusion of cross-border aspects of international banks.²⁵ The concept of COMI is of significance as courts use the concept to determine the jurisdiction which opens main insolvency proceedings, and hence, the governing law applicable to such proceedings.²⁶ The concept of COMI is also used to determine the COMI of a multinational group which has been used in international bank insolvency cases such as *Stanford Bank*. This is further discussed in chapter 6.

Conflicts between national legal systems also indicate that there is a real need to resolve conflicts between national insolvency regimes. The study of creditors' rights across national

²⁴ Irit Mevorach, 'On the Road to Universalism: A Comparative and Empirical Study of the UNCITRAL Model Law on Cross-border Insolvency', (2011) 12(4) *European Business Organisation Law Review* 517.

²⁵ See specifically Article 1(2) in the Australian version of the Model law which is duplicated in countries such as Britain and United States of America.

²⁶ Menjucq & Dammann, above n8, 145.

legal systems has shown that there are powerful forces for convergence²⁷ driven by the globalization of markets and the growth of transnational companies which operate on a global level across jurisdictional boundaries. This lends itself to further analysis using methodology from legal literature, as well as international insolvency law, and international economic law literature. The debates over legal doctrine and policy present a significant opportunity to reconsider the policies underlying the insolvency of international banks in national legal systems and the jurisdictional conflicts that arise.

Therefore, this thesis will examine and evaluate the application of the EU Insolvency Regulation and the UNCITRAL (United Nations Commission on International Trade Law) Model Law on Cross-border Insolvency,²⁸ and the international harmonization of insolvency law in particular, based on the principle of COMI and related legal issues.

The thesis aims to do so by focusing on international insolvency regimes and the national treatment of international banks in cross-border insolvency which has not previously been examined.

The major question to be addressed in this study is: what are the critical issues that need to be addressed in the cross-border insolvency of international banks?

The aims of this thesis are:-

- i. To examine the conflicts between jurisdictions arising from international bank insolvencies including that of COMI and distributional outcomes;
- ii. To examine the weaknesses in the EU Insolvency Regulation and the Model Law concerning international bank insolvencies and COMI;
- iii. To clarify whether these problems can be addressed in an international convention.

²⁷ Lawrence M Friedman, 'On the Emerging Sociology of Transnational Law' (1996) 32 *Stanford Journal of International Law* 65, 76.

²⁸ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997).

1.5 The Significance of the Research

The significance of this study is that, in examining the critical issues of international insolvency regimes and law, it provides a theoretical insight that will instigate a move to find potential solutions that are much needed to resolve the cross-border conflicts arising from the insolvency of international banks. There have been an increasing number of cross-border insolvencies but national legal systems have not developed adequate rules to resolve these.²⁹ The significance of the research lies in the fact that a systematic study of the legal literature and international jurisprudence attempts to highlight issues in the resolution of international insolvency regimes as these legal frameworks do not address, in particular, the cross-border insolvency of international banks. For example, the EU legal framework does not address the subsidiaries of large, complex financial institutions which can potentially create new jurisdictional conflicts concerning COMI. This impacts on the home and host country jurisdictions of the international bank, and the distributional outcomes to creditors. As indicated, the international initiatives are the European Union Insolvency Convention 1995 and the successor text to this Convention, Council Regulation 1346/2000 of May 29, 2000, as well as the UNCITRAL Model Law on Cross-Border Insolvency.³⁰ These are the two main international insolvency regimes in cross-border insolvency that use the concept of COMI in their frameworks. In international bank insolvency cases which apply the concept of COMI, either one of these regimes would be used to assist courts to determine the governing jurisdiction of the insolvency proceeding. The concept of COMI is, arguably, the single most important precept of the Model Law and its operation³¹, and in the EU Insolvency Regulation, the concept of COMI is the focal point of the economic life of the debtor and as a connecting factor, has acquired international recognition to a certain degree.³² This is an important issue for it is certain that where a COMI is located ‘will allow insolvency risks and the availability of restructuring procedures to be assessed with greater clarity by lenders and

²⁹ Paul J Omar, ‘Jurisdictional Criteria and Paradigms in International Insolvency Texts,’ (2004) 12 *Insolvency Law Journal*, 7, 8.

³⁰ Paul Omar, ‘Cross-border Insolvency: A Commentary on the UNCITRAL Model Law’, (2007) 18(2) *International Commercial and Company Law Review* 70.

³¹ Scott A. Atkins, ‘COMI Confusion: The Imperative for Model Law Clarification’, *INSOL World*, Fourth Quarter 2012, viewed at <http://www.insol.org/files/newinsolworld/Fellows%20Articles/2012/Fellow%20Article%20-%20COMI%20Confusion.%20Scott%20Atkins.pdf> on July 31, 2013.

³² Francisco Garcimartin, ‘The EU Insolvency Regulation: Rules on Jurisdiction’ viewed at http://www.ejtn.net/PageFiles/6333/Rules_on_jurisdiction.pdf on August 8th, 2013.

companies alike.’³³ The deeper layer of complexity in cross-border bank insolvency has also been influenced by globalisation.

Internationally, cross-border banks have led the way in globalization, operating in sometimes hundreds of countries through hundreds of different legal entities.³⁴ The divergence in the tests to determine COMI that have been applied by different courts creates significant challenges for future international bank insolvency cases, particularly those with operations across jurisdictions with conflicting laws. For example, Sarra notes that:

... recognition of a group COMI could be an inappropriate extension of domestic law in one jurisdiction and could prejudice creditors in those jurisdictions where priorities or preferences differ or where there are statutory protections under the jurisdictions in which the subsidiaries are located.³⁵

Although financial and economic studies have been conducted addressing the cross-border insolvency of banking groups, a study concerning these very difficult and complex critical issues has not previously been conducted in depth in the legal field with a view to finding a potential solution. Even though the 2008 financial crisis magnified the conflicts that ensued from the collapse of international banks such as *Lehman Brothers* and *Bear Stearns*, the cross-border aspect of their insolvency remains unchanged in the event of a future similar occurrence.

The economic implications of a revision and reform of international insolvency regimes are that there is the potential to change the outcomes of future international bank insolvencies, resulting in greater stability, certainty, economic efficiency and a more just and fair outcome to creditors worldwide.

The increasing global operation of companies and the international effect of their insolvencies require new models and perspectives. This has already led to some convergence

³³ Ian Jack & Louise Webb, ‘Baker & McKenzie: Where is the COMI?’, viewed at <<http://www.bakermckenzie.com/RRGoverningDeterminingCOMIJul09/>> on July 29, 2013.

³⁴ Kaufmann, above n20, 100.

³⁵ Janis Sarra, ‘Oversight and Financing of Cross-border Business Enterprise Group Insolvency Proceedings’, 44 (2008-2009) *Texas International Law Journal* 547, 561.

in national law driven by UNCITRAL and the World Bank.³⁶ However, the one-size-fits-all approach of these uniform law models has been widely criticized and has created new problems in international and national insolvency regimes.³⁷ Scholars have drawn attention to the importance of creditors' rights 'in influencing the development of financial systems and in affecting firm corporate governance and financing patterns.'³⁸ This has been recognized by the World Bank Principles for Effective Insolvency and Creditor Rights Systems (Revised) 2005 which are intended to be a distillation of international best practice and consistent with the UNCITRAL Legislative Guide on Insolvency Law. The latter builds on World Bank and INSOL (International Association of Restructuring, Insolvency and Bankruptcy Professionals) efforts to promulgate a legislative guide on best practice in national bankruptcy laws. Underlying the Principles is the proposition that 'legal and institutional mechanisms must align incentives and disincentives across a broad spectrum of market-based systems - commercial, corporate, financial, and social.'³⁹ They have been designed as a benchmark for national systems.⁴⁰ In practice, these goals are proving almost impossible to achieve⁴¹ because of conflicting national laws and differing public policy choices underlying them. This research study examines the conflicts that arise from national laws and proposes potential solutions as to how they could be resolved.

1.3 The Theoretical Framework

The theoretical framework for this study is drawn from the legal literature. The literature has been reviewed from two perspectives. The first is legal doctrine and policy. The second perspective draws on international insolvency law. The literature acknowledges the importance of the UNCITRAL Model Law as a source of 'reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the existing

³⁶ World Bank, *Creditor Rights and Insolvency Standard based on World Bank Principles for Effective Creditor Rights and Insolvency Systems and UNCITRAL Legislative Guide on Insolvency Law*, Revised Draft (December 2005).

³⁷ Kent Anderson, 'Testing the Model Soft Law Approach to International Harmonisation: A Case Study Examining the UNCITRAL Model Law on Cross-Border Insolvency,' (2004) 23 *Australian Year Book of International Law* 1, 7.

³⁸ Stijn Claessens & Leora F Klapper, 'Bankruptcy around the World: Explanations of Its Relative Use,' (2005) 7 *American Law and Economics Review* 253, 254.

³⁹ World Bank, *The World Bank Legal Review: Law and Justice for Development*, Volume 1, (The International Bank for Reconstruction and Development/World Bank, 2003), p629.

⁴⁰ *Ibid*, 1.

⁴¹ Anderson, above n37, 7.

adequacy of existing laws and regulations.’⁴² The literature also accepts that reconciling international insolvency regimes between national legal systems is a key objective of insolvency law. The doctrinal approach indicates that the existence of institutional differences in the overall legal system of the country may impact on formal insolvency law and could explain some of the disparities between insolvency laws and also predetermine the approaches taken in particular jurisdictions.⁴³ The international insolvency law literature also recognizes the significant role of the judiciary, administrative structures and dominant actors in regards to how local and foreign interests are administered, the rules of priority and distribution schemes, how creditors’ rights are addressed, as well as legal culture.⁴⁴

This study will focus on the conflicts between jurisdictions and traditions that have shown that there are substantial variations between them which make it difficult to avoid cross-border conflict.⁴⁵ This requires greater consideration if insolvency regimes are to be more equitable and efficient. The literature suggests that comparative analysis is crucial in the further evolution of international cooperation in insolvency.⁴⁶ The study includes a comparative study of the EU Insolvency Regulation and the Model Law specifically, in relation to COMI and its related legal issues.

However, there have been major criticisms of the Model Law including its failure to provide for corporate groups.⁴⁷ An international bank, as a financial group, can be classified as a corporate group. The Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency,⁴⁸ only attempts to provide for this deficiency. Other initiatives aiming to establish cross-border insolvency frameworks also lack explicit

⁴² United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004).

⁴³ Bob Wessels, *International Insolvency Law* (Kluwer, 2nd ed, 2006), 221.

⁴⁴ Eleanor M Fox, ‘The Politics of Law and Economics in Judicial Decision Making: Antitrust as a Window,’ (1986) 61 *New York University Law Review* 554.

⁴⁵ John Townsend, ‘International Cooperation in Cross-border Insolvency: HIH Insurance’, 92(2008) 71(5) *Modern Law Review* 801, 818.

⁴⁶ *Ibid.*

⁴⁷ UNCITRAL-INSOL International, Fourth Multinational Judicial Colloquium: Evaluation Session 16-17 with the Sixth World Congress of INSOL International, *Report on the 4th UNCITRAL-INSOL Judicial Colloquium on Cross-Border Insolvency Evaluation Session*, UN Doc. No.A/CN.9/518 (2001).

⁴⁸ United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004).

consideration of corporate groups⁴⁹ and in deciding to what extent, and in which ways, the entities in a group should be linked during insolvency.⁵⁰

International and domestic law addressing the treatment of international banks and the cross-border aspects of their insolvency is generally underdeveloped. In considering these critical issues, this project assumes that insolvency law should operate in accordance with the international insolvency goals of decreasing the inequity of imperfect markets, to help save productive ventures and to provide for the orderly and equitable liquidation of failing and unproductive firms.⁵¹ The failure to develop consistent international principles relating to international banks, the lack of standardised and consistent international rules, and the lack of an international insolvency regime that addresses the cross-border aspects of international bank insolvency limits the harmonisation between national laws and practices on insolvency, and the centralization of insolvency proceedings that can mitigate the jurisdictional conflicts.

1.4 The Conceptual Nature of the Thesis

The conceptual nature of the thesis concerns the problem of international insolvency law to resolve the cross-border jurisdictional conflicts arising from international bank insolvencies. In international bank insolvency, the principle of territorial sovereignty of states can be overridden by government interest in the assets and liabilities of the international bank. While ‘national governments are the principal regulators of international finance and the formulators of international policies,’⁵² nationalistic self-interest can cause major difficulties when an attempt is made to find just and uniform solutions to a conflict of laws.⁵³ In international bank insolvencies, this limitation is also influenced by the political function of courts in determining the jurisdiction to commence the insolvency proceedings. The approach that regards state interests as relevant to private international law will tend to analyse the banking group in terms of general jurisdiction.

⁴⁹ Ibid.

⁵⁰ Mevorach, above n4, 429.

⁵¹ Ibid.

⁵² Andrew T. Guzman & Alan O. Skyes (ed.), *Research Handbook in International Economic Law* (Edward Elgar Publishing Ltd, 2007), 363.

⁵³ *Dicey, Morris, and Collins on the Conflict of Laws*, under the general editorship of Lord Collins of Mapesbury with specialist editors, (Sweet & Maxwell, 2012), 4.

This approach will examine the relationship between the state and the banking group, and ask whether the exercise of jurisdiction over the group can be justified in terms of state policy or political rights. This approach does not consider the complexity, conflicts and difficulties prevalent in international bank insolvencies or their complex legal structures which may be formed to evade state policy.⁵⁴ It may be argued that the recent large, international bank insolvencies demonstrated that a transnational approach to private international law is needed that is less conceptual, more economically efficient, more predictable, and more unified.

It is therefore argued that the resolution of the cross-border conflicts of international banks needs to be addressed in international law because political functions and economic factors will influence the parameters of the solutions. In corporate law, the complicated group structures may be used by international banks to avoid regulation and to conceal the true financial position of the company.⁵⁵ When some of the affiliated companies are in different jurisdictions, these problems are exacerbated. Furthermore, the failure of one entity within a corporate group may damage or cause further damage to related entities.⁵⁶ In corporate law, the integrated economic enterprise pertains to one of the main abuses of the group relationship. The creation of separate companies for particular operations which exceeds the normal pattern of economic integration⁵⁷ may be used to avoid liability to external creditors.⁵⁸ The integration of international banks can also be manipulated to shift its COMI from one jurisdiction to another which is further considered in Chapter 3.

In international economic law⁵⁹, the perspective of justice is intertwined with economic principles. A core principle is the “maximin” principle by which the inequality between states can be justified if there is a proportionate or more proportionate advantage for every other state at the bottom of the distribution scale. Fairness is a relative and subjective concept in international economic law and hence may be a source of ongoing conflicts. This

⁵⁴ John Trowbridge, *The Architecture of Group Supervision*, Australian Prudential Regulation Authority, Australian Prudential Regulation Authority (2010) viewed at <http://www.apra.gov.au/Speeches/Documents/Trowbridge-Architecture-of-Group-Supervision-28Jun10-2.pdf> on July 4th, 2011, 14.

⁵⁵ *Ibid.*

⁵⁶ *Ibid.*

⁵⁷ *Ibid.*, 189.

⁵⁸ *Ibid.*

⁵⁹ International economic law includes the study of all the rules applicable to the conduct of sovereign states in their economic relations and of private parties involved in cross-border business transaction, and in particular ‘the private law of the transaction, national government regulation of the transaction and national law’ as defined in Asif H. Qureshi & Andreas R. Ziegler, *International Economic Law*, (Sweet & Maxwell, 2011).

concept of fairness relates to the inconsistency of outcomes that international bank insolvencies encounter amid ongoing jurisdictional disagreements. Effective international cooperation is a solution that would ensure that national interests are not responsible for negative externalities affecting other jurisdictions or the whole world, and can be extended to domestic jurisdictions.⁶⁰

1.5 Research Methodology

This research project covers several fields including private international law, international bank insolvency law and international insolvency law. The basic methodology has been adapted from that of De Cruz⁶¹ for an international law study. The steps are:

1. The problem of international bank insolvency and COMI in international insolvency law must be identified and stated as precisely as possible in the research questions.

2. The primary sources of law required for the national legal systems and COMI are the legislation and case law. As such, reports and publications by agencies of national governments, law reform commissions, and commissions of inquiry into specific insolvencies will also be collected for analysis. They will be supplemented by relevant sources of international law including treaties and conventions as well as reports published by the European Commission, UNCITRAL, IMF, World Bank and by relevant sources of international law such as INSOL's reports and recommended policies, and other relevant international bodies such as the Bank of International Settlements and the Basel Committee. Sources will also include a review of professional practice commentaries on relevant laws as well as literature in scholarly monographs and serials literature. Additional sources concerning significant cross-border insolvency legal issues such as COMI have been collected by this researcher attending the UNCITRAL Working Group V (Insolvency) Thirty-ninth session 3 October-4 November 2010, Vienna; Fortieth session 31 October-4 November 2011, Vienna; the Forty-first session 7 May- 11 May 2012, New York, and the Forty-second session 26 November-30 November 2012, Vienna. This was further developed by the researcher undertaking a legal internship at UNCITRAL, Vienna in September-

⁶⁰ Asif H. Qureshi & Andreas R. Ziegler, *International Economic Law*, (Sweet & Maxwell, 2011), 2617.

⁶¹ Peter De Cruz, *Comparative Law in a Changing World* (Cavendish Publishing Ltd, 2007), 235.

December 2010 and conducting research at the UNCITRAL library, Vienna in November 2011 and 2012.

The possible answers to the problems will be provisionally mapped out with a careful consideration of the different theoretical approaches which are as follows:

i. Universalism

ii. Modified Universalism

ii. Territorialism

3. The legal principles will initially be critically analysed in terms of their intrinsic meaning in each legal system rather than according to any outside standard. De Cruz's methodology will then be supplemented in two ways: (i) by undertaking a closer study of the UNCITRAL Model Law, which is considered to be the optimal cross-border insolvency law, and (ii) by examining case studies of international insolvency cases across common and civil law systems.⁶² The first supplementary activity is in order to recognize the importance of international law. The second supplement is to partly follow the methodology of Lindblom and Etzioni, referred to below.

Lindblom's 'incremental model'⁶³ is a descriptive and normative case study analysis. The model involves a general scan of existing knowledge and a series of successive limited comparisons of particular areas of law in terms of both data and issues, with specific incremental comparisons being made. The incremental methodology breaks down the handling of values or objectives in policy research so as to focus on specific comparisons. This recognises that 'shifts of policy take place through a series of relatively small changes'⁶⁴ rather than a major seismic shift. By utilizing an incremental approach, there is less risk of major mistakes in analysis occurring, there are greater chances of accuracy, and policy-making may be made more effective. To this methodology is added Etzioni's refinement of 'mixed scanning' in which some areas are looked at in different ways, including more detail

⁶² Lorenzo Segato, 'A Comparative Analysis of Shareholder Protections in Italy and the United States: Parmalat as a Case Study', (2005-6) 26 *Northwestern Journal of International Law and Business* 373; Claudio Celani, 'The Story Behind Parmalat's Bankruptcy', *Executive Intelligence Review*, January 16 (2004); Magda Bianco & Paola Casavola, 'Italian Corporate Governance: Effects on Financial Structure and Firm Performance' (1999) 43 *European Economic Review* 105.

⁶³ Charles E Lindblom, 'The Science of 'Muddling Through' (1959) 19 *Public Administration Review* 79.

⁶⁴ *Ibid.*

to see if anything may have been missed in a broader ‘scan’ of the field.⁶⁵ This will take the form of various case studies that have applied the EU Insolvency Regulation and the UNCITRAL Model Law including international bank insolvency cases. It will supplement the incremental scan of the general literature to determine the reliability of these two international insolvency regimes, the influence of different factors on the treatment of international banks, and the causes of key conflicts between jurisdictions including home and host country problems. It is generally recognized that case studies have a distinctive place in evaluative research.⁶⁶ Overall, the approach is context-specific and depends less on preconceived ideas than on investigative processes.⁶⁷

4. The conclusions will be set out within an international framework with critical commentary, wherever relevant, and will relate to the original aims of the enquiry. The commentary will include not only references to legal doctrine and policy but also to relevant law and economics literature.

1.6 Limitations of the Research

The limitations of the research include that the study has been limited to jurisdictions that apply the EU Insolvency Regulation and the UNCITRAL Model law on Cross-border Insolvency with the exception of Iceland, in the case study of the Icelandic banking crisis which has been analysed to illustrate home and host country jurisdictional conflicts. The scope of the study does not include jurisdictions that are not relevant to these international insolvency regimes.

The magnitude of the field concerning the cross-border insolvency of international banks is also a significant limitation. For this reason, the study focused specifically on the cross-border conflicts between jurisdictions concerning COMI and distributional outcomes, and relevant home and host country conflicts.

⁶⁵ Amitai Etzioni, ‘Mixed Scanning: A "Third" Approach to Decision-Making’ (1967) 27 (5) *Public Administration Review* 385–92; Amitai Etzioni, ‘Mixed-Scanning Revisited’ (1986) 46 *Public Administration Review* 8-14.

⁶⁶ Robert K Yin, *Case Study Research: Design and Methods* (1989), 35.

⁶⁷ *Ibid.*

Although the resolution of international banks such as systemically important financial institutions is very topical, this is outside the scope of this study, as reorganisation and restructuring themes would constitute too wide a focus. Therefore, this study focuses in particular on possible solutions to cross-border conflicts within the scope of COMI in order to narrow the focus of the topic. The limitations of the study also include the time factor as the study needs to be aligned with the momentum of the current developments of the EU Insolvency Regulation and the Model Law. As the revision and reform of the EU Insolvency Regulation is pending and expected for late 2013, and the UNCITRAL Working Group has begun discussing large, complex financial institutions in the context of the work of other international bodies, the completion of this thesis must be timely so that it parallels these developments and remains relevant.

1.7 The Thesis Structure

In order to discuss the most appropriate solutions, this thesis is structured as follows.

Chapter 2 of this thesis will examine the theoretical approach to cross-border insolvencies in a banking crisis. This part includes the analysis of the Icelandic banking crisis using the theoretical approaches of universalism and territorialism which has not previously been analysed in this context in the legal field. As with Chapter 6, this chapter will support the argument that national interests tend to preside over international cooperation to the detriment of international solutions.

Chapter 3 of this thesis will examine the unpredictability and uncertainty of determining COMI in various jurisdictions. This examination will include the theoretical approaches of universalism and territorialism as applied by various jurisdictions in the determination of COMI. The chapter will also consider the legal, institutional and international bank insolvency framework of international bank insolvencies, in the context of which COMI is determined. The conclusion of this chapter is that the determination of COMI has been complicated by the limitations of the legal frameworks within which international banks and banking activities operate.

The two main regimes for international insolvency, the EU Regulation on Insolvency Proceedings and the Model Law, ignore insolvency in the context of a multinational group of companies including international banks. This thesis aims to address this gap.

Chapter 4 of this thesis will examine the significant problems in the EU legal framework in respect of large, complex financial institutions including the implementation of Article 3(1) of the EU Insolvency Regulation concerning the COMI of the company. This chapter will also address the conflicts created by these problems in the EU such as the conflict between national sovereignty and international cooperation. It will further examine the host and home country conflicts, the issue of cross-border bank insolvency laws, and related issues. The purpose is to identify the changes that are required in the EU legal framework to mitigate these problems in future banking crises in the EEA. This chapter will draw the conclusion that further harmonisation of the EU legal framework is a possible solution to resolve cross-border conflicts in international bank insolvencies.

Chapter 5 will address the UNCITRAL Model Law on Cross-Border Insolvency and the presumption of COMI in the Model Law. It will also consider the impact of the Model Law and COMI across common and civil legal systems, and the theoretical approaches of universalism, territorialism and modified universalism. This chapter will consider the Model Law in Australia in the cases of *In re Betcorp Limited (in Liquidation)*⁶⁸ and *HIH*. In *Betcorp*, the Model Law was applied to determine the COMI, and this was the first time that an Australian winding-up had been recognised in the United States, or anywhere else, as a ‘foreign main proceeding’.⁶⁹ The chapter will also discuss the limitation of the Model Law’s presumption of COMI, the recognition of foreign proceedings, and the conflicts of laws problems that result from this recognition in international bank insolvencies. The international insolvency of *Lehman Brothers Holdings Inc.* illustrates the difficulties of applying the Model Law to the case of a global, systemically important financial institution. This chapter will conclude with how the Model Law can be applied to assist in resolving the problem of the conflict of laws between national legal systems in international bank insolvencies and in respect of COMI.

⁶⁸ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009).

⁶⁹ Allens: Publications: Focus: Cross-border insolvency and the Betcorp decision, 27 February, 2009 viewed at <<http://www.allens.com.au/pubs/insol/foinsolfeb09.htm> on July 19>, 2012.

Chapter 6 of this thesis, before the conclusion, suggests and will discuss the possible solution of an international convention to resolve the conflicts discussed in the previous chapters. The theoretical debate between universalism and territorialism will be re-examined to illustrate how these approaches cannot adequately resolve conflicts between jurisdictions in international bank insolvencies. Einhorn notes that the conflicts have created additional problems such as the vast opportunities for forum shopping which are due to the lack of harmonisation of rules pertaining to conflicts.⁷⁰ Chapter 7 concludes the thesis, and suggests that greater harmonisation should be implemented to resolve cross-border jurisdictional conflicts pertaining to international bank insolvencies.

⁷⁰ Talian Einhorn 'American vs European Private International Law- The Case for a Model Conflict of Laws Act (MCLA)', in *Convergence and Divergence in Private International Law*, Kurt Siehr, (Eleven International Publishing, 2010), 34.

CHAPTER 2: THE THEORETICAL APPROACH TO CROSS-BORDER INSOLVENCIES

Chapter Overview

The theoretical approaches in international insolvency law must firstly be understood. This chapter analyses the theoretical approaches of universalism and territorialism in the context of an international banking crisis, specifically the Icelandic banking crisis, and their potential as solutions in the resolution of international bank insolvencies. The theory of modified universalism, used in the EU Insolvency Regulation and the Model Law, is also analysed as a potential solution.

This chapter also discusses the theory of secondary bankruptcy which is a hybrid theory derived from territorialism and universalism. The chapter analyses the significant home and host country conflict which adversely affects the orderly resolution of an international bank conflict, and analyses this in the context of the Icelandic banking crisis. The chapter discusses the case of *Dexia*, and the effects of international cooperation which is imperative in resolving the cross-border aspects of insolvency. The theme is that complex issues of law arise from the dichotomy between domestic laws and cases in an international setting.

The chapter concludes with the issue of conflicting jurisdictions and the problems of ringfencing and comity in insolvency regimes, and how this affects the resolution of conflicts pertaining to international banks. In conclusion, the chapter states that an international framework for international bank insolvency which changes the legal, regulatory and financial structures within which the global economic system operates, is critical.

2. Introduction

This chapter discusses the theoretical approaches to cross-border insolvencies and demonstrates the legal challenges to effectively winding down an international bank that operates across the globe. It may be argued that a central issue is that the general insolvency laws on which authorities rely, fail to fully consider the repercussions of disruptions to financial stability⁷¹ and the systemic impact of collapsed international banks. In all jurisdictions, authorities discovered that they lacked the mechanisms and tools needed to resolve internationally active systemically important financial institutions (SIFIs).⁷² During the most recent crisis, the procedures for dealing with an international bank in distress were inadequate in a number of jurisdictions, and there was a necessity for special rules to deal with international banks whose collapse had enormous systemic consequences. As illustrated by the Icelandic banking crisis, different entities within the same group may be subjected to different regimes administered by different authorities. These cases further illustrate that an uncoordinated framework for resolving financial groups on a national plane is compounded in an international context.⁷³

This chapter focuses on the major theoretical approaches in cross-border insolvencies which provide the background for the thesis, and the two major international insolvency regimes and the concept of COMI which are examined in preceding chapters. The Icelandic banking crisis illustrates these theoretical approaches in action and potential problems in order to better understand the cross-border insolvency of international banks.

⁷¹ Adrienne Coleton, 'Bank Insolvency Regimes and Cross-border Banks - Complexities and Conflicts: Is the Current European Framework Efficient and Robust Enough to Effectively Resolve Cross-border Banks, Can there be a One-Size Fits All Solution?', 2012 27(2) *Journal of International Banking Law and Regulation* 63, 72.

⁷² Eva Hupkes, 'Resolving Crises in Global Financial Institutions: the Functional Approach Revisited' in *Financial Crisis Management and Bank Resolution*, John Raymond Labrosse, Rodrigo Olivares-Caminal, Dalvinder Singh (eds), (Informa Law, 2009), 291.

⁷³ *Ibid*, 294.

2.1 Resolution of international bank insolvency: the Icelandic banks

The failure of the Icelandic banks in the most recent global financial crisis represents a test case for cross-border resolution of conflicts pertaining to financial institutions.⁷⁴ The failure of the Icelandic banks raised significant issues regarding the cross-border regulation of financial institutions.⁷⁵ Historically, banking regulations developed as a response to crises resulting from the nature of banking business as a fractional reserve system based on the management of credit and duration risks. In today's economy, this risk is increased as bank, capital and other financial markets become increasingly connected to a broader financial system more than ever before.⁷⁶ Some economists argue that regulation is necessary only in the presence of market failure or deficiencies.⁷⁷ The magnitude of recent crises has generated proposals for reforms in banking regulation and supervision.⁷⁸ However, there is a lack of international regulation in dealing with cross-border issues in banking law.⁷⁹ The existing legal and regulatory arrangements are not designed to resolve problems in financial groups that operate through multiple, separate entities. There is no international insolvency framework for financial institutions.⁸⁰

One significant issue concerns the difficulties in the resolution of the Icelandic banking crisis where there was inadequate regulation.⁸¹ The inadequate cross-border regulation to deal with

⁷⁴ Christine Cumming & Robert A. Eisenbeis, 'Resolving Troubled Systemically Important Cross-border Financial Institutions: Is A New Corporate Organisational Form Required?', Federal Reserve of New York Staff Reports, Staff Report No. 457, July 2010, 1, 26.

⁷⁵ House of Commons Treasury Committee, 'Banking Crisis: The Impact of the Failure of the Icelandic Banks, Fifth Report of Session 2008-09 (House of Commons London: The Stationary Office Limited, 4 April 2009), 43.

⁷⁶ Arner & Norton, above n9, 116.

⁷⁷ Nana Esi Astem, 'What Works Best for Banking Regulation: Market Discipline or Hard-wired Rules?', International Centre for Financial Regulation, (24 February 2010) viewed at <www.iccfr.org> on May 18th, 2012).

⁷⁸ James R. Barth, Gerard Caprio, Jr. and Ross Levine, 'Bank Regulation and Supervision: What Works Best?', 13(2) (2004) *Journal of Financial Intermediation* 205.

⁷⁹ Thomas Schobel, 'Telos Versus Unilateralism: Cross-banking Business and International Applicability of Domestic Banking Law', (2009) 63 *Consumer Finance Law Quarterly Report* 177, 182.

⁸⁰ Bank for International Settlements, *Basel Committee on Banking Supervision: Report and Recommendations of the Cross-border Resolution Group*, (March, 2010), 4.

⁸¹ See Eva H.G. Hupkes, *The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada*, (Kluwer Law International, 2000), 18 where she states that: In the absence of any express exemption, banks are subject to statutes of general application such as company law and insolvency laws. The principles applicable to the resolution of failed banks would be the same as those applicable to commercial companies generally. Some commentators contend that there are universal and social concerns which should have precedence over economic activities during insolvency procedures. Ibid, 19 she further states that: One of the reasons that legislators choose to exclude banks from general insolvency and reorganisation statutes is because in an insolvency situation, there is no time to negotiate a reorganisation plan that would require sanctioning by the court before it is effective. In addition, bank insolvency law also refers to special

branches and subsidiaries of the Icelandic banks resulted in substantial taxpayer support to provide rapid taxpayer-funded compensation to UK depositors of Icelandic banks that ‘passport’ into the UK.⁸² The FSA stated that “recent events, including the crisis in retail Icelandic bank branches, demonstrate that the EU single market rules need to be considered”.⁸³

In 2009, the International Monetary Fund proposed a framework for the resolution of cross-border banks to the G20. The proposal stated that, most importantly, when regulators are faced with the insolvency of a multinational bank that is within their own jurisdiction, they tend to favour creditors of branches or subsidiaries located within their own jurisdiction. The issue of too big to fail and systemic cross-border banks in the international financial system is being addressed through the G20 process and by international standard setters such as the IMF and Financial Stability Board (FSB). However, at present, a consensus at the G20 and the EU level on a general bank insolvency law is out of reach.⁸⁴ In implementing the EU’s Winding Up Directive, where failing banks have branches in other Member States, actions taken by national authorities will have full force throughout the EU. The legal effect on branches does not depend on the approval of the local authorities where the branches are located. In each jurisdiction, the special resolution regimes will extend to the cross-border branches of multinational banks in the EU. The proposal further stated that the resolution systems for banks would not be effective unless the framework applies to a cross-border company.⁸⁵ Since many systemically important banks operate globally, an uncoordinated application of resolution systems will make it very difficult to limit contagion and place the financial burden of bank resolutions on shareholders and creditors.⁸⁶ Policies need greater limitations, modifications and foresight in the identification of potentially systemic interconnections, and the potential link with systemic risk requires closer examination to limit the effects of the next financial crisis.

provisions such as prudential regulations that authorize the banking supervisory authority to intervene to better protect creditors. In the US, banks are fully exempt from the application of insolvency law while in most European countries, general insolvency law is applied to banks as *lex generalis*, and special rules (*lex specialis*) or exemptions are applied where there are specificities in respect of bank insolvency.

⁸² Ibid, 48.

⁸³ House of Commons Treasury Committee, above n75, 11-12.

⁸⁴ Sester, above n119, 512. The concept of TBTF specifically refers to systemically significant financial institutions although the policy may include other financial companies.

⁸⁵ European Commission, *European Commission’s Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings* (December 12, 2012).

⁸⁶ International Monetary Fund, above n18.

In addition, the legal frameworks of many jurisdictions fail to sufficiently facilitate coordination of actions in respect of an insolvent bank. In the context of an international bank, the overlapping responsibilities of various national supervisory authorities and difficulties in discerning these responsibilities are magnified.⁸⁷ The cross-border context of bank insolvency also raises the issue of special resolution regimes at the national level.⁸⁸ The cross-border dimension complicates the already challenging process of resolution. The development of a global insolvency mechanism for financial institutions that would involve the loss of sovereignty in major countries is not realistic. A feasible approach must recognise that financial institutions will be resolved under national regimes. The legal frameworks in national resolution regimes must be compatible at a minimum and mutually supportive at their best.⁸⁹ However, national special resolution regimes may not be adequate to address cross-border issues.⁹⁰ These regimes may not be able to resolve the conflicts between different national laws and authorities. The possibility of agreements in an international framework for the resolution of cross-border banks is currently still the subject of international debate. Although there is a strong conceptual case for the resolution of systemically important banks to be considered in a special resolution regime, standard judicial regimes fail to consider all relevant factors, and lack speed and decisiveness which are necessary in a financial crisis.⁹¹ As a consequence, the continuing integration of international banks demands a reassessment of the nationally-based regulatory and supervisory systems. It requires a minimisation of the gap between national supervision and regulation, international standards and global governance, and jurisdictional differences and parochial regulators.

In 2008, Iceland's extended banking system collapsed, sending shockwaves through the world's financial markets. The collapse of the two largest Icelandic banks, Landsbanki and Kaupthing, illustrated how the host regulators have little or no influence over the regulation

⁸⁷ Ibid.

⁸⁸ Eva H.G. Hupkes, 'Dealing with Distressed Banks- Some Insights from Switzerland', (2002) 17(6) *Journal of International Economic Law* 160.

⁸⁹ Eva H.G. Hupkes, 'Rivalry in Resolution: How to Reconcile Local Responsibilities and Global Interests?', (2010) 2 *European Company and Financial Law Review* 216, 218.

⁹⁰ Martin Cihak and Erland Nier, 'The Need for Special Resolution Regimes for Financial Institutions- The Case of the European Union, (International Monetary Fund Working Paper, WP/09/200, September 2009), 24.

⁹¹ Ibid, 26.

of passporting firms such as the Icelandic banks.⁹² The ‘passporting’ of Icelandic banks into host countries relied on complex, sometimes confusing, ownership structures⁹³ and ultimately, allowed a European Economic Area (EEA) Member State to ignore its legal responsibilities to these foreign depositors. The failure of offshore subsidiaries of the Icelandic banks impacted on foreign depositors⁹⁴ arising from the branching of the financial institution into host countries. When this occurred, the ability of the host countries to challenge the decisions of the home regulator that did not sufficiently recognize these risks,⁹⁵ was significantly impaired. Furthermore, the home authorities may also lack the capacity and resources to detect problems arising from foreign jurisdictions that threaten an international bank’s viability.⁹⁶

The absence of an effective cross-border resolution framework not only undermines financial stability, but it can also inadvertently hasten the failure of a financial institution.⁹⁷ In the case of the Icelandic banks, the conflict between the UK and Icelandic national authorities caused uncertainty and uncoordinated actions to occur, which made it increasingly difficult for effective resolution actions to be taken. The Isle of Man government stated that Kaupthing, a solvent bank, had been rendered insolvent by the actions of UK authorities when the UK attempted to protect its own position against Iceland.⁹⁸ When the UK government used the *Anti-Terrorism, Crime and Security Act 2001*⁹⁹ to freeze the assets of Landsbanki UK, there were implications for the Icelandic authorities in maintaining a functional financial system.¹⁰⁰ At present, no appropriate legislation is available that can be used in similar circumstances in the future. The theoretical approaches to deal with cross-border bank insolvencies, and the modified universalism approach of the EIR and the Model Law in the context of the Icelandic banking crisis, will be analysed in the next section.

⁹² Ibid, 57. See <QFinance Dictionary viewed at <<http://www.qfinance.com/dictionary/passporting>> on July 6th, 2013 where passporting is defined as ‘the exercise by a company registered in the European Economic Area of a right to carry on business in another EEA state.’

⁹³ Ibid, 12.

⁹⁴ Ibid, 48.

⁹⁵ The De Larossiere Group, The Larossiere Report, ‘The High Level Group of Supervision in the EU’, Brussels, 25 (February 2009), 40.

⁹⁶ Ibid, 85-86.

⁹⁷ Mariam Ioseliani, Aspects of Bank Insolvency, (Erasmus Universiteit, 2011), 30.

⁹⁸ House of Commons Treasury Committee, above n75, paragraphs 1.8.30, 24.

⁹⁹ Ibid.

¹⁰⁰ House of Commons Treasury Committee, above n75, 45.

2.2 The Theoretical Approach of Universalism in an International Banking Crisis

The theoretical approach of universalism has been overwhelmingly advocated by academic and professional opinion.¹⁰¹ According to the universalist approach to insolvency, one single jurisdiction is in charge of the insolvency proceedings and responsible for the resolution of all domestic and cross-border activities of the failing financial institution.¹⁰² The insolvency law of the country in which the insolvency has been initiated is effective in all other jurisdictions in which the bank (parent entity) has assets or branches.¹⁰³ The universalism approach permits foreign law and foreign courts to govern the assets and liabilities of its foreign branches, i.e. wholly domestic relationships.¹⁰⁴ This approach would wind up the assets and liabilities of the parent bank and its foreign branches as one legal entity.¹⁰⁵

However, as the universalist approach seeks to gain access to all of the debtor's assets and liabilities at home and abroad, the host country could be adversely affected during resolution. Under universalism, it has been argued that the home country might not fully consider the interests of other countries during the resolution process as the home country regulator is responsible only to the home country taxpayers.¹⁰⁶ When there is limited impact on the home country, its taxpayers may also object to assisting foreign creditors if the causes of the banking crisis relate to events that have occurred outside of their home jurisdiction. For the universalism approach to be workable in the resolution of an international bank crisis, all national rules for resolution, its processes, and insolvency would have to recognize the universality principle. This means that countries would recognize the extra-territorial effects of proceedings that are initiated abroad. No nation would be able to bring suit in the host country once a bankruptcy has been filed in the home country, and ringfencing assets would be ruled out.¹⁰⁷ This principle can result in the disparate treatment of foreign depositors if the home country fails to recognize the impact of the insolvency on the host country which can also occur during the resolution process.

¹⁰¹ Jay Lawrence Westbrook, 'Multinational Financial Distress: the Last Hurrah of Territorialism', (2006) 41 *Texas International Law Journal* 321, 322.

¹⁰² Stijn Claessens, Richard J. Herring, Dirk Schoemaker, International Centre for Monetary and Banking Studies, Geneva Reports on the World Economy 12, 'Resolution in an International Context', July 2010, 88-89.

¹⁰³ Bank for International Settlements, above n80, 2.

¹⁰⁴ Lynn M. LoPucki, 'Cooperation in International Bankruptcy', 84 (1999) *Cornell Law Review* 696.

¹⁰⁵ Rosa M. Lastra (ed.), *Cross-Border Bank Insolvency* (Oxford University Press, 2011), 166.

¹⁰⁶ *Ibid.*

¹⁰⁷ Jonathan M. Edwards, 'A Model Law Framework for the Resolution of Multinational Financial Groups', (International Finance Seminar Paper, Harvard Law School, April 25, 20112), 19.

2.3 The Theoretical Approach of Territorialism in an International Banking Crisis

Under territorialism, any conflict arising in a unit of an international bank would be resolved according to local international banks that have functionally independent subsidiaries, separately incorporated entities that do not depend on other entities in the group for critical functions. Hence, conflicts would be easily resolvable under local laws in different jurisdictions. The Geneva Report on the World Economy noted that the entities would be licensed, regulated and supervised by local authorities, which would also assume sole responsibility for resolution in a crisis.¹⁰⁸ Clark and Goldstein note that the main problem with a territorial model is that it does not address more complex cases in which the debtor has various interests in different jurisdictions.¹⁰⁹ This stand-alone subsidiary model could help insulate individual components of the international bank from shocks as a failing financial group could be resolved more easily by selling its sound subsidiaries to other market participants. Under territorialism, the subsidiary model addresses some issues associated with cross-border financial problems or crisis. In the subsidiary model, firewalls between an international financial institution's subsidiaries are assured by a holding company structure which can limit direct financial spillovers. Indirect financial spillovers may occur when the insolvency of a subsidiary of an international bank that operates under the same name as its parent could affect the ability of the rest of the group to attract funds.¹¹⁰

In a territorial regime, each country would have jurisdiction over the portion of the insolvent multinational firm within its border.¹¹¹ Territorialism presents the specter of multiple conflicting decisions that could produce problems in various jurisdictions in the case of international banks with accounts, operations, inventory and customers worldwide.¹¹² Under territorialism, each country seizes the debtor's assets which are located within its borders and conducts a separate proceeding to divide those assets among local creditors according to domestic law.¹¹³

¹⁰⁸ Ibid.

¹⁰⁹ Hon. Leif M. Clark & Karen Goldstein, 'Sacred Cows: How to Care for Secured Creditors' Rights in Cross-Border Bankruptcies', (2011) 46 *Texas International Law Journal* 513, 518.

¹¹⁰ Claessens, Herring, Shoenmaker, above n102, 88.

¹¹¹ LoPucki, above n104, 701.

¹¹² Westbrook, above n101, 326.

¹¹³ Lore Unt, 'International Relations and International Insolvency Cooperation: Liberalism, Institutionalism, and Transnational Legal Dialogue', (1997) *Law and Policy International Business* 1037, 1040.

The territorialist approach has considerable disadvantages. Firstly, territorialism would increase the international legal costs because of the need to file separately in each country.¹¹⁴ Secondly, the distribution of assets to similarly situated creditors is unpredictable and unequal, and debtors and creditors could act strategically to enhance their private interests to the detriment of other creditors.¹¹⁵ The territorial approach can be beneficial when host authorities use ringfencing as a strong incentive to ensure that assets of the local branch exceed liabilities. In this context, ringfencing can more closely align the supervisory authority of the host country with the assets available to pay stakeholders of the local branch or other office.¹¹⁶

3. The Icelandic Banking Crisis and Competing Theoretical Approaches

The Icelandic banking crisis occurred during October 2008, following the collapse of Lehman Brothers, when three internationally active Icelandic banks -Glitnir, Landsbanki, and Kaupthing- experienced a liquidity crisis.¹¹⁷ The Icelandic authorities requested a \$2billion loan from the IMF and a \$4billion loan from its Nordic neighbours. The collapse of these banks brought about the end of Iceland as a leading international banking nation.¹¹⁸

The Icelandic banking crisis illustrated the key problem with universalism in the resolution of a systemically important financial institution (SIFI) when the Iceland government decided that its taxpayers deserved priority over the external and domestic creditors (except the insured depositors) of the banks.¹¹⁹ The presumption that the home country resolution authority leads the resolution process can also be problematic when the financing and potential costs exceed the home country's capacity and fiscal resources. This was exemplified by the Icelandic banking crisis in which its banks were too big to fail. When a bank is 'too big to fail' (TBTF), governments may be willing to put taxpayer money at risk to

¹¹⁴ Jamie Altman, 'A Test Case in International Bankruptcy Protocols: The Lehman Brothers Insolvency', 12 (2010-2011) *San Diego International Law Journal* 463, 471.

¹¹⁵ *Ibid.*

¹¹⁶ Bank for International Settlements, above n80, 18.

¹¹⁷ *Ibid.*, 19.

¹¹⁸ Willem H. Buiter & Anne Sibert, 'The Icelandic Banking Crisis and What To Do About It: The Lender of Last Resort Theory of Optimal Currency Areas, (Centre for Economic and Policy Research, Policy Insight No. 2, October 2008), 1.

¹¹⁹ *Ibid.*, 2.

avert the bank's failure in order to stave off systemic, economic or political risks.¹²⁰ The concept of TBTF specifically refers to systemically significant financial institutions although the policy may include other financial companies.¹²¹

In the Icelandic banking crisis, the disparate treatment of foreign creditors led the U.K.'s Chancellor to ringfence Landsbanki's branch assets which exacerbated the lack of cooperation and coordination with Icelandic authorities.¹²² The crisis illustrated the negative consequence of territorialist ringfencing when assets of the Icelandic banks' foreign branches were sold by host authorities at fire sale prices.¹²³ When Iceland did not ringfence Icelandic banks from its overseas operations, contagion spread to its UK operations.¹²⁴ The failure to coordinate the resolution with the jurisdictions in question resulted in some of these countries seizing Icelandic bank assets to protect their own depositors.¹²⁵

Ultimately, the concept of universality and territoriality which are entity-centric are not determinative in the situation of financial groups consisting of multiple legal entities.¹²⁶ In practice, neither universalism nor territorialism governs the resolution of subsidiaries of foreign institutions. The subsidiaries are subject to separate insolvency proceedings.¹²⁷ In insolvency, subsidiaries of foreign financial institutions will be resolved as separate legal entities under the local law in all jurisdictions.¹²⁸ As indicated in Chapter 1, because neither pure universalism nor pure territorialism is practical, 'modified universalism' and 'cooperative territorialism' have emerged as practical alternatives.¹²⁹ The theoretical foundation of both the EU Insolvency Regulation and the Model Law is 'modified universalism' which posits that there is one jurisdiction in which the debtor should file for insolvency, and that insolvency should have universal effect.¹³⁰ One reason that the EU

¹²⁰ Edward F. Greene, Knox L. McIlwain & Jenifer T. Scott, 'A Closer Look at 'Too Big To Fail': National and International Approaches to Addressing the Risks of Large, Interconnected Financial Institutions', (2010) 5(2) *Capital Markets Law Journal* 117, 118.

¹²¹ Benton E. Gup (ed.), *Too Big to Fail: Policies and Practices in Government Bailouts*, (Praeger Publishers, 2004), 31.

¹²² Edwards, above n106, 20.

¹²³ Basel Committee on Banking Supervision, above n80, 18.

¹²⁴ *Ibid.*

¹²⁵ *Ibid.*

¹²⁶ *Ibid.*, 18.

¹²⁷ *Ibid.*

¹²⁸ *Ibid.*, 16.

¹²⁹ Clarke & Goldstein, above n108, 518.

¹³⁰ Jose M. Garrido, 'No Two Snowflakes are the Same: The Distributional Question in International Bankruptcies', 46 *Texas International Law Journal* 459, 472.

approach is considered as modified universality is that it does not extend to non-EU incorporated financial institutions or EU branches of non-EU banks.¹³¹

3.1 Modified universalism as a solution

In the resolution of international banks, it may be argued that the universalist approach does not resolve the conflict of international jurisprudence. For example, the universalism approach of the European Insolvency Regulation does not contain a specific provision to address the question if and when two different courts in two different Member States both open main proceedings, both equally convinced that the COMI is in their respective jurisdiction.¹³² This is complicated when most national insolvency systems such as the United States, United Kingdom and Canada claim jurisdiction over the assets of a filing debtor wherever located, including assets located in different jurisdictions.¹³³ LoPucki notes that the territorialist nature of modified universalism relieves courts of the non-forum country from the obligation to sacrifice domestic creditors' interests for the benefit of foreign interests. However, unlike pure universalism, modified universalism introduces uncertainties that make predictability elusive.¹³⁴ The modified universalism theory 'recognises the problems of a global system where debtors can easily choose a substantive law that will govern their insolvency and that this may be contrary to the expectations of creditors.'¹³⁵

The issue of uncertain distributional creditor outcomes occurs because, firstly, the regime or regimes that will distribute the debtor's assets may depend on the jurisdiction in which the assets are located at the time of bankruptcy.¹³⁶ Modified universalism could generate an insolvency proceeding in every country in which the debtor has assets, and possibly even more.¹³⁷ Secondly, modified universalism does not address the key problem of identifying the

¹³¹ Bank for International Settlements, above n80, 17.

¹³² Bob Wessels, *International Jurisdiction to Open Insolvency Proceedings in Europe, In Particular Against (Groups of) Companies*, (Working Paper Series No. 19, Institute for Law and Finance, Johann Wolfgang Goethe-Universität, 2003), 19.

¹³³ Phillip R. Wood, *Principles of International Insolvency*, (Sweet & Maxwell Ltd, 1995), 50-51 (listing England, United States, Argentina, Denmark, Finland, Norway and Sweden as claiming all assets globally and only Japan as limiting proceedings to territorial property).

¹³⁴ LoPucki, above n104, 696.

¹³⁵ Edward S. Adams & Jason K. Finke, 'Co-ordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism', 15 (2009) *Columbia Journal of European Law* 43, 51.

¹³⁶ LoPucki, above n104, 729.

¹³⁷ *Ibid.* For example a creditor or trustee might initiate proceedings in the United States to obtain discovery here, although the debtor has no assets in the United States.

home country.¹³⁸ The preference of most academic commentators would be a rule that the home country of the multinational provide the single forum, and controlling law, for handling all international insolvencies.¹³⁹ Westbrook noted that the home country law is the one law that can be most reliably predicted in advance.¹⁴⁰

In the context of international banks, modified universalism could necessitate dozens of complex proceedings.¹⁴¹ The individual components of a financial group will be subject to different authorities and legal proceedings in many jurisdictions. ‘Different domestic and foreign regulators and judicial or administrative insolvency authorities will claim competence over individual parts of the group and seize the assets of group companies in their jurisdictions.’¹⁴² The conduct of individual procedures with respect to individual group companies creates multiple intra-group claims which are likely to divert attention from the more significant goal of resolving the crisis most efficiently and with the lowest societal cost.¹⁴³ The inefficiency of this conduct and its impact on societal cost was illustrated by the collapse of Lehman Brothers. When the Lehman Brothers Holding Company (LBHI) filed for Chapter 11 protection in the US, some of Lehman’s constituent legal entities were immediately put into insolvency or an equivalent procedure in other jurisdictions, thereby creating international conflict.¹⁴⁴ As mentioned, the main Lehman holding company was incorporated in the US with operating subsidiaries in numerous countries. Judge Peck, the judge in charge of the LBHI proceedings in the US, issued an early order allowing the enterprise to continue operating under its pre-petition cash management system. However, the order did not prohibit the assets from being frozen by the laws of other jurisdictions as¹⁴⁵

‘The cash management system and by extension, the operation of the entire enterprise was managed by a corporation whose COMI was undeniably in the US; but because

¹³⁸ Ibid, 730.

¹³⁹ Robert K. Rasmussen, ‘A New Approach to Transnational Insolvencies’, 19 (1997) *Michigan Journal of International Law* 1, 26.

¹⁴⁰ Jay Lawrence Westbrook, ‘Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum’, 65 (1991) *American Bankruptcy Law Journal* 457, 469.

¹⁴¹ Ibid.

¹⁴² Eva Hupkes, ‘Form Follows Function’- A New Architecture for Regulating and Resolving Global Financial Institutions’, (2009) 10 (3) *European Business Organisation Law Review* 369, 375.

¹⁴³ Ibid, 373.

¹⁴⁴ Ibid. Chapter 11 is a chapter of the US Bankruptcy Code that enables reorganisation to occur under the bankruptcy laws of the US.

¹⁴⁵ Anthony V. Sexton, ‘Current Problems and Trends in the Administration of Transnational Insolvencies Involving Enterprise Groups: the Mixed Record of Protocols, the UNCITRAL Model Insolvency Law, and the EU Insolvency Regulation’, 12 *Chicago Journal of International Law* 811, 820.

COMI analysis focuses on the place of incorporation and operation of each member of the enterprise individually, multiple foreign proceedings were filed including, importantly, the main proceeding for Lehman Brothers International Europe (LBIE), which controlled most of Lehman's European assets.¹⁴⁶

Ultimately, as illustrated by Lehman Brothers, the vast differences in insolvency regimes worldwide means that modified universalism will often lead to a refusal to cooperate, exacerbating jurisdictional conflict and efficiency concerns. The discrepancies between the applicable company and insolvency law would trigger additional bankruptcy costs, risk-inadequate credit contracts might be concluded, non-adjusting creditors exploited, and there would be repercussions for credit markets.¹⁴⁷

However, in the resolution of international bank conflicts, the modified universalist model would give host countries the right, but not the obligation, to apply local resolutions to local branches of an international bank, while the home country addresses its overall resolution. International cooperation between jurisdictions with compatible resolution schemes would be possible using the modified universalism model. One key condition of this model is that there is equitable treatment of a bank's creditors at all its entities in the home and host jurisdictions.¹⁴⁸ A modified form of universalism would involve host authorities choosing to defer to and cooperate with a resolution suggested by the home country authorities provided that specific conditions are adhered to. At the international bank level, preconditions for a modified universalist approach may include:

1. equitable treatment of all creditors regardless of their jurisdiction. If creditors in host countries were likely to be penalised in a resolution brought by home country authorities, host countries would have a strong incentive to ringfence;
2. broad harmonization of resolution regimes across jurisdictions¹⁴⁹

¹⁴⁶ Ibid.

¹⁴⁷ Horst Eidenmuller, 'Abuse of Law in the Context of European Insolvency Law', (2009) *European Company and Financial Law Review* 1, 5.

¹⁴⁸ Hupkes, above n142, 373.

¹⁴⁹ Paul Tucker, 'Resolution of Large and Complex Financial Institutions: The Big Issues', (European Commission's Conference on Crisis Management, 19 March 2010), 9.

It may be further argued that unified modified universalism is needed to change resolution regimes when dealing with international banks. According to Edwards, unified modified universalism is a form of universalism that can transform the universalism frameworks currently dominating the academic literature in the resolution of conflicts in multinational financial groups. As mentioned, in modified universalism, there would be multiple insolvency proceedings in multiple countries that foreign jurisdictions would recognize as a main proceeding. In contrast, in a unified modified universalism regime, this would still be the case but one national authority controls every insolvency proceeding.¹⁵⁰ Edwards further notes that unified modified universalism is more predictable than pure universalism because parties would only need to determine which country is the home and which is the host country, and not the control of the financial institution. From a domestic policy perspective, he argues that countries could still achieve their objectives with their insolvency laws while providing a mechanism for a unified insolvency proceeding.¹⁵¹

Finally, the European Union and numerous other countries have taken steps to develop a more universalist approach for bank crisis resolution. Cihak and Nier argue that the special resolution regimes across the EU have the potential to make an important contribution towards more effective resolution of cross-border group conflict. Across the EU, special resolution regimes are imperative to increasing the effectiveness of resolution within member countries, and contributing to more effective resolution of cross-border financial groups. However, the introduction of special resolution regimes would not be able to resolve all conflicts that might arise between the interests of different national authorities.¹⁵² In these circumstances, national priorities adopt a territorial approach where local assets are ringfenced for the benefit of depositors and creditors in the jurisdiction. For example, each subsidiary of Lehman's former entities engaged in ringfencing to defend their own assets when the complexity of its structure proved too difficult to contend with.¹⁵³

The collapse of Lehman Brothers and the Icelandic banks have made clear the need for a more universalistic approach to bank insolvency. The Basel Committee's Cross-Border Resolution Group's Report¹⁵⁴ recommends a 'middle ground approach' that recognises the

¹⁵⁰ Edwards, above n106, 43.

¹⁵¹ Ibid, 44.

¹⁵² Cihak & Nier, above n90, 27.

¹⁵³ International Monetary Fund, above n18, 9.

¹⁵⁴ Bank for International Settlements, above n80.

strong possibility of territorial ring-fencing in a crisis and which helps ensure that home and host countries, and financial institutions focus on needed resiliency within national borders. This approach may require discrete changes to national laws and resolution frameworks to create a more complementary legal framework that facilitates financial stability and continuity of key financial functions across borders.¹⁵⁵

3.2 The Hybrid of Territorialism and Universalism: The Theory of Secondary Bankruptcy

Finally, the theoretical approach of secondary bankruptcy is a hybrid theory of the other two theories, namely territorialism and universalism; where partial distribution of the assets is in accordance with local priorities, and the balance is distributed in accordance with home country priorities.¹⁵⁶ Secondary bankruptcy draws on variations in territorialism and universalism¹⁵⁷ and:

‘contemplates the use of the local bankruptcy process to distribute local assets in accordance with local priority rules. Any excess assets remaining after claims are satisfied in the local bankruptcy proceeding would be remitted to the central foreign proceeding for distribution in accordance with its claims and priority process.’¹⁵⁸

This approach has been viewed as a form of modified territorialism as it defers to the rules of local law. Under secondary bankruptcy, foreign creditors who have perfected their security interests would be accorded equal status with domestic secured creditors, and foreign unsecured creditors may be permitted to file unsecured creditor claims in the domestic proceeding.¹⁵⁹ The Model Law and Chapter 15 recognize the principle that ‘similarly situated unsecured general creditors should receive the same distribution without regard to assets available or the amount of debt located in a particular jurisdiction’.¹⁶⁰ In practice, this

¹⁵⁵ Ibid, 19.

¹⁵⁶ LoPucki, above n104, 733.

¹⁵⁷ Paul L Lee, ‘Ancillary Proceedings under section 304 and Proposed Chapter 15 of the Bankruptcy Code’, (2002) 76 *American Bankruptcy Law Journal* 115, 120.

¹⁵⁸ Ibid.

¹⁵⁹ Ibid, 121.

¹⁶⁰ *Cambridge Gas Transport Corporation v Official Commissioner of Unsecured Creditors of Navigator Holdings, PLC*, [2006] UKPC 26, [2007] 1 A.C. 508 (appeal taken from the Isle of Man) (UK).

approach also favours domestic creditors and ‘sophisticated, well-heeled foreign creditors’¹⁶¹ over the general creditors. In theory, the complexity, additional cost of multiple proceedings, and multiple efforts impede the efficiency of this approach. The claims of secured and other priority creditors would consume the local assets, leaving little or no excess to be remitted to the central foreign proceeding.¹⁶² On the other hand, advocates of this approach argue that domestic interest in enforcing security interests and local priorities is a valid concern for domestic jurisdictions.¹⁶³ It has also been argued that

‘a modification to the secondary bankruptcy approach that would have the local bankruptcy process distribute assets only to secured and other priority creditors under the local bankruptcy regime would be efficient. General creditors, whether local or foreign, would not receive any distribution from the local bankruptcy proceeding. Assets remaining after secured and other priority claims are satisfied would be remitted to the central foreign proceeding where all general creditors would have to file their claims and take subject to the priority scheme of the foreign forum.’¹⁶⁴

At present, in the European Union, the efforts to develop a coordinated insolvency regime have also depended on the secondary bankruptcy approach.¹⁶⁵ The case of Dexia illustrates the successful resolution of the financial group through cooperation, rather than through the EU Directive.

Dexia

Dexia was established in 1996 as a result of a merger between a Belgian and a French bank, Crédit Communal de Belgique and Crédit Local de France. It had a significant presence in Luxembourg. In 2008, Dexia began to fail. It was recapitalised via funding of EUR 6.4 billion, of which Belgian and French public and private sector investors contributed EUR 3 billion each and the Luxembourg State contributed EUR 376 million in convertible bonds. Belgium, France and Luxembourg subsequently agreed to a joint guarantee mechanism to

¹⁶¹ Lee, above n157, 121.

¹⁶² Ibid

¹⁶³ Ibid.

¹⁶⁴ Ibid.

¹⁶⁵ *European Union Convention on Insolvency Proceedings*, November 23, 1995, Article 35 ILM 1234 (1995); Ian Fletcher, ‘The European Union Convention on Insolvency Proceedings: Choice of Law Proceedings’, 33 (1998) *Texas International Law Journal* 119, 121.

facilitate Dexia's access to finance; 60.5 per cent was covered by Belgium, 36.5 per cent by France and 3 per cent by Luxembourg.¹⁶⁶ In effect, all three companies cooperated with each other to orchestrate a bailout to save the financial group. The success of this was instigated by the strong presence of public and municipal investments in Dexia, as well as a burden-sharing formula that proportionally allocated the financial burden based on investments held by institutional investors and public authorities.

Dexia illustrates, despite tensions, just how effective burden-sharing can be in crisis management. Despite competing national interests and responsibilities, the home and host countries clearly pledged their support to the financial group. Coleton stated that:

One of the main learnings supplied from the crisis management of Dexia were that while the centralisation of liquidity management within a cross-border group can lead to tensions in the case of liquidity problems, these can be surmounted by adequate cooperation between the relevant central banks. The successful resolution of Dexia did not result from the application of the Winding-Up Directive for this, as it was resolved as a group through informal cooperation between national authorities rather than relying on statutory law. It has been submitted that the Dexia crisis management should be reviewed as a blueprint for cross-border resolution in the future.¹⁶⁷

4. Conclusion

This chapter used the Icelandic banking crisis to illustrate the application of the main theoretical approaches of universalism and territorialism when a systemically important financial institution collapses. The theoretical approach of modified universalism is the approach of the EU Insolvency Regulation and the UNCITRAL Model Law on Cross-border Insolvency which is discussed in Chapters 4 and 5 respectively. In a similar vein, the theory of secondary bankruptcy is also used in the EU to develop coordination efforts. The insolvencies of Lehman Brothers and Dexia further illustrated that the lack of a coordinated framework, in most jurisdictions, for resolving financial groups on a national plane is compounded in an international context.¹⁶⁸ One possible step towards a stronger coordinated

¹⁶⁶ Coleton, above n71, 71; Garry Schinasi, "US and EU Reform Efforts in Improving the Management of Systemic Financial Risk" paper prepared for "An Ocean Apart? Comparing Transatlantic Responses to the Financial Crisis", (Rome, Italy: September 10-11, 2009), 11-12.

¹⁶⁷ Ibid.

¹⁶⁸ Hupkes, above n72, 294.

framework is greater harmonization of insolvency law and regimes for international banks on key issues which will allow for greater coordination and clarity during a crisis and any ensuing resolution.¹⁶⁹ Internationally, there is recognition of the need to harmonize insolvency laws. However, this is a very long-term project.¹⁷⁰ For example, although the EU has acknowledged the need to harmonize insolvency law,¹⁷¹ this may be highly unlikely where there are different rules on the management of insolvency proceedings, priority of creditors, reorganisation plans, establishment of the insolvency estate, avoidance actions, different entry criteria to be met prior to commencing, and the effect of commencing insolvency proceedings.¹⁷²

For example, the diverse national approaches within Europe illustrate the deficiencies in cross-border bank insolvency law and consequently, a less-than-adequate insolvency regime.¹⁷³ Each jurisdiction must also consider how to divide responsibilities among regulatory agencies, how to ensure coordination between separate agencies, and how to set regulatory priorities when there are different standards within these agencies.¹⁷⁴ Pan notes that cross-border cooperation will always struggle in terms of the problem of domestic concerns being prioritised above international ones, and the accountability and legitimacy of international regimes.¹⁷⁵ National regimes need to understand the operation of regulatory, banking and insolvency regimes in the respective home and host jurisdictions¹⁷⁶ concerning international banks, while internationally, the implementation of measures to mitigate cross-border conflict needs to operate efficiently within the financial and economic systems.

¹⁶⁹ Lastra above n105, 308.

¹⁷⁰ Coleton, above n71, 80.

¹⁷¹ *European Parliament Report with Recommendations to the Commission on Insolvency Proceedings in the context of EU Company Law*, 2011/2006(INI); Annex to the Motion for a Resolution: Detailed Recommendations as to the Content of the Proposal Requested; Part 1: Recommendations Regarding the Harmonisation of Specific Aspects of Insolvency and Company Law (17 October 2011). See also INSOL Europe Harmonisation of Insolvency Law at European Level viewed at <<http://www.insol-europe.org/eu-research/harmonisation-of-insolvency-law-at-eu-level/>> on June 21, 2013.

¹⁷² Neil Cooper, *Insolvency Proceedings in Case of Groups of Companies: Prospects of Harmonisation at Group Level*, Briefing Note: European Parliament: Directorate General for Internal Neil Cooper Policies, (2011), 7.

¹⁷³ Coleton, above n71, 72.

¹⁷⁴ *Ibid*, 103.

¹⁷⁵ Eric Pan, 'Four Challenges to Financial Regulatory Reform', (2010) 55 *Villanova Law Review* 101, 104.

¹⁷⁶ Hupkes, above n71, 301.

CHAPTER 3: THE CONCEPT OF COMI

Chapter Overview

This chapter considers the principle of comity in the development of the concept of centre of main interest (COMI). As there is no statutory definition of COMI and no uniform interpretation, the legal issue of COMI in cross-border bank insolvency proceedings has become very significant, even more so in the aftermath of the global financial crisis. The COMI of a multinational bank in a cross-border insolvency situation determines which court has jurisdiction to open the main insolvency proceedings and, consequently, the law applicable to such proceedings.¹⁷⁷ This chapter defines and discusses the concept of COMI and the problems with COMI in international bank insolvencies. When the complexities of resolving cross-border bank insolvencies increase, the difficulty of determining the COMI is exacerbated. The transnational problems arising from COMI in international bank insolvencies include the opportunity for forum shopping. This chapter examines the manipulation of COMI by transnational banks during insolvency whereby bank funds can be migrated to a more attractive jurisdiction within seconds. This chapter argues that judicial co-operation in international bank insolvencies is imperative if these problems are to be resolved. The ambiguity in national legal regimes over the determination of COMI has created conflicts between jurisdictions.

The determination of home country jurisdiction is illustrated in a discussion of *Bank of Credit and Commerce International* (BCCI).¹⁷⁸ As previously stated in Chapter 1, BCCI was the first large complex financial institution to become insolvent. The multijurisdictional problems that its insolvency created are paralleled by the Lehman Brothers case which is discussed in this chapter. These cross-border insolvencies illustrate well the changes that are needed in legal regimes to overcome the present difficulties of resolving the failure of cross-border banks. The significant case of *Stanford International Bank* exemplifies the conflicts over the determination of COMI in two competing jurisdictions. The common factor in these cases is that the insolvency created the possibility of disputing the COMI to the detriment of

¹⁷⁷ Menjuq & Dammann, above n8, 145; Andrew Campbell, 'Issues in Cross-border Bank Insolvency: The European Community Directive on the Reorganization and Winding Up of Credit Institutions', (International Monetary Fund Seminar on Current Developments in Monetary and Financial Law May 7-17, 2002) viewed at <www.imf.org/external/np/leg/sem.2002/cdmfl/eng/campb/pdf> on May 22, 2011.

¹⁷⁸ *Bank of Credit and Commerce International SA* (No 9), Re [1994] 3All ER 784.

creditors. In *Eurofood IFSC Ltd*,¹⁷⁹ the problems are analysed to better understand the concept of COMI in its application to multinational banks and to provide the context for possible improvements. This chapter introduces the concept of COMI in the context of comity, as applied by the EU Insolvency Regulation and the critical issues pertaining to this.

¹⁷⁹ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

3. Introduction

This chapter discusses how the issue of COMI is being addressed in national legal frameworks and, specifically, by the EU Insolvency Regulation, the UNCITRAL Model Law on Cross-Border Insolvency, and the US Bankruptcy Code. Since the conception of these frameworks, the financial, economic and regulatory environments have changed dramatically. Most cross-border insolvency cases falling within the scope of these regulations involve corporate groups.¹⁸⁰ Multinational banks have complex legal structures with many parent and subsidiary branches. Developments in technology mean that electronic banking can transmit funds to more attractive jurisdictions within seconds. It may be argued that multinational banks have the greatest opportunity to migrate their COMI at any time and specifically immediately prior to the opening of insolvency proceedings because of these factors. Wessels states that insolvency regulation lacks adequate provisions for corporate groups such as multinational banks.¹⁸¹ It may be further stated that insolvency regulation lacks adequate provisions concerning the COMI of multinational banks prior to and post cross-border insolvency.

It has been argued that a possible solution is the application of universalism. However, LoPucki criticised universalism's inability to consolidate corporate groups and argued that universalism has the potential to facilitate and even exacerbate forum shopping.¹⁸² The theoretical debate between universalism and territorialism in the context of cross-border bank insolvencies will be discussed in Chapter 5. This chapter concludes with the issue of judicial cooperation in cross-border bank insolvency cases and the judicial use of the public policy exception.

¹⁸⁰ Menjucq & Dammann, above n8, 146.

¹⁸¹ Bob Wessels, 'Cross-border Insolvency Law in Europe: Present Status and Future Prospects', (2008) 11(1) *Potchefstroom Electronic Law Journal* 68, 93.

¹⁸² John A. E. Pottow, 'The Myth (and Realities) of Forum Shopping in Transnational Insolvency', (2007) 32 *Brooklyn Journal of International Law* 785, 786.

3.1 The principle of comity

As there is no uniform definition of COMI, the Virgos-Schmit report is used as an unofficial guide in the interpretation of COMI in literature and court decisions in the EU. The report was issued to serve as an interpretive guide to the EU 1995 Insolvency Convention. After five years, the 1995 Insolvency Convention was amended to become the Insolvency Regulation.¹⁸³ The report states that COMI normally corresponds to the head office, or to the place where the debtor conducts the business' administration and has centralized the management of its affairs (i.e., the location from which it contracts with third parties), and does not correspond to the place where the assets of the debtor, whatever the value, are located, nor to the place where goods are manufactured. The EU Insolvency Regulation defines COMI as “the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.”¹⁸⁴

Chapter 15 of the US Bankruptcy Code follows the Model Law definition of COMI as “the debtor’s registered office, or habitual residence in the case of an individual, is presumed to be the centre of the debtor’s main interests.”¹⁸⁵ Despite this widespread use, the lack of agreement on the factors underlying COMI and the considerable uncertainty surrounding its operations has rendered the concept too undeveloped¹⁸⁶ to extend the concept specifically to banks.

Therefore, the principle of comity is used as the guiding principle in the development of the current interpretation of COMI.¹⁸⁷ The principle of comity is the recognition that one nation

¹⁸³ Wessels, above n43, 258.

¹⁸⁴ *European Union Insolvency Regulation No. 1346/2000 of 19 May 2000 on Insolvency Proceedings*, (entered into force on 31 May 2002); hereafter EU Insolvency Regulation/Insolvency Regulation, Recital 13.

¹⁸⁵ 11 USC Chapter 15, §1516(c) (2006).

¹⁸⁶ Wessels, above n43, 335.

¹⁸⁷ Scott A. Bomhof and Adam M. Slavens, ‘Shifting Gears in Cross-border Insolvencies: From Comity to COMI’, (2008) 24 *Banking and Finance Law Review* 31. The concept of COMI was first noted in the *European Convention on Certain International Aspects of Bankruptcy*, May 5, 1990 (also referred to as the “Istanbul Convention”). Under Article 4, the convention states that: (1) The courts or other authorities of the Party in which the debtor has the centre of his main interests shall be considered as being competent for opening the bankruptcy. For companies and legal persons, unless the contrary is proved, the place of the registered office shall be presumed to be the centre of their main interests.

(2) The courts or other authorities of the Party in whose territory the debtor has an establishment shall also be considered as being competent:

(a) if the centre of the debtor's main interests is not located in the territory of any Party; or

(b) if the bankruptcy cannot be opened by a court or other authority of the Party competent under paragraph 1 because of the provisions of its national law and of the capacity of the debtor. In this event, that Party shall not be obliged to apply this Convention.

gives within its territory to the legislative, or judicial acts of another nation with due regard to international obligations and convenience.¹⁸⁸

The principle of comity is distinguished from the principle of COMI in that the former was developed to assist international cooperation. Courts apply the principle of comity to cooperate in conducting an orderly resolution of a firm's financial distress.¹⁸⁹ The doctrine of comity originated in the 17th century with attempts to reconcile the emerging concept of national sovereignty with the ongoing practice of applying foreign law in applicable cases.¹⁹⁰ It expresses the principle that in international practice, the laws of each nation exercised within its territory are effective everywhere in so far as the interests of another state and its citizens are not prejudiced.¹⁹¹ It was an attempt to resolve the basic dilemma between territorial sovereignty and the needs of international commerce¹⁹² where there were conflicting laws.¹⁹³ This is significant in the context of international bank insolvency. In a bankruptcy proceeding, the use of comity may enable the assets of the debtor to be dispersed in an equitable, orderly, and systematic manner. In the United Kingdom, the courts have discretion to refuse recognition if this is contrary to public policy, and under s426 of the Insolvency Act, the courts are required to give assistance, at the request of the relevant court, if it is designated as being in a 'relevant' territory.¹⁹⁴ Similarly to British courts, US courts have discretion but have to consider more specific factors including the protection of creditors and whether a broadly similar legal framework exists in the other jurisdiction before applying the principle of comity to assist a foreign court.¹⁹⁵ US courts have consistently recognised the interests of foreign courts when winding up the affairs of foreign domestic

However, when the bankruptcy of a debtor is opened under paragraph a or by courts or other authorities in various Parties in which he has an establishment, the court or authority which first gave judgment shall be considered competent.

¹⁸⁸ *Morguard Investments Ltd v De Savoye*, 3 SCR 1077 (1990), paragraph 31.

¹⁸⁹ Bomhof & Slavens, above n 186, 31.

¹⁹⁰ Brian Pearce, 'The Comity Doctrine as a Barrier to Judicial Jurisdiction', (1994) 30 *Stanford Journal of International Law* 525, 526.

¹⁹¹ Hessel E. Yntema, 'The Comity Doctrine', (1966) 65(1) *Michigan Law Review* 9, 26.

¹⁹² *Ibid*, 9.

¹⁹³ 'Cross-border Insolvency Challenges' viewed at <www.oecd.org/dataoecd/1/35/44071421.pdf> on May 22, 2011.

¹⁹⁴ *United Kingdom Insolvency Act 1986*, (UK), s426.

¹⁹⁵ Andrew Campbell, 'Issues in Cross-border Bank Insolvency: The European Community Directive on the Reorganization and Winding Up of Credit Institutions', (International Monetary Fund Seminar on Current Developments in Monetary and Financial Law May 7-17, 2002) viewed at <www.imf.org/external/np/leg/sem.2002/cdmfl/eng/campb/pdf> on May 22, 2011.

business entities.¹⁹⁶ However, COMI in cross-border insolvency is still subject to different and competing interpretations between legal regimes.

3.2 Factors in the Determination of COMI

One of the most significant issues for consideration in an international legal framework for cross-border banks is the problem of defining the home country, the centre of the debtor's main interests. The COMI is intended to be the location of the company's head office functions.¹⁹⁷ Wessels, however, noted that there are two conceptual approaches that the courts use in the determination of COMI in the EU. The first is a 'contact with creditors' or business activity approach where a debtor's COMI is determined through the eyes of creditors.¹⁹⁸ A second concept is the 'mind of management' or 'head office functions' approach where, in order to rebut the presumption that the COMI is the place of incorporation, it will be necessary to show that the head office functions are carried out in a Member State other than the state in which the registered office is situated.¹⁹⁹ As indicated, under the Model Law, the debtor's registered office is presumed to be its COMI and the determination of a debtor's COMI is central to its legal framework as this decides the main proceeding.²⁰⁰ In the determination of COMI, many factors have been considered by the courts, indicating its complexity, including the:

- i. location of the debtor's headquarters²⁰¹ or head office functions²⁰² or 'nerve centre',²⁰³;
- ii. location of a debtor's management or those who actually managed the debtor²⁰⁴ or of the operational management of the debtor²⁰⁵;

¹⁹⁶ *Cunard Steamship Coy/Salen Reefer Services* AB 773 F2d 452 at 458 (2d Cir NY, 1985).

¹⁹⁷ Miguel Virgos & Etienne Schmidt, 'Report on the Convention on Insolvency Proceedings', Virgos Schmidt Report, paragraph 76 viewed at <<http://aei.pitt.edu/952/>> on May 22, 2011.

¹⁹⁸ Wessels, above n180, 79.

¹⁹⁹ *Ibid*, 80.

²⁰⁰ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 20.

²⁰¹ *In re Tradex Swiss AG*, 384 BR 34 (Bankr. D. Mass. 2008); *Re Stanford International Bank*, [2009] EWHC 1441 (Ch); *Re MPOTEC GmbH* [2006] BCC 681.

²⁰² *ENERGOTECH SARL* [2007] BCC123; *In re MPOTEC GmbH* [2006] BCC 681 (Trib. de Grande Instance (Nanterre)); *In Re Hellas Telecommunications (Luxembourg) II SCA* [2009] EWHC 3199 (CH).

²⁰³ *Hertz Corp. v Friend* (US Supreme Court, No. 08-1107); *In the case of the Bankruptcy of Stanford International Bank. Superior Court, District of Montreal. Quebec, decision on the application of the SEC receiver, Fairfield Sentry*.

²⁰⁴ *In re Tradex Swiss AG*, 384 BR 34 (Bankr. D. Mass. 2008); *Re Stanford International Bank*, [2009] EWHC 1441 (Ch).

- iii. location of the debtor's main assets and/or creditors²⁰⁶ or the location of the majority of creditors who would be affected by the case²⁰⁷;
- iv. jurisdiction whose law would apply to most disputes²⁰⁸;
- v. location from which the administration of the debtor was organized²⁰⁹;
- vi. location from which reorganisation of the debtor was being conducted²¹⁰;
- vii. location in which the debtor was subject to supervision or regulation²¹¹; and
- viii. location which creditors recognised as being the centre of the company's operations.²¹²

The concept of COMI is flexible as it can be applied to any class of debtor and to any type of organisational structure of a debtor. However, it involves the examination and the evaluation of the debtor's circumstances and the resulting flexibility is considered a weakness by many.²¹³ It increases the risks of different conclusions being reached by courts in different jurisdictions²¹⁴; in spite of claims made about the laws in which it is used that it is an autonomous concept whose meaning is uniform and independent of any national laws.²¹⁵ The Virgos-Schmit report states that COMI normally corresponds to the head office, or to the place where the debtor conducts the business' administration and has centralized the management of its affairs (i.e., the location from which it contracts with third parties), and does not correspond to the place where the assets of the debtor, whatever the value, are located, nor to the place where goods are manufactured. According to the report, assessing where COMI is located is a matter of fact. A debtor's COMI can move but it can only have

²⁰⁵ *Eurotunnel Fin. Ltd, Tribunal de Commerce [TDC] Commercial Court Paris, Aug 2, 2006(Fr.); In re British American Insurance 425 BR 884 (Bankr. SD Fla 2010).*

²⁰⁶ *In re Tradex Swiss AG, 384 BR 34 (Bankr. D. Mass. 2008); 'Ernst & Young, Eurotunnel Fin. Ltd, Tribunal de Commerce [TDC] Commercial Court Paris, Aug 2, 2006(Fr.); In re British American Insurance 425 BR 884 (Bankr. SD Fla 2010).*

²⁰⁷ *Re Stanford International Bank, [2009] EWHC 1441 (Ch).*

²⁰⁸ *Re Stanford International Bank, [2009] EWHC 1441 (Ch). Ernst & Young; British American Insurance*

²⁰⁹ *Re Eurofood, IFSC Ltd [2005] BCC 1021; Daisytex.*

²¹⁰ *Eurotunnel Fin. Ltd, Tribunal de Commerce [TDC] Commercial Court Paris, Aug 2, 2006(Fr.); In re Ernst & Young Inc 383 BR 773 (Bankr D Colo 2008); In Re Hellas Telecommunications (Luxembourg) II SCA [2009] EWHC 3199 (CH).*

²¹¹ *In re Ernst & Young Inc 383 BR 773 (Bankr D Colo 2008).*

²¹² *Re Eurofood, IFSC Ltd [2005] BCC 1021. See also United Nations Commission of International Trade Law, Working Group V (Insolvency Law), Thirty-ninth session, Vienna, 6-10 December 2010, UN Doc. No. A/CN.9/WG.V/WP.95/Add.1, 6-7.*

²¹³ Miguel Virgos Soriano, Francisco Garcimartin & Francisco J. Garcimartin Alferez, *The European Insolvency Regulation: Law and Practice*, (Kluwer Law International, 2004), 38.

²¹⁴ *Ibid.*

²¹⁵ Look Chan Ho, 'Cross-border Fraud and Cross-border Insolvency: Proving COMI and Seeking Recognition under the Model Law', (2009) *Butterworths Journal of International Banking and Financial Law* 538.

one COMI at any given time.²¹⁶ In practice, it is often the debtor that makes the first filing, and therefore has the opportunity to present an argument to the court arguing why its COMI is located in a particular jurisdiction.²¹⁷

3.3 Factors pertaining to the Time of Recognition of COMI

Under both the Model Law and the EC Regulation, there are numerous cases concerning a debtor shifting its COMI in close proximity to the opening of insolvency proceedings.

‘The Model Law does not address the possibility to make any mention of timing with respect to the determination of COMI. It has been suggested that the timing should be made with respect to the debtor’s operational history and not merely by assessing where the COMI lay on the date of application of the commencement of the proceedings or on the date of application of recognition of those proceedings.’²¹⁸

The UNCITRAL Working Group has acknowledged and discussed the issue as to:

‘whether the time in which a company maintains its COMI in a jurisdiction should be a factor in determining the COMI of a debtor [such as] whether the COMI of a debtor should be determined as at the date on which the company was actually transacting business, and conducting business operations prior to insolvency or thereafter when the company was insolvent and under the direction of a liquidator or at the date of the application for recognition.’²¹⁹

Under the Model Law, the court considering an application for recognition must determine whether the foreign proceeding for which recognition is sought is taking place in a forum that was the debtor’s COMI when the proceeding commenced.²²⁰ Under the EC Regulation, the

²¹⁶ Sarra, above n35, 555.

²¹⁷ Adam Gallagher, ‘Centre of Main Interest: The EU Insolvency Regulation and Chapter 15’, July/August (2009) *ABI Journal European Update* 44, 45.

²¹⁸ United Nations Commission of International Trade Law, Working Group V (Insolvency Law), Thirty-ninth session, Vienna, 6-10 December 2010, Doc. No. A/CN.9/WG.V/WP.95/Add.1, 9.

²¹⁹ United Nations Commission of International Trade Law, Working Group V (Insolvency Law), Forty-third session, New York, 15-19 April 2013, Doc. No. A/CN.9/WG.V/WP.114, 123A.

²²⁰ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 15.

decision concerning COMI is made by the court receiving an application for commencement of insolvency proceedings at the time of consideration of that application.²²¹ The different purposes that COMI serves in both regimes are also arguably reflected in the different interpretations as to the time of recognition of COMI.

The various interpretations include the following:

In *Shierson v Vlieland Boddy*, the court held that the location of the debtor's COMI should be decided at the time that the court is required to decide whether to commence insolvency proceedings against the debtor.²²² This could be the date of the hearing of the petition, but could be an earlier date such as the date on which a creditor sought interim relief in advance of the hearing.²²³

In the case of *Schefenacker*, the German holding company dealing in automotive supplies had subsidiaries in England, US, Australia and Germany. Schefenacker was financially troubled and shifted its COMI to England in order to take advantage of English insolvency law for restructuring and entering into a voluntary company arrangement. The holding company's place of incorporation and COMI was shifted to England by transferring its assets and liabilities to an English holding company. The main proceedings were commenced in England and recognised across Europe. The US court held that the COMI of the debtor was in the UK and recognised the proceedings as foreign proceedings.²²⁴

In *Betcorp*, the court concurred with the lower court in *Yuval Ran* that the correct time of recognition was when the Chapter 15 case commenced, and that this was consistent with English cases interpreting the EU Regulation, which seemed to select the time connected to the commencement or service of the relevant insolvency proceeding.²²⁵

In the most recent decision of *Morning Mist Holdings Ltd v Krys (In re Fairfield Sentry)*,²²⁶ the US Second Circuit Court of Appeal held that the location of a foreign debtor's COMI is to be determined from the time of the filing of the petition in the US under Chapter 15 of the Bankruptcy Code; overriding consideration of the debtor's operating history. The

²²¹ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 16(2).

²²² *Shierson v Vlieland Boddy* [2005], 33.EWCA (Civ) 974, paragraph 55.

²²³ *Shierson v Vlieland Boddy* [2005], 33.EWCA (Civ) 974, paragraph 55.

²²⁴ *In re Schefenacker plc, No. 07-Bk-11482 (Bankr SDNY filed June 15, 2007)*.

²²⁵ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009).

²²⁶ *In re Fairfield Sentry Ltd* 440 BR 60 (2010 (July 22 2010)). (Sentry was the largest of the feeder funds that had investments with Bernard Madoff).

manipulation of a debtor's COMI could be offset by the court's consideration of the time period between the initiation of the foreign liquidation proceeding and the filing date of the petition.²²⁷ The lower court had also taken the view that 'even courts that had recently relegated the COMI focus to the time of application for recognition would likely support a totality-of-circumstances approach where appropriate.'²²⁸

These few cases alone demonstrate that the time of recognition of COMI has shown distinct variations in case law. Further examination as to the issue of time of recognition of COMI is beyond the scope of this thesis which mainly focuses on the concept of COMI.

4. The failure of a cross-border bank: problems with COMI

As mentioned above, in cross-border corporate and bank insolvencies, the basis for international jurisdictions to open insolvency proceedings is the debtor's COMI.²²⁹ International banks operating through foreign branches and subsidiaries dealing with international transactions as well as multi-bank syndicates comprising banks from many countries²³⁰ have complicated the determination of COMI in cases of cross-border insolvency. The difficulties that arise when determining the uniform criteria for the identification of COMI²³¹ have created conflicts between jurisdictions in insolvency proceedings as noted in the above cases.

One criticism is that the COMI is too important to decide at the outset before all of the interested parties have had a chance to be heard. Another is that each entity in a corporate group will have its own COMI so that the reorganization or liquidation of a multinational company will continue to be split between jurisdictions. In the case of cross-border banks, their banking activities are not explicitly addressed by national banking laws in many countries²³²; hence, this has created complex issues of law. It is increasingly obvious that a bank in financial distress will have operations in various jurisdictions.²³³ The home country

²²⁷ *In re Fairfield Sentry Ltd* 440 BR 60 (2010 (July 22 2010)).

²²⁸ *In re Fairfield Sentry Ltd* 440 BR 60 (2010 (July 22 2010)) at 66.

²²⁹ Wessels, above n180.

²³⁰ Gabriel Moss & Nick Segal, 'Cross-border Issues' in (ed.) Oditah, *Insolvency of Banks: Managing the Risks*, (FT Law and Tax 1996), 324.

²³¹ Simona D. Sano, 'COMI: The Sun Around which Cross-Border Insolvency Proceedings Revolve', Part 1, (2009) 24 (2) *Journal of International Banking Law and Regulation* 88, 94.

²³² Schobel, above n81, 195.

²³³ Campbell, above n195, 1.

of a multinational bank is not always clear and can be prone to manipulation. It has been argued that the COMI standard adopted by the EU and the Model Law was meant to solve the problem, but recent cross-border bank insolvency cases have demonstrated that choice of law problems continue in universalist systems.²³⁴ Universalism posits a one-law approach so that in any given bankruptcy, one national bankruptcy law is chosen to apply worldwide.²³⁵ Furthermore, the insolvency regime that may be applicable to the COMI of a cross-border bank will often be a critical issue in a restructuring transaction.²³⁶

The efficient resolution of cross-border banks is also hampered by conflicting court-administered procedures in various jurisdictions that present multiple challenges²³⁷ in the determination of COMI. The different approaches, the procedural and substantive differences in insolvency law²³⁸, and regime differences have expanded and exacerbated the complexity of resolving cross-border bank insolvencies. A critical issue in the determination of COMI is that the national supervisory authorities are likely to focus on domestic interests.²³⁹ The potential for serious problems increases where foreign bank operations are large compared to domestic arrangements where the home country is small and where foreign operations are not capable of being carved out in the event of a crisis.²⁴⁰ Where the foreign operation is a branch and not a subsidiary, then the bank is the responsibility of a home country that may not regard the bank as a systemic risk. Even in the event that the various countries agree on a joint solution, the host countries may not be able to ensure that the actions of the banking group follow what they would wish for in their country.²⁴¹

As noted above, there is no statutory definition of COMI,²⁴² and furthermore, the COMI of a cross-border bank can be manipulated to avoid contributing to maximising the debtor's net

²³⁴ Paulo Fernando Campana Filho, 'The Legal Framework for Cross-border Insolvency in Brazil', (2009) 32 *Houston Journal of International Law* 97, 104-5.

²³⁵ LoPucki, above n104.

²³⁶ Alistair Marshall & Cyril Pardiwala, 'Changing COMI Prior to Insolvency is Fair Game', (2007) 4(6) *International Corporate Rescue* 312.

²³⁷ Gillian G.H. Garcia, Rosa M. Lastra and Maria J. Neto, 'Bankruptcy and Reorganisation Procedures for Cross-border Banks in the EU: Towards an Integrated Approach to the Reform of the EU Safety Net', (2009) 17(3) *Journal of Financial Regulation and Compliance* 240.

²³⁸ Bank for International Settlements, above n80, 26.

²³⁹ International Monetary Fund, above n18, 11.

²⁴⁰ David G. Mayes, 'Resolution Methods for Cross-Border Banks in the Present Crisis', in Chapter 19, in John Raymond Labrosse, Rodrigo Olivares-Caminal and Dalvinder Singh, *Financial Crisis Management and Bank Resolution* (InformaLaw, 2009); 310.

²⁴¹ *Ibid*, 309.

²⁴² COMI is not defined in the Model Law, EU Regulation, or Chapter 15 of the US Bankruptcy Code or Chapter 47 of the Statutes of Canada 2005.

assets. As insolvency proceedings must be commenced where the debtor has its COMI at the time when insolvency proceedings are lodged, there is the opportunity to shift the COMI to where relevant debts were incurred and away from where creditors are located. However, attempts to shift COMI after proceedings are lodged will be ineffective.²⁴³ A strategically selected and well-established COMI can be beneficial to certain stakeholders in consideration of the specific circumstances of the insolvent bank, and can create value for certain stakeholders through the judicial process of insolvency proceedings.²⁴⁴ As noted above, in the migration of COMI, there is also the issue that COMI can be shifted to a jurisdiction that would benefit a debtor at the expense of creditors or some creditors at the expense of others.²⁴⁵ Differences in insolvency regimes mean that certain jurisdictions will be more attractive to the debtor than others.²⁴⁶ In respect of change in COMI, the change of registered office is unlikely to result in a genuine shift of COMI because the presumption that the COMI is the location of the head office is rebuttable on evidence.²⁴⁷ However, COMI can be shifted by the migration of assets and liabilities to another jurisdiction if the transfer of the assets and liabilities is valid as a matter of law in both the original and new jurisdictions. If this is not possible, the third option is to demonstrate that the administration is conducted in another jurisdiction as opposed to the country of incorporation. Whether a shift in COMI is recognised will depend on whether there has been a genuine shift of COMI that is ascertainable to third parties.²⁴⁸ In the EU Insolvency Regulation, if a company shifts its COMI from one Member State to another, this activity is protected under freedom of establishment. A company may move its real seat from one Member State to another if the change is to a more attractive regulatory environment.²⁴⁹ As will be discussed in Chapter 4, the EU Directive on the Reorganisation and Winding-up of Credit Institutions aims to address the exclusion of credit institutions from Council Regulation EC 1346/2000 on Insolvency Proceedings,²⁵⁰ but it does not address the concept of COMI which tends to occur at the onset of insolvency proceedings.

²⁴³ Louise Webb and Matthew Butler, 'Insolvency Proceedings: Shopping for the Best Forum', (2009) <<http://www.practicallaw.com>> viewed on 10 May. 2011.

²⁴⁴ Marshall and Pardiwala, above n236, 312.

²⁴⁵ Eidenmuller, above n147, 1.

²⁴⁶ Webb and Butler, above n243.

²⁴⁷ *Re Stanford International Bank*, [2009] EWHC 1441 (Ch) at 50-61.

²⁴⁸ *Re Eurofood, IFSC Ltd* [2005] BCC 1021 at 96-106.

²⁴⁹ Paschalis Paschalidis, *Freedom of Establishment and Private International Law for Corporations*, (Oxford University Press, 2012), 187.

²⁵⁰ Europa, Summaries of EU Legislation, Reorganisation and Winding-up of Credit Institutions viewed at <http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_banking/124008_en.htm> on August 4th, 2013.

The shift to a new applicable insolvency regime is made with the consideration that the new COMI are where creditors would be best protected. In spite of this, there have been cases in which the shifting of COMI amounts to an abuse of freedom of establishment. In the case of cross-border banks, there is also the potential for eve-of-bankruptcy reincorporation to occur such as in the case of *Bank of Credit and Commerce International*²⁵¹ which moved its headquarters to Saudi Arabia before the bank filed for bankruptcy. In this case, the shift of COMI was not an attempt to forum shop for bankruptcy law but an attempt to flee personal criminal jurisdiction.²⁵²

The highly liquid assets of a bank are readily movable. Eve-of-bankruptcy asset transfers and intra-debtor transfers that exploit the choice of law rules of territorialism²⁵³ can also shift COMI to the detriment of creditors. In the case of *National Warranty Insurance*,²⁵⁴ US\$24 million of its reserves were wired to the Cayman Islands just prior to filing for winding up under Cayman Islands law.²⁵⁵ It may be argued that the lack of a developed concept of COMI in international law has created the possibility for this to occur in cross-border bank insolvency. Once COMI has been determined, there is also the issue of conflicting supervisory approaches between the home and host countries of cross-border banks. Another significant issue is the problem of identifying the home country jurisdiction of an insolvent cross-border bank with complex structures, and the lack of international cooperation by banking supervisory authorities.

4.1 Home country jurisdiction and bank supervision: Bank of Credit and Commerce International

The highly complex legal structure that must be dealt with in bank insolvency law is illustrated by the Swiss banking sector. Swiss global banks, UBS and Credit Suisse Group (CSG), have their main activities outside of Switzerland where the parent companies are incorporated. Both banks are managed from a multitude of financial centres whose operations span multiple jurisdictions and time zones. The complex legal structure and

²⁵¹ *Bank of Credit and Commerce International SA* (No 9), Re [1994] 3AII ER 784.

²⁵² *Bank of Credit and Commerce International SA* (No 9), Re [1994] 3AII ER 784 at 794. See also John A.E. Pottow, above n182, 799.

²⁵³ *Ibid*, 800.

²⁵⁴ *Re National Warranty Insurance Risk Retention Group*, 42 Bankruptcy Court Decisions 179 (2004).

²⁵⁵ Pottow, above n182, 801.

organisation of global business units cut across various legal entities and regulatory sectoral boundaries between banking, securities and insurance. This creates problems between home and host countries' supervision²⁵⁶ and between host countries' supervision. These problems of cross-border contexts have made the resolution of insolvency in transnational banks infeasible within the current legal and regulatory frameworks. It has been argued that the only option is improved cross-border cooperation.²⁵⁷

Although not a Swiss bank, the insolvency of BCCI which involved the incorporated parent company in Luxembourg, operational headquarters in London, and the global spread of group assets²⁵⁸, indicates the greater clarity needed for an acceptable COMI.²⁵⁹ The World Bank Policy Research Working Paper²⁶⁰ argues that the BCCI case also illustrated the lack of effective international cooperation by banking supervisory authorities.²⁶¹ This is confirmed by Judge Rattee who noted specifically, that:

The affairs of SA and Overseas are hopelessly intertwined. This is a classic situation in which it is desirable for the courts having insolvency jurisdiction in respect of the two companies respectively to cooperate to the fullest extent possible.²⁶²

The most extreme examples of a complex, multijurisdictional insolvency and the problems which may arise where there are multiple jurisdictions are well illustrated in this case, as well as in Lehman Brothers²⁶³ which will be discussed in Chapter 5.

The BCCI Group has conducted banking business in almost 70 countries.²⁶⁴ At various times, its centre of operations was in London or Abu Dhabi. Its three major holding companies illustrate the complexity. BCCI Saudi Arabia (BCCI SA) was incorporated in

²⁵⁶ This thesis refers to home country in the context of bank supervision which occurs at the home jurisdiction of an international bank while host country supervision occurs where its affiliates such as branches and subsidiaries are located.

²⁵⁷ Eva Hupkes, 'Bank Insolvency Resolution in Switzerland' in David Mayes & Aarno. Liuksila, *Who Pays for Bank Insolvency?* (Palgrave, 2003), 242-271.

²⁵⁸ *Bank of Credit and Commerce International SA* (No 9), Re [1994] 3All ER 784.

²⁵⁹ Irit Mevorach, 'The 'Home Country' of a Multinational Enterprise Group Facing Insolvency' (2008) 57 *The International and Comparative Law Quarterly* 427, 441.

²⁶⁰ Katia D'Hustler, 'Cross-border Banking Supervision: Incentive Conflicts in Supervisory Information Sharing between Home and Host Supervisors', *The World Bank Policy Research Working Paper*, 5871, (November 2011), 1.

²⁶¹ *Ibid.*

²⁶² *Bank of Credit and Commerce International SA* (No 9), Re [1994] 3All ER 784.

²⁶³ Lastra, above n105, 91.

²⁶⁴ *Ibid.*, 110.

Luxembourg, and was the wholly-owned subsidiary of another Luxembourg company, BCCI Holdings, while the third holding company, BCCI Overseas, was incorporated in the Cayman Islands. Luxembourg and the Cayman Islands had weak banking regulations and strong bank secrecy laws so that any consolidated supervision was highly unlikely.²⁶⁵

The group conducted limited business in the three jurisdictions in which the Group's three principle holding companies were incorporated compared with the jurisdictions where its actual business was conducted, such as England.²⁶⁶ During its operation, BCCI effectively shifted its assets and liabilities from one jurisdiction to another using electronic banking technology, and shifted funds from one location to another to correspond with audit and examination cycles in different countries.²⁶⁷ The Group's complex structure and the way its transactions were conducted enabled it to confuse regulators in different jurisdictions and escape consolidated supervision.²⁶⁸ BCCI collapsed in 1991. When the group collapsed, the regulators in Saudi Arabia and the Cayman Islands, where BCCI SA and BCCI Overseas were respectively incorporated, were both unable and unwilling to exercise supervision over the empire of banking operations conducted by each parent company.²⁶⁹

BCCI SA was also the subject of winding-up proceedings before the Court of Luxembourg²⁷⁰ which stated that it was impossible to exercise adequate consolidated supervision when 98 per cent of group activities fell outside its jurisdiction²⁷¹ and for which none of the other banking supervisory authorities were prepared to take responsibility as the primary banking authority. The Bank of England, as the British banking regulator, acknowledged that BCCI Holdings was a Luxembourg bank and it believed that the optimum way to administer the Group would be to consolidate all the assets and claims on a worldwide basis.²⁷² This would require a single scheme of administration and distribution by co-ordinating the multiple,

²⁶⁵ Ibid.

²⁶⁶ Ibid.

²⁶⁷ Ibid, 116.

²⁶⁸ Richard Dale, 'Reflections on the BCCI Affair', (1992) 26 *The International Lawyer* 949.

²⁶⁹ Raj K. Bhala, *Foreign Bank Regulation after BCCI*, (Carolina Academic Press, 1994) at 115.

²⁷⁰ *Re Bank of Credit and Commerce International SA* (N02) [1991] BCC 715 at 720. The litigation of BCCI lasted 15 years. See [2006] EWHC 816 (Comm), paragraph 10 which states that 'On 23 September 2005, the English Liquidation Committee of BCCI, representing its biggest creditors, passed "a strongly worded resolution calling on Deloitte (the liquidators) to discontinue [the action] forthwith." The liquidators evidently did not comply with that resolution but instead applied to the Chancellor of the High Court, Sir Andrew Morritt, for directions. The fact that the Chancellor concluded that it was no longer in the best interests of the creditors for the litigation to continue and that he directed that it be discontinued speaks for itself.'

²⁷¹ *Re Bank of Credit and Commerce International SA* (N02) [1991] BCC 715 at paragraph 40.

²⁷² *Re Bank of Credit and Commerce International SA* (N02) [1991] BCC 715 at 770.

parallel insolvency proceedings in different countries through structured agreements which were judicially sanctioned by the courts of England, Luxembourg, and the Cayman Islands.²⁷³ The contrast between the legal structure of the Group and the economic reality illustrated the need for a new definition of home country jurisdiction.²⁷⁴ The BCCI case showed that greater international cooperation is needed among bank regulators²⁷⁵ where conflict between the various jurisdictions is easily created by the complex legal structures.

5. The unpredictability of COMI in insolvency proceedings

In complex cross-border insolvency proceedings, the location of the COMI is less predictable and often litigated²⁷⁶; in fact, it is the most litigated issue in international insolvency.²⁷⁷ A growing body of legal decisions has developed in countries in which the EU Insolvency Regulation or the Model Law is implemented. While some courts determine COMI based solely on the presumption that the registered office is the COMI, other jurisdictions review the specific facts and circumstances of a debtor's operation to determine if the registered office is the COMI or if the COMI is where the primary business operations are conducted, the primary decisions take place, and which is readily ascertainable by creditors.²⁷⁸

5.1 Judicial interpretations of COMI

As indicated, under both the EU Insolvency Regulation and the UNCITRAL Model Law, the location of the debtor's COMI or the establishment in the jurisdiction where an insolvency proceeding is commenced, determines international judicial jurisdiction.²⁷⁹ In *re Stanford International Bank*,²⁸⁰ the English court held that after *Eurofoods*, the place of the registered office was only one of the factors that a court should consider together with the whole evidence, when analyzing the debtor's COMI²⁸¹. Justice Lewison stated that:

²⁷³ *Re Bank of Credit and Commerce International SA* (N02) [1991] BCC 715 at 770.

²⁷⁴ Dale, above n268, 950.

²⁷⁵ Gerald E. Corrigan, J. Virgil Jnr Mattingly, William Taylor, 'Federal Reserve's Views on BCCI Symposium: International Bank Supervision Post BCCI', (1992) 26 *The International Lawyer* 963, 985.

²⁷⁶ Christopher J. Redmond, 'COMI: In Search of Predictability' in (2010) *Norton Annual Review of International Insolvency*, 2.

²⁷⁷ Edward J. Janger, 'Virtual Territoriality', 48 (2009-2010) *Columbia Journal of International Law* 401, 410.

²⁷⁸ *Ibid.*

²⁷⁹ Samuel L. Bufford, 'Co-ordination of Insolvency Cases for International Enterprise Groups: A Proposal', (2012) 86 *American Bankruptcy Law Journal* 685, 690.

²⁸⁰ *Re Stanford International Bank* [2009] EWHC 1441 (Ch).

²⁸¹ *Re Stanford International Bank* [2009] EWHC 1441 (Ch) at 50.

the place where the head office functions are actually carried out, without considering where the location of those functions is ascertainable by third parties, is the wrong test.²⁸²

He referred to *Re Eurofood*,²⁸³ where the Italian administrator argued that:

The focus must be on the head office functions rather than simply on the location of the head office because a "head office" can be just as nominal as a registered office if head office functions are not carried out there. In transnational business the registered office is often chosen for tax or regulatory reasons and has no real connection with the place where head office functions are actually carried out. That is particularly so in the case of groups of companies, where the head office functions for the subsidiary are often carried out at the place where the head office functions of the parent of the group are carried out.²⁸⁴

In *Re Eurofood*,²⁸⁵ the court stated that the mere fact that a parent company controls the administration of its subsidiary is not sufficient, in itself, to rebut the presumption.²⁸⁶ The ECJ confirmed that the COMI must be assessed for the subsidiary as a separate legal entity and that therefore, a subsidiary's COMI will depend on whether it is ascertainable to third parties, and not on the location of a controlling parent company.²⁸⁷

Courts have used various interpretations of COMI to clearly determine COMI with an emphasis on the reasonable ascertainment of the debtor's COMI to third parties. These recent cases contrast with past decisions by demonstrating the development of a more narrow interpretation of COMI, acknowledging that the legal structure of the group does not necessarily indicate how the company is actually managed,²⁸⁸ and recognizing that several factors contribute to identifying an establishment such as the economic impact of

²⁸² *Re Stanford International Bank* [2009] EWHC 1441 (Ch) at 61.

²⁸³ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

²⁸⁴ *Re Eurofood, IFSC Ltd* [2005] BCC 1021 at 111.

²⁸⁵ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

²⁸⁶ *Re Eurofood, IFSC Ltd* [2005] BCC 1021 at 121.

²⁸⁷ *Re Eurofood, IFSC Ltd* [2005] BCC 1021 at 4.

²⁸⁸ Bufford, above n279, 690.

the debtor's operations on the market, the maintenance of a minimum level of organization for a period of time, and the objective appearance to creditors indicating whether the debtor has a local presence.²⁸⁹ Recent cases illustrate the development of COMI from the leading EU Insolvency Regulation and Model Law cases of *Eurofood* and *Stanford* which will be studied in Chapters 4 and 5 respectively, and point towards an interpretation of COMI that assists the centralisation of insolvency proceedings.

In *Ackers v Saad Investment Company*,²⁹⁰ the Federal Court of Australia adopted the approach of the ECJ in the determination of a company's COMI. One critical issue was whether the COMI of SAAD Investments should be deemed as the registered office, as in the Model Law Article 16(3).²⁹¹ In determining the COMI, the court held that the COMI should correspond to the place where the debtor conducts the administration of her/his interests on a regular basis and which is ascertainable by third parties.²⁹² The court held that the proceedings in the Cayman Islands was a foreign proceeding for the purposes of Article 17(1) and, as a foreign main proceeding for the purposes of Article 17(2), as the COMI was presumed to be in the Cayman Islands.²⁹³

In *re Millennium Global Emerging Credit Master Fund Limited*,²⁹⁴ the US Bankruptcy Court held that the debtor's COMI was Bermuda.²⁹⁵ Two of the Funds' three directors were located in Bermuda, and the location of the Funds' banks, their custodian and their auditors were also located in Bermuda.²⁹⁶ The only center of main interests that was reasonably ascertainable by third parties pointed to Bermuda.²⁹⁷ The Offering Memorandum clearly disclosed that the Funds were located in Bermuda, and investors could have reasonably expected that Bermuda would most probably have been the venue for winding up or liquidation proceedings, and there was insufficient evidence to establish that the COMI was in any location other than Bermuda. The court reasoned that recognition of the Bermuda proceedings would be consistent with centralizing insolvency

²⁸⁹ *Ibid.*

²⁹⁰ *Ackers v Saad Investment Company* [2010] FCA 1221.

²⁹¹ *Ackers v Saad Investment Company* [2010] FCA 1221 at 2.

²⁹² *Ackers v Saad Investment Company* [2010] FCA 1221 at 42-44.

²⁹³ *Ackers v Saad Investment Company* [2010] FCA 1221 at 58.

²⁹⁴ *In re Millennium Global Emerging Credit Master Fund Limited* [2011] 458 BR 63.

²⁹⁵ *In re Millennium Global Emerging Credit Master Fund Limited* [2011] 458 BR 63.

²⁹⁶ *In re Millennium Global Emerging Credit Master Fund Limited* [2011] 458 BR 63 at 77.

²⁹⁷ *In re Millennium Global Emerging Credit Master Fund Limited* [2011] 458 BR 63 at 79.

proceedings relating to an enterprise in one forum - the principal purpose of establishing a COMI requirement.²⁹⁸

The case of *Interdil Srl*²⁹⁹ contrasts with earlier case law in which a vast majority of European courts have broadly interpreted Article 3(1) of the EU Insolvency Regulation, and decided that the COMI of each entity in a corporate group is located in the country of the parent company's registered office.³⁰⁰ In *Interdil Srl in liquidation*,³⁰¹ the court in considering the objective and ascertainable factors which might rebut a presumption³⁰² stated the following:

The presumption in the second sentence of Article 3(1) of the Regulation may be rebutted, however, where, from the viewpoint of third parties, the place in which a company's central administration is located is not the same as that of its registered office.³⁰³ The fact nevertheless remains that the presence of company assets and the existence of contracts for the financial exploitation of those assets in a Member State other than that in which the registered office is situated cannot be regarded as sufficient factors to rebut the presumption laid down by the European Union legislature unless a comprehensive assessment of all the relevant factors makes it possible to establish, in a manner that is ascertainable by third parties, that the company's actual centre of management and supervision and of the management of its interests is located in that other Member State.³⁰⁴

This significant case will be further considered in Chapter 4.

²⁹⁸ *In re Millennium Global Emerging Credit Master Fund Limited* [2011] 458 BR 63 at 81.

²⁹⁹ *Interdil Srl in Liquidation v Fallimento Interdil Srl and Intesa Gestione Crediti SpA*, Case C-396/09, [2011] WLR D 334 ECJ.

³⁰⁰ Bufford, above n279, 715.

³⁰¹ *Interdil Srl in Liquidation v Fallimento Interdil Srl and Intesa Gestione Crediti SpA*, Case C-396/09, [2011] WLR D 334 ECJ.

³⁰² *Interdil Srl in Liquidation v Fallimento Interdil Srl and Intesa Gestione Crediti SpA*, Case C-396/09, [2011] WLR D 334 ECJ at 51.

³⁰³ *Interdil Srl in Liquidation v Fallimento Interdil Srl and Intesa Gestione Crediti SpA*, Case C-396/09, [2011] WLR D 334 ECJ at 50.

³⁰⁴ *Interdil Srl in Liquidation v Fallimento Interdil Srl and Intesa Gestione Crediti SpA*, Case C-396/09, [2011] WLR D 334 ECJ at 53.

5.2 Judicial co-operation in international bank insolvency

The concept of judicial cooperation aims to minimise the conflict between different insolvency proceedings, and minimise the loss of efficiency and the higher costs resulting from a multiplicity of cases.³⁰⁵ Pottow notes that ‘one of the recurring concerns in transnational insolvency is the information costs in gaining familiarity with the law of different jurisdictions’.³⁰⁶ The ability of courts to refuse cooperation is not a solution³⁰⁷ but a reflection of the conflict in the determination of COMI in cross-border cases. The failure of a cross-border bank creates conflicts in insolvency laws as well as jurisdictional conflicts between courts in the application of those laws. This is further complicated by the role of judges in insolvency proceedings. Although judges are central to insolvency proceedings, the judicial role is not conducive to implementing reciprocity strategies³⁰⁸ that may be needed to facilitate the determination of COMI.³⁰⁹ Furthermore, when the country of incorporation, the country in which the headquarters are located, and the country with the largest share of the debtor’s assets are different, national courts also tend to differ widely in their determination of the home country. Although most courts seem to regard the country of incorporation as having the strongest claim to home country status, this is not universally accepted.³¹⁰

In the case of international bank insolvencies where significant assets and liabilities are an issue, and where there are competing local interests, there is likely to be a contest over home country status.³¹¹ It has been argued that local courts can too easily manipulate the vagueness of COMI and may rule opportunistically.

There are other sources of complications and difficulties in cooperation. There are differences between legal systems even where those systems pursue the same objectives in

³⁰⁵ Christoph Paulus, ‘Judicial Cooperation in Cross-Border Insolvencies’ viewed at <http://siteresources.worldbank.org/GILD/Resources/GJF2006JudicialCooperationinInsolvency_PaulusEN.pdf> on April 7th, 2011.

³⁰⁶ John Pottow, ‘Procedural Incrementalism: A Model for International Bankruptcy’, 45(4) (2005) *Virginia Journal of International Law* 935, 1105. See also footnote 268.

³⁰⁷ Janger, above n277, 408.

³⁰⁸ Frederick Tung, ‘Is International Bankruptcy Possible?’, 23 (2001) *Michigan Journal of International Law* 31, 39.

³⁰⁹ *Ibid.*, 50.

³¹⁰ LoPucki, above n104, 714.

³¹¹ Tung, above n308, 50.

insolvency law.³¹² COMI also represents a choice of law rule³¹³ in which the courts may choose to apply domestic law when they find foreign law substantially objectionable.³¹⁴ Similarly, the concept of sovereignty, which protects the judicial framework of jurisdictions,³¹⁵ may be used to limit international cooperation between courts.³¹⁶ The uncertainties created in the determination of COMI and by these three other factors in international bank insolvencies render judicial cooperation difficult or impossible.

This is demonstrated in the *Lehman-Perpetual*³¹⁷ cases involving entitlements to collateral worth millions of US dollars under a contract clause purporting to reverse the priority of the parties in a complex investment vehicle. The contract gave the Lehman entity priority in the collateral except in circumstances of specified defaults, including the filing of an insolvency proceeding. The priority would shift to other parties if the Lehman entity were to file for insolvency. The English court upheld the contractual ‘flip’ in priority, but the US bankruptcy court held that it violated the US rule against making default a bankruptcy condition, and that the priorities of the parties must remain as they were before the Lehman filing. The English and US courts made inconsistent rulings. The trustee, the Bank of New York, was at risk of being ordered to obey these contradictory orders. The judges recognized this difficulty and encouraged the parties to reach agreement.³¹⁸ This case illustrates the risk of inconsistent judgments that inevitably arise from a failure to address international problems in a single forum or with a central, main proceeding.³¹⁹

The importance of judicial cooperation in international bank insolvency proceedings is increasing as the universality principle gains prominence in the treatment of cross-border insolvencies.³²⁰ In spite of this, Paulus noted that the universality ideal, in which insolvency cases are resolved in one proceeding under the law of one jurisdiction, is seldom achievable.

³¹² Giorgio Corno, ‘Cross-Border Insolvency: the EU Community Law Approach’, (2003) 1 *Business Law International* 3.

³¹³ Edward J. Janger, ‘Reciprocal Comity’, 46 (2010-2011) *Texas International Law Journal* 441, 443.

³¹⁴ Erin A. O’Hara & Larry E. Ribstein, ‘From Politics to Efficiency in Choice of Law’, 67 (2000) *University of Chicago Law Review* 1151, 1158-60.

³¹⁵ Bob Wessels, *Judicial Cooperation in Cross-Border Insolvency Cases* (Kluwer, 2008), 22.

³¹⁶ LoPucki, above n104, 760.

³¹⁷ *Lehman Brothers Special Financing Inc. v BNY Corporate Trustee Services Ltd* 422 BR 407 (Bankr SDNY 2010).

³¹⁸ *Lehman Brothers Special Financing Inc. v BNY Corporate Trustee Services Ltd* 422 BR 407 (Bankr SDNY 2010).

³¹⁹ Jay Lawrence Westbrook, ‘A Comment on Universal Proceduralism’, (2010) 48(3) *Columbia Journal of Transnational Law* 503, 513.

³²⁰ Tung, above n308, 32.

The main proceeding in cross-border insolvencies is often disrupted by the commencement of parallel proceedings in another jurisdiction.³²¹ In the absence of a system in which there is automatic recognition of the opening of an insolvency proceeding, it is difficult to avoid parallel proceedings in multiple jurisdictions each seeking to be recognised as a main proceeding.³²² The necessity for judicial cooperation in cross-border insolvencies is discussed further in Chapter 7. The public policy exception as applied by courts is discussed in the following section.

6. The public policy exception

Under the public policy exception, a court may refuse to enforce a foreign judgment because enforcement would violate public policy in the jurisdiction in which the court is situated.³²³ Article 6 of the Model Law, if interpreted literally, allows a domestic court to refuse to take action if such an action would be manifestly contrary to the public policy doctrine or ordre public of the domestic state.³²⁴ The Model Law's Guide to Enactment indicates that in relation to COMI, the public policy exception should be interpreted restrictively and that it is only intended to apply in exceptional circumstances concerning matters of fundamental importance to the enacting state which would be contravened. However, the application of the public policy exception varies between jurisdictions that have adopted Article 6. The EU Insolvency Regulation also provides in Article 26 that

'any member state may refuse to recognise insolvency proceedings recognised in another member state or to enforce a judgement handed down in the context of such proceedings where the effects of such recognition or enforcement would be manifestly contrary to that state's public policy.'³²⁵

³²¹ Christoph Paulus, 'Judicial Cooperation in Cross-Border Insolvencies' viewed at <http://siteresources.worldbank.org/GILD/Resources/GJF2006JudicialCooperationinInsolvency_PaulusEN.pdf> on April 7th, 2011.

³²² Irit Mevorach, 'Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency', (2010) 18 *Cardozo Journal of International and Comparative Law* 359, 391.

³²³ Karen E. Minehan, 'The Public Policy Exception to the Enforcement of Foreign Judgements: Necessary or Nemesis?', (1995-6) 18 *Loyola of Los Angeles International and Comparative Law Journal* 95.

³²⁴ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997).

³²⁵ *European Union Insolvency Regulation, No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002).

In England, the recognition of foreign legislation remains subject to considerations of public policy. In *Metliss v National Bank of Greece*,³²⁶ the Greek authorities amended a relevant decree retrospectively, so that guaranteed bonds and other foreign currency obligations were excluded from the succession to the rights and obligations of a predecessor bank.³²⁷ This led to further proceedings and, in *Adams v National Bank of Greece*,³²⁸ the House of Lords characterized this amendment as a law which had the effect of discharging the obligations under the bonds. The Greek law failed in its objective of relieving the bank of its obligations. However, it was suggested that the English court could in any event have disregarded the amending decree on the grounds that it discriminated against creditors and, as such, it would have been contrary to public policy.³²⁹ The debtor or creditor is placed in a position analogous to one who holds security to a value equivalent to the debt that is owed.

The public policy exception in common law courts contrasts with the more restrictive interpretation in civil law jurisdictions. In civil law, all creditors who are indebted to the insolvent estate are required to repay the full debt, as a precondition for eligible participation in the distribution of the realised assets. According to this principle in civil law jurisdictions, set-off is admissible only in the special situation where the two-way liabilities arise out of the contract between the two parties in question.³³⁰ In *Re Bank of Credit and Commerce International SA (In Liquidation) (No 10)*,³³¹ an English court applied principles of public policy to the doctrine of set-off. It was prepared to protect the interests of English creditors where the application of foreign law was prejudicial to their interests.³³² As a matter of public policy, there was no possibility for the wider understanding of set-off to not be applied in the context of English insolvency proceedings.³³³ *Eurofood IFSC Ltd*³³⁴ tested the EU's understanding of the limits of national determinations of public policy in refusing to recognise foreign insolvency proceedings. The European Court of Justice urged greater restraint in construing public policy and acknowledged the option of recognizing foreign proceedings although they are manifestly contrary to domestic public policy. The court held

³²⁶ *Metliss v National Bank of Greece* [1958] AC 509.

³²⁷ *Metliss v National Bank of Greece* [1958] AC 509.

³²⁸ *Adams v National Bank of Greece and Athens SA* [1961] AC 255 HL.

³²⁹ *Adams v National Bank of Greece and Athens SA* [1961] AC 255 at 279-281, 287-288 HL.

³³⁰ Ian F. Fletcher, 'International Insolvency Issues: Recent Cases', (1997) (September) *Journal of Business Law* 471, 472.

³³¹ *Re Bank of Credit and Commerce International SA (In Liquidation) (No 10)* [1997] 2 WLR 172.

³³² *Re Bank of Credit and Commerce International SA (In Liquidation) (No 10)* [1997] 2 WLR 172, paragraph 5.

³³³ *Re Bank of Credit and Commerce International SA (In Liquidation) (No 10)* [1997] 2 WLR 172, paragraph 5.

³³⁴ *Re Eurofood, IFSC Ltd* (2005) BCC 1021, [Case C-314/04 on Council Regulation 1346/2000 on Insolvency Proceedings].

that the public policy exception should be used only where the recognition or enforcement of another member state's judgement is at variance to an 'unacceptable degree' with the legal order of the member state in which enforcement is sought.³³⁵ The court left the decision to individual member states to determine whether a foreign proceeding would warrant non-recognition pursuant to Article 26.

7. Conclusion

The potential conflicts arising from the law governing the initiation of insolvency proceedings which determines when and how supervisory intervention and insolvency will occur, is a complication in cross-border bank resolution and crisis management.³³⁶ As indicated, the challenges faced by the failure of international banks include multiple insolvency actions in multiple jurisdictions, spill-over into other financial institutions and markets, and a grab for national assets by local authorities.³³⁷ In cross-border bank insolvency, there are few standard international rules to govern the failure of banks and financial institutions³³⁸ and to effectively deal with these challenges. The few international rules that exist tend to address insolvency rules within economic or geographical relationships such as the EU Insolvency Regulation which does not apply to banks. Article 1(2) excludes from its scope insolvency proceedings concerning insurance undertakings, credit institutions, investments undertakings, holding funds or securities for third parties, and collective investment undertakings. It has been argued that these international rules address primarily judicial and regulatory cooperation rather than the substance of the law governing insolvency. These rules are appropriate for addressing "hard" assets but not the liquid assets of banks. The current international insolvency law might also not be appropriate for addressing the possible contagion effects of the rapidly changing markets and payment processes of banks.³³⁹ International insolvency law might be inadequate in preventing these cross-border banks from migrating liquid assets and manipulating intra-group transactions.

³³⁵ *Re Eurofood, IFSC Ltd* [2005] BCC 1021, (C-341/04 ECJ May 2, 2006) at 1041-1047.

³³⁶ Michael H. Krimminger, 'The Resolution of Cross-border Banks: Issues for Deposit Insurers and Proposals for Co-operation', (2008) 4(4) *Journal of Financial Stability* 376, 382.

³³⁷ Richard J. Herring, 'International Financial Conglomerates: Implications for the Bank Insolvency Regime', *Second Annual International Policy Seminar*, Policy Changes for the Financial Centre in the Context of Globalization sponsored by the World Bank, International Monetary Fund & Federal Reserve Board, Washington D.C., June 6, 2002 viewed at <http://www1.worldbank.org/finance/assets/images/Herring--intl_finance> on March 10th, 2011.

³³⁸ Krimminger, above n336, 379.

³³⁹ *Ibid.*

It can be argued that a key problem is that although international bank insolvency has become increasingly complex, the legal infrastructure of international insolvency remains largely unchanged.

International insolvency regimes require an international system that can enforce market discipline, international standards and regulation, and provide clear solutions. The limitations of the legal frameworks in which banks and banking activities operate have prevented finding a solution to the jurisdictional conflicts in cross-border bank insolvencies and have complicated the determination of COMI. The determination of COMI in international bank insolvencies has magnified the inability of the current legal framework to provide effective solutions. This chapter introduced the concept of COMI and discussed the transnational problems arising from the lack of a universal definition. The next chapter will elaborate on this discussion by examining the concept of COMI in the EU Insolvency Regulation.

CHAPTER 4: THE EU INSOLVENCY REGULATION, INTERNATIONAL BANKS AND COMI

Chapter Overview

This chapter examines the EU Insolvency Regulation as the first international insolvency regime, and the regulation which establishes a common framework for insolvency proceedings in the EU. The chapter elaborates on the preceding chapters and considers the concept of COMI and the concept of corporate groups in the EU Insolvency Regulation. This chapter furthermore discusses the test for jurisdictions to open proceedings and the case of *Kaupthing Capital Partners II Master LP Inc.* It examines the problem related to the implementation of Article 3(1) in the Insolvency Regulation which focuses on the concept of COMI as the ground for opening main insolvency proceedings.

The chapter undertakes a legal analysis of Article 3(1) and its problems of implementation in cross-border bank insolvency proceedings. In international bank insolvency, one significant problem is that Article 3(1) implies that the concept of COMI can work only with the universality principle whereby one court is competent to open a single set of insolvency proceedings, leading to a worldwide insolvency proceeding and that a specific COMI can be determined for each individual firm utilizing the single-entity approach. In international bank insolvencies, this process is complicated by their legal and operational structures which produce a different conclusion. In the EU Insolvency Regulation, the concept of COMI applies to determine the home country of a financial institution as the COMI concerns the proper place for commencement of proceedings and thus, the applicable law. In the Model Law, the COMI forms the basis of the recognition process and determines the relief flowing from recognition of a foreign proceeding.³⁴⁰

The chapter also discusses the European Union Directive on the Re-organisation and Winding Up of Credit Institutions and the gap in the Directive and the EU legal framework of addressing subsidiaries of large, complex financial institutions. In the Directive, the jurisdiction of courts is not based on COMI and secondary proceedings cannot be opened.

³⁴⁰ United Nations Commission on International Trade Law, Working Group V (Insolvency Law), Forty-fifth session, New York, 21-25 April 2014, 'Insolvency law: Facilitating the cross-border insolvency of multinational enterprise groups', Doc. No. A/CN.9/WG.V/WP.120, 4.

The idea is that in the single entity approach a bank is wound up as one legal entity and that the supervision of the home Member State should not be interrupted. Exclusive jurisdiction is provided to the home Member State's administrative or judicial authorities to decide on the implementation of one or more reorganization measures. Decisive is (not COMI, but) the institution's registered seat. The single entity approach follows from the addressees of the measures 'in' a credit institution 'including branches established in other Member States'. The concept of COMI is still relevant as the parent-subsidiary relationship means that subsidiary companies of the parent bank can each have their own COMI in various jurisdictions leading to multi-jurisdictional conflict. When courts are likely to declare COMI status on behalf of debtors that are beneficial to national interests, this can result in a first to file/first to win race.³⁴¹

This chapter discusses the issue of cross-border banking laws which is not explicitly addressed by many national legal systems and those which do generally fail to address crucial cross-border issues concerning the regulation of banking activities. The study of the *Eurofood IFSC Ltd* case illustrates the significance of this problem and *MPOTEC GmbH*³⁴² illustrates the court's use of the headquarters functions test to locate the COMI of subsidiaries at the registered office of the controlling company.

³⁴¹ Pedro Jose F. Bernardo, 'Cross-border Insolvency and the Challenges of the Global Corporation: Evaluating Globalization and Stakeholder Predictability through the UNCITRAL Model Law on Cross-border Insolvency and the European Union Insolvency Regulation', 56 (2012) *Anteneo Law Journal* 799.

³⁴² *Re MPOTEC GmbH* [2006] BCC 681.

4. Introduction

Article 3 of the EU Insolvency Regulation concerns international jurisdiction. Article 3(1) states that:

The courts of the Contracting State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or a legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.

Article 3(2) states that:

Where the centre of a debtor's main interests is situated within the territory of a Contracting State, the courts of another Contracting State shall have jurisdiction to open insolvency proceedings against that debtor only if he possesses an establishment within the territory of that other Contracting State. The effects of those proceedings shall be restricted to the assets of the debtor situated in the territory of the latter Contracting State.

Article 3(3) states that:

Where insolvency proceedings have been opened under paragraph 1, any proceedings opened subsequently under paragraph 2 shall be secondary proceedings. These latter proceedings must be winding up proceedings.

The problem with the implementation of the Insolvency Regulation focuses on the concept of COMI as a ground for opening main insolvency proceedings and its Article 3(1).³⁴³ As indicated, Article 3(1) of the Directive concerns international regulatory authority and the principle of unity. Exclusive jurisdiction is provided to the home Member State's judicial or administrative authorities to decide on the implementation of bank reorganisation. The assets

³⁴³ Note Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings, Article 16(2): Recognition of the proceedings in Article 3(1) shall not preclude the opening of the proceedings referred to in Article 3(2) by a court in another Member State. The latter shall be secondary insolvency proceedings within the meaning of Chapter III.

of the bank in its home Member State include the assets of branches in a host state jurisdiction.³⁴⁴ All worldwide creditors can prove their claims in the unified proceeding.³⁴⁵

The first problem with Article 3(1) is that the concept of COMI can only work with the universality principle whereby one court is competent to open a single set of insolvency proceedings, leading to a worldwide insolvency proceeding. The Insolvency Regulation implies that a specific COMI can be determined for each individual firm utilizing the single-entity approach. However, the practical experience with the Regulation lends itself to a different conclusion. International groups with operations in different countries have the chance to open insolvency proceedings in one of various countries, leaving an option for forum shopping. The vast majority of legal scholars take the view that there can be only one COMI, whose location has to be constructed by the national judge on a case-by-case basis in the light of universal criteria deriving from the EU Insolvency Regulation as interpreted by the decisions of the European Court of Justice (ECJ).³⁴⁶ In the European Union, domestic courts have interpreted the Insolvency Regulation in a manner which effectively fills in the gaps of coordinated corporate group insolvencies that the Regulation has failed to address. However, there is the risk that several courts will take on insolvency jurisdiction in a particular case on the basis of different interpretations of Article 3(1).³⁴⁷

In Europe, there are mainly two judicial viewpoints regarding the concept of COMI. Firstly, there are courts that place emphasis on Article 3(1) of the Insolvency Regulation. They assume that the debtor's COMI corresponds to the statutory seat of the company or its place of incorporation. This viewpoint was clearly exemplified in the *Eurofood IFSC Ltd* decision of the Irish Supreme Court. It saw very little reason to depart from the presumption in Article 3(1).³⁴⁸ Secondly, there is the viewpoint that emphasis should instead be placed on Recital 13 to the Insolvency Regulation. The fact that the place from where the interests are administered needs to be ascertainable to third parties is strongly emphasized. The third parties are the creditors. The courts that take this viewpoint easily overturn the presumption

³⁴⁴ *European Union Insolvency Regulation, No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002), Article 3(1). See Bob Wessels, *Current Topics on International Insolvency Law* (Kluwer, 2004), 270.

³⁴⁵ *Ibid.*

³⁴⁶ Sano, above n231, 93.

³⁴⁷ Paul J. Omar, *International Insolvency Law* (Ashgate Publishing, 2008), 177.

³⁴⁸ *Re Eurofood, IFSC Ltd* [2005] BCC 1021. (C-341/04 ECJ May 2, 2006), paragraph 32.

in Article 3(1) and take main insolvency jurisdiction over the companies.³⁴⁹ Ultimately, in order for adequate legal protection and certainty to exist, it is imperative that the COMI be predictable and relatively stable.³⁵⁰ The current approach of the Insolvency Regulation creates significant impediments to the implementation of an effective COMI in one applicable jurisdiction which governs the applicable law.

4.1 The EU Insolvency Regulation and Corporate Groups

The EU Regulation on Insolvency Proceedings ignores insolvency in the context of a multinational group of companies including banks and financial institutions. Internationally, most jurisdictions do not have insolvency laws specifically developed to address corporate groups and there is an absence of a coherent definition for domestic or international groups.³⁵¹ During the GFC, certain large insolvency cases involving multinational enterprises organized as corporate groups made it clear that the issues of group insolvency need to be dealt with at an international level.³⁵² When these regimes first appeared, there was consensus that it would be virtually impossible to reconcile the need for an effective international approach and pressure at the level of national jurisdictions to enforce a separate national treatment for each company in the group.³⁵³ Both regimes confine their application to a much less frequent and, as a practical matter, much less important situation in which the insolvent debtor (a legal entity) is a single corporation with assets or creditors in more than one national jurisdiction.³⁵⁴ Lastra stated that the absence of a group-wide approach could lead to the failure of subsidiaries or the entire group, which could otherwise have been reorganized and remained wholly or partially solvent.³⁵⁵

In respect of the EU Insolvency Regulation, Mazzoni noted that its rigidity has caused the proliferation of certain legal problems in cases in corporate groups with assets or liabilities in more than one Member State producing legal uncertainties and encouraging forum

³⁴⁹ Omar, above n347, 178-180.

³⁵⁰ Nicholaes W.A. Tollenaar, 'Dealing with the Insolvency of Multinational Groups under the European Insolvency Regulation', (2010) 23(5) *Insolvency Intelligence* 65, 66.

³⁵¹ Mevorach, above n322, 330.

³⁵² *Ibid.*

³⁵³ Alberto Mazzoni, 'Cross-border Insolvency of Multinational Groups of Companies: Proposals for an European Approach in the Light of the UNCITRAL Approach', (2010) 24(4) *Dritto del Commercio Internazionale* 755, 755-756.

³⁵⁴ *Ibid.*, 756.

³⁵⁵ Lastra, above n105, 166.

shopping.³⁵⁶ Although the rules for COMI are designed to prevent manipulation,³⁵⁷ Wessels is of the opinion that the current impetus of the EU law mandates for the admissibility of forum shopping. It is usually more difficult to move a centre of main interest across a border than a registered office or to move the factual criteria that constitute the company's centre to another country.³⁵⁸ Gelter notes that in Europe, the substantive rules of bankruptcy may lend themselves to actual regulatory competition, which implies states adapting their law to attract insolvency filings, may also be possible.³⁵⁹ According to LoPucki, judges are motivated by the glamour of handling 'celebrity' bankruptcies and their increased standing in the legal community resulting from these. Gelter further notes that shopping between different European bankruptcy regimes may create regulatory arbitrage.³⁶⁰ There is the problem that firms cannot commit to insolvency proceedings in a particular jurisdiction to their creditors as the decision of the applicable legal regime is made only when insolvency proceedings are initiated. He argues that the European Insolvency Regulation offers ex-post forum shopping opportunities³⁶¹ that reduce ex-ante predictability for creditors and therefore increases the agency cost of debt.³⁶²

The case for new European rules that address the cross-border insolvency of financial groups has been highlighted in the recent financial crisis of 2008.³⁶³ The exposure of European banks to the US sub-prime mortgage crisis had exacerbated the impact of the EU crisis on the cross-entity linkages in financial groups. As discussed in Chapter 1, the solvency of particular entities may be very much contingent upon the financial situation of other group members, and the extent of their integration as a group.³⁶⁴

³⁵⁶ Mazzoni, above n353, 757.

³⁵⁷ Wolf-Georg Ringe, 'Forum Shopping under the EU Insolvency Regulation', (2008) 9(4) *European Organisation Law Review* 579, 594.

³⁵⁸ H.C. Duursma-Kepplinger, 'Aktuelle Entwicklungen in Bezug auf die Vorschriften über die internationale Eröffnungszuständigkeit nach der Europäischen Insolvenzverordnung', 16 *Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht* (2006), 177, 179.

³⁵⁹ Luca Enriques & Martin Gelter, 'How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law', Harvard John M. Olin Center for Law, Economics, and Business Fellows' Discussion Paper Series, Discussion Paper No. 19 (July, 2008), 52.

³⁶⁰ *Ibid.*, 53.

³⁶¹ *Ibid.*, 59.

³⁶² *Ibid.*, 54.

³⁶³ Walter W. Eubanks, 'The European Union's Response to the 2007-2009 Financial Crisis', August 13, 2010 viewed at <<http://www.fas.org/sgp/crs/row/R41367.pdf>> on February 11th, 2012.

³⁶⁴ Mevorach, above n4, 432.

The initiatives by the EU and the Model Law address only internationally active affiliated enterprise systems.³⁶⁵ The law of affiliated enterprise systems concerns corporate groups where each member of the group is a separate and independent company with its own legal personality. The OECD includes subsidiaries and branches as affiliated enterprises.³⁶⁶ These legal entities are affiliated but independent.³⁶⁷ The presence of the parent corporation, its component parts, and the extent that it exercises control over the subsidiary are issues relevant to affiliated enterprise systems.³⁶⁸ It is the parent corporation that bears the economic risks of all group members and if the parent corporation becomes insolvent, the entire group breaks down economically and all group members become insolvent. In spite of this, the subsidiary has its own rights and incurs its own obligations. The rights of the subsidiaries are never simultaneously the rights and obligations of the parent corporation or of the group. The corporate group does not have a legal personality of its own. Apart from extremely rare cases of two equal holding corporations, affiliated enterprise systems internationally are based on the degree of “control” that one corporation exercises over another.³⁶⁹

The European countries have traditionally relied more on statutory law and these statutes have included provisions for affiliated enterprise systems.³⁷⁰ For example, the *German Stock Corporations Act*³⁷¹ includes detailed provisions applicable to different forms of affiliation according to the nature of their association. At the core of these provisions is the concept of ‘*konzerne*’ (affiliated enterprise systems) which is defined as a group of enterprises joined by uniform management.³⁷² The European legal systems and US case law³⁷³ show that control does not change the legal situation, especially not common law, private law and corporate law. The parent corporation’s exercising control over the subsidiary may produce problems when cross-ownership in various jurisdictions and different approaches to affiliated enterprise systems occur, as in international banks.³⁷⁴

³⁶⁵ Marcus Lutter, Book Reviews: Enterprise Law Corp. v Entity Law Inc- Phillip Blumberg’s Book From the Point of View of an European Lawyer, 960-961, (1990) 38 *American Journal of Comparative Law* 49, 52. Phillip I. Blumberg, *American Journal of Comparative Law*, 952..

³⁶⁶ Organisation for Economic Co-operation and Development, ‘Glossary of Foreign Direct Investment Terms and Conditions’, viewed at <<http://www.oecd.org/dataoecd/56/1/2487495.pdf>> on February 7, 2012.

³⁶⁷ Lutter, above n365, 959.

³⁶⁸ Ibid.

³⁶⁹ Ibid, 952.

³⁷⁰ Ibid.

³⁷¹ Ibid.

³⁷² Ercklentz, Enno W., Jr, *Modern German Corporation Law*, (Dobbs Ferry/New York: Oceana Publications Inc., 1979).

³⁷³ Ibid.

³⁷⁴ Ibid.

Ultimately, the international financial crisis has given a powerful momentum to the initiatives aimed at making international rules in respect of the insolvency of international corporate groups³⁷⁵ and strengthened the case for new European rules. During the recent financial crisis, among policy makers and regulators, no-one was responsible for looking at the system as a whole.³⁷⁶ In a similar vein, it may be argued that the insolvency of multinational enterprise groups (MEG) implies taking a worldwide perspective.³⁷⁷ The group problem in the context of large, complex financial institutions will be discussed further in this chapter.

5. COMI in the EU Insolvency Regulation

As indicated, the European Regulation adopts the COMI test for ascertaining jurisdiction for the main proceeding involving an international corporation.³⁷⁸ Recital 13 provides that COMI should relate to the place where the debtor conducts the administration of its interests on a regular basis. Every debtor is supposed to have only a single COMI and all temporary places where the debtor establishes a COMI are ruled out.³⁷⁹ The debtor's COMI is pivotal to the entire structure of the Insolvency Regulation.³⁸⁰ The lack of definition of COMI in the Regulation is an expression of the EU's legislator's intention '...to leave some scope for judicial discretion and common sense to be exercised in the light of circumstances encountered in each case'.³⁸¹ Although theoretically this would remove uncertainties, in practice, the uncertainty that remains with the scope of judicial discretion lies in the varied evidentiary requirements to comply with the test for determination of COMI.³⁸² Although the

³⁷⁵ Ibid.

³⁷⁶ Brenda Cronin, 'Economists Debate Financial Crisis Causes, Cures', Real Time Economics, *The Wall Street Journal*, December 14, 2011.

³⁷⁷ Irit Mevorach, 'Multinational Enterprise Groups Facing Insolvency', *International and Comparative Law Quarterly*, 435.

³⁷⁸ Irit Mevorach, 'Jurisdiction in Insolvency: A Study of European Courts' Decisions', *Journal of Private International Law* 6(2) 327.

³⁷⁸ EU Regulation on Insolvency Proceedings, Recital 13; Bogdan, M., 'The EU Bankruptcy Convention' (1997) *International Insolvency Review* 114, 119.

³⁷⁹ *European Union Insolvency Regulation, No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002, Recital 13; Michael Bogdan, 'The EU Bankruptcy Convention' (1997) *International Insolvency Review* 114, 119.

³⁸⁰ Sano, above n231, 93.

³⁸¹ Ibid.

³⁸² Vanessa M. Cross, 'COMI, Corporate Groups and Forum Shopping: A Comparison of EU and US Cross-border Insolvency Law', (Research paper submitted in partial fulfillment of the requirements of the degree of LL.M., 25 June 2007), 10.

Insolvency Regulation addresses COMI, the development of the concept is from ECJ case law³⁸³ with different judicial interpretations of the COMI standard.

Furthermore, the uncertainty in respect of the definition produces uncertainty about the enforceability of the EU Insolvency Regulation as a whole. The efficient coordination of cross-border insolvency proceedings and the automatic recognition of the decisions concerning the opening, the development and the ending of the main insolvency proceedings are also adversely affected by the uncertainty surrounding COMI.³⁸⁴ The Insolvency Regulation attempts to enhance legal certainty through the introduction of a rebuttable presumption that the COMI of a company or legal persons is the place of its registered office.³⁸⁵ The place from where the administration of the commercial interests is conducted seems to be preferred above the location of assets.³⁸⁶ In many cases, the place of registration will provide an important indication but it cannot be the determinative factor.³⁸⁷ The landmark case of *Interdil Srl* illustrates the recent interpretation of the concept of COMI.

Interdil Srl³⁸⁸

Interdil³⁸⁹ had its registered office in Italy. On 18 July 2001, it transferred its registered office to London and was registered with the United Kingdom register of companies as a foreign company. On 28 October 2003, Intesa, one of Interdil's creditors, filed a petition for the opening of proceedings against Interdil. Interdil challenged the jurisdiction of the court arguing that its COMI was in England and not Italy, following the *Eurofoods* case. On 20 May 2005, the Corte Suprema di Cassazione held that the Italian courts had jurisdiction. The view taken was that the COMI corresponded to the place of the registered office and could be rebutted as a result of various circumstances. In this case, this constituted the presence of immovable property in Italy owned by Interdil, the existence of a lease agreement in respect

³⁸³ Ibid.

³⁸⁴ Ibid, 47.

³⁸⁵ Ibid.

³⁸⁶ Omar, above n347, 177.

³⁸⁷ H De Wulf & P. Wautelet, 'Aspecten van international privaatrecht' in Braekmans, H., E. Dirix, and E. Wymeersch (eds), *Faillissement en Gerechtelijk Akkoord: Het Nieuwe Recht*, (1998, Kluwer Editions Juridique Belgique, Waterloo) 132, 151-152.

³⁸⁸ *Interdil Srl in Liquidation v Fallimento Interdil Srl and Intesa Gestione Crediti SpA*, Case C-396/09.[2011] WLR D 334 ECJ. The Interdil case concerns the interpretation of Article 3 of Council Regulation (EC) No1346/2000 of 29 May 2000 on insolvency proceedings (OJ 2000 L 160, p. 1) ('the Regulation').

³⁸⁹ *Interdil Srl in liquidation*, Case C-396/0920, October 2011.

of two hotel complexes and a contract concluded with a banking institution, and the fact that the Bari register of companies had not been notified of the transfer of Interedil's registered office. The case placed renewed emphasis on the management and supervision of the company. The Tribunale di Bari decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling, doubting the validity of the Corte Suprema di Cassazione's finding, in consideration of the criteria that was put forth by the Court in Case C-341/04 *Eurofood IFSC* [2006] ECR I-3813. The four questions were:

- '1. Is the term "the centre of a debtor's main interests" in Article 3(1) of [the] Regulation ... to be interpreted in accordance with Community law or national law, and, if the former, how is that term to be defined and what are the decisive factors or considerations for the purpose of identifying the "centre of main interests"?
2. Can the presumption laid down in Article 3(1) of [the] Regulation ..., according to which "[i]n the case of a company ... the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary", be rebutted if it is established that the company carries on genuine business activity in a State other than that in which it has its registered office, or is it necessary, in order for the presumption to be deemed rebutted, to establish that the company has not carried on any business activity in the State in which it has its registered office?
3. If a company has, in a Member State other than that in which it has its registered office, immovable property, a lease agreement concluded by the debtor company with another company in respect of two hotel complexes, and a contract with a banking institution, are these sufficient factors or considerations to rebut the presumption laid down in Article 3(1) of [the] Regulation ... that the place of the company's "registered office" is the centre of its main interests and are such circumstances sufficient for the company to be regarded as having an "establishment" in that Member State within the meaning of Article 3(2) of [the] Regulation ...?
4. If the ruling on jurisdiction by the Corte [suprema] di cassazione in the aforementioned Order ... is based on an interpretation of Article 3 of [the] Regulation ... which is at variance with that of the Court of Justice ..., is the application of that provision of Community law, as interpreted by the Court of Justice, precluded by Article 382 of the

[Italian] Code of Civil Procedure, according to which rulings on jurisdiction by the Corte [suprema] di cassazione are final and binding?³⁹⁰

The ECJ held that greater importance must be attached to the place of the company's central administration which may be established by objective factors which are ascertainable by third parties. The ECJ stated that the presumption cannot be rebutted where the management and supervision of a company are in the same place as its registered office and the management decisions are taken in a manner that is ascertainable by third parties. It further emphasized the central administration of the company when it stated that:

Where a company's central administration is not in the same place as its registered office, the presence of company assets and the existence of contracts for the financial exploitation of those assets in a Member State other than that in which the registered office is situated cannot be regarded as sufficient factors to rebut the presumption unless a comprehensive assessment of all the relevant factors makes it possible to establish, in a manner that is ascertainable by third parties, that the company's actual centre of management and supervision and of the management of its interests is located in that other Member State; where a debtor company's registered office is transferred before a request to open insolvency proceedings is lodged, the company's centre of main activities is presumed to be the place of its new registered office.³⁹¹

There are now two decisions from the ECJ that attach greater importance to the place where the company has its central administration. The registered office presumption is undoubtedly weaker.

³⁹⁰ *Eurofood IFSC* [2006] ECR I-3813, paragraph 44.

³⁹¹ *Interdil Srl in Liquidation v Fallimento Interdil Srl and Intesa Gestione Crediti SpA*, Case C-396/09.[2011] WLR D 334 ECJ, paragraph 65.

5.1 Test for jurisdiction to open proceedings: *Kaupthing Capital Partners II Master LP Inc.*³⁹²

Kaupthing Capital Partners II Master LP (Master) was a Guernsey limited partnership. Master was a special purpose vehicle used in connection with an investment fund known as *Kaupthing Capital Partners II*.³⁹³ It was set up to allow the *Kaupthing* group to invest alongside the group parent, *Kaupthing Bank hf*, the Icelandic bank which was the largest investor in the fund. Master elected to have a separate legal personality under Guernsey Law.³⁹⁴ Master kept registered offices in Guernsey but its day-to-day activities were managed by its operator in London, which was part of a larger group of companies that delegated certain administrative functions to *Kaupthing Bank Luxembourg SA* (BankLux) and delegated investment management to *Kaupthing, Singer & Friedlander Limited* (“KSF”).³⁹⁵ On 7 October, 2008, the formal insolvency of *Kaupthing Bank hf* immediately affected the rest of the group. The next day, BankLux demanded repayment of Master’s credit facility of £67 million. Master was unable to comply and also became insolvent.³⁹⁶ Towards the end of Master’s administration, there was a disagreement between the administrators and the creditors as to what the administrators ought to consider when selling one of Master’s remaining assets, a debt owed by KSF. The creditors applied to court for the administrators to be removed from office on the ground that the entire administration had been invalid from the outset. The creditors asserted that Master’s COMI had been Guernsey for the purposes of the Council Regulation on Insolvency Proceedings (1346/2000/EC). Guernsey was not an EU Member State. If Master’s COMI was Guernsey, the English court would have had no jurisdiction to open administration proceedings.³⁹⁷ The court held that the presumption under the EC regulation that Master’s COMI was the place of its registered office was rebutted. It was apparent that both objectively and ascertainably to third parties, all of Master’s head office functions were carried out on its behalf in England. The court applied the following principles:

- i. There is the presumption that the COMI is in the state where its registered office is located;

³⁹² *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch); [2011] B.C.C. 338

³⁹³ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch), paragraph 2.

³⁹⁴ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch), paragraph 2.

³⁹⁵ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch), paragraph 5.

³⁹⁶ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch), paragraph 5.

³⁹⁷ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch), paragraph 8.

- ii. The presumption can be rebutted only by factors which are both objective and ascertainable by third parties;
- iii. The place where the head office functions are carried out is only relevant if so ascertainable by third parties;
- iv. Each body or individual has its own COMI, there is no COMI constituted by an aggregation of bodies or individuals.³⁹⁸

The court concluded that the location of the head office functions was not the test.³⁹⁹ It held that the key third parties to consider here were Master's creditors, not its 'insider' investors or shareholders. Investors were not the type of third party envisaged by the test in *Stanford* mentioned in Chapter 5, as they were, technically, industry insiders as opposed to people who conducted business with Masters.⁴⁰⁰ The correct third party had to be Master's creditors to whom it must have been apparent that Masters operated only as a letterbox company in Guernsey.⁴⁰¹ The presumption of the COMI was rebutted so that the court did have jurisdiction to determine the issue, applying *Re Eurofood* and *Stanford*.

6. EU Directive on the Re-organisation and Winding-Up of Credit Institutions

As the current European framework is not prepared to deal with distressed financial institutions with cross-border implications,⁴⁰² the EU Winding-Up Directive for Credit Institutions aims for the resolution of a troubled bank as a single entity. Its universalist approach adopts mutual recognition of the home country's reorganization measures and winding-up proceedings, with equal treatment for creditors.⁴⁰³ The main aim of Directive 2001/24 is to ensure that there is cooperation between the home and host Member State's administrative, judicial and supervisory authorities in the reorganization and winding up of a

³⁹⁸ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch).

³⁹⁹ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch), paragraph 18.

⁴⁰⁰ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch), paragraph 22.

⁴⁰¹ *Kaupthing Capital Partners II Master LP Inc, Re* [2010] EWHC 836 (Ch), paragraph 25.

⁴⁰² See Brown Rudnick LLP, *The New Recovery and Resolution Directive for Financial Institutions*, April 2013 viewed at

<http://www.insol.org/emailer/Apr13_downloads/New%20Recovery%20&%20Resolution%20for%20Recovery Directive Brown%20Rudnick.pdf> on May 1st, 2013.

⁴⁰³ Gillian G.H. Garcia & Maria J., Nieto, 'Banking Crisis Management in the European Union: Multiple Regulators and Resolution Authorities', (2005) 6(3) *Journal of Banking Regulation* 206, 215.

credit institute and its branches.⁴⁰⁴ The Directive outlines a set of private international law rules regarding cross-border bank insolvency. However, there are no international harmonized standards for banks.⁴⁰⁵

European Directive 2001/213 proposes a way of resolving coordination issues. It recommends the mandatory appointment of a supervisor for any cross-border bank. Upon the insolvency of either the main bank or one of its branches or subsidiaries, the supervisor will lead the restructuring and winding up process, whereas local authorities will have legal responsibilities in their respective countries according to prearranged agreements. EU Commission communication 2009/561 stipulates that the problems related to coordinating the actions of different national regulators can be avoided by establishing a single authority responsible for coordinating proceedings of cross-border banks, and a harmonized bank insolvency code in all EU Member States.⁴⁰⁶ Cihak and Nier argue that one way to resolve cross-border bank issues is to have a revised Winding-Up Directive to cover banks with a provision, in exceptional circumstances, to cover systemically important financial institutions and that extends the resolution power to all EU subsidiaries.⁴⁰⁷

Recent initiatives to address the difficulties of a LCFI in crisis include the Economic and Financial Affairs Council (ECOFIN) crisis management principles, adopted in October 2007, and the June 2008 crisis management MoU. Notwithstanding this, country authorities have found these principles unattainable in the heat of a crisis.⁴⁰⁸ Furthermore, the EU rules do not seek to harmonize legislation concerning bank insolvency proceedings, which vary across the EU.⁴⁰⁹ In the EU, there is no common threshold for the initiation of bank insolvency proceedings and very few countries specify rules for reorganization and winding up for banking groups.⁴¹⁰ The shortcomings of the EU Winding Up Directive in terms of its scope, for example in its exclusion of subsidiaries; failures in procedure; failings in substance such as the disparity that exists at national level in the form and substance of insolvency law, lend

⁴⁰⁴ *European Parliament and Council Directive 2001/24/EC on the Reorganisation and Winding-up of Credit Institutions* (entered into force on 5 May 2001).

⁴⁰⁵ The Directive may be adopted by the European Parliament as early as July 2013. The current draft may be subject to revision following the Cypriot banking crisis.

⁴⁰⁶ *European Commission, Communication 561/2009 on EU Framework for Cross-Border Crisis Management in the Banking Sector* (2009).

⁴⁰⁷ Cihak & Nier, above n90, 25.

⁴⁰⁸ *Ibid.*

⁴⁰⁹ Cihak & Nier, above n90, 22.

⁴¹⁰ *Ibid.*

themselves to a less than optimal cross-border insolvency regime.⁴¹¹ The case of *Dexia* illustrates where the successful resolution of the financial group occurs through cooperation, rather than through the EU Directive. If international cooperation across borders is achieved, the concept of COMI to determine the governing jurisdiction may be less detrimental to insolvency proceedings.

7. Gap in the EU legal framework: subsidiaries of LCFIs

Since the onset of the recent financial crisis, the limited scope of the EU Directive to deal with the subsidiaries of a cross-border banking group has been acknowledged. Matters are intensified for a LCFI with numerous branches and operationally integrated subsidiaries.⁴¹² The European cases of *Enron Directo Sociedad Ulimitada*⁴¹³, *Eurofood IFSC Ltd*⁴¹⁴, and *Daisytek*⁴¹⁵ illustrate the difficulty of applying COMI involving subsidiaries in corporate groups.

The difficulty occurs as secondary proceedings can be opened in different jurisdictions where there are subsidiaries of a corporate group. ‘If the COMI of a local subsidiary is deemed to be located in a different jurisdiction than where its main economic activities and assets are located, the subsidiary will most likely be deemed to have an “establishment” in the country where it carries out its operations, allowing secondary proceedings to be opened.’⁴¹⁶ The opening of secondary proceedings can result in multiple office-holders and cause the office-holder in the main proceeding to lose its grip on the foreign assets and operations.⁴¹⁷ Furthermore, sweeping the COMIs of local subsidiaries into a single jurisdiction can severely prejudice the rights of affected parties.⁴¹⁸ The *Eurofood IFSC Ltd* case illustrates the reasoning that the ECJ used to determine the COMI of a subsidiary.

⁴¹¹ Coleton, above n71, 74.

⁴¹² Ibid.

⁴¹³ *Enron Directo Sociedad Limitada* (unreported case and judgement).

⁴¹⁴ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

⁴¹⁵ *Re Daisytek* [2003] BCC 562.

⁴¹⁶ Tollenaar, above n350, 65.

⁴¹⁷ Ibid, 66.

⁴¹⁸ Ibid, 68.

Eurofood IFSC Ltd

Eurofood concerned an Irish subsidiary of Parmalat, an Italian food producer whose insolvency was administered in Parma, Italy. Italy was the main jurisdiction in which the insolvency of Eurofood was administered. In 1997, Eurofood was registered as a ‘company limited by shares’ with its registered office in the International Financial Services Centre in Dublin. Eurofood was a wholly owned subsidiary of Parmalat SpA which was incorporated in Italy with the principal objective being the provision of financing facilities for companies in the Parmalat Group.⁴¹⁹

In 2003, the Parmalat Group collapsed. The fallout led to the filing of insolvency proceedings for Eurofood in both Ireland and Italy, raising the issue of which was the appropriate venue to deal with its insolvency.⁴²⁰ Both courts, relying on different criteria in determining COMI, decided that Eurofood’s COMI was in its own respective jurisdiction. The Italian court held that the appointment of a provisional liquidator had not opened proceedings in Ireland and that the COMI was in Italy. It opened main proceedings in respect of the company. However, the Irish court held that the appointment of a provisional liquidator had opened the proceedings and declined to recognize the Italian opening because it believed⁴²¹ that the provisional liquidator had not been treated fairly in the Italian proceedings. The judgement stated that:

In that context, where a national court entertaining a petition for liquidation on the ground of insolvency appoints a provisional liquidator “with powers to take possession of the assets of the company, manage its affairs, open a bank account and appoint a solicitor all with the effect in law of depriving the directors of the company of power to act”, it would seem consistent with the aim of the Regulation that that appointment should be regarded as a judgment opening insolvency proceedings⁴²²

The recognition of the opening of main proceedings in Ireland was appealed by the Italian administrators to the High Court.

⁴¹⁹ *Re Eurofood, IFSC Ltd* [2005] BCC 1021 at 17.

⁴²⁰ Hon. Samuel L. Bufford, ‘Centre of Main Interests, International Insolvency Case Venue, and Equality of Arms: the Eurofood Decision of the European Court of Justice’, (2007) 27 *Northwestern Journal of International Law and Business* 351, 362.

⁴²¹ *Re Eurofood, IFSC Ltd* [2005] BCC 1021 at 53.

⁴²² *Re Eurofood, IFSC Ltd* [2005] BCC 1021 at 53.

The High Court held that Eurofood's COMI was located in Ireland and that the Irish proceeding was the main one for Eurofood.⁴²³ The court found overwhelming evidence that all of Eurofood's administrative activities took place in Ireland. Furthermore, the creditors presented detailed evidence of the lengths to which they had gone to satisfy themselves that the COMI was in Ireland. The presumption that Eurofood's COMI was located in Ireland because its registered office was located there was supported by this evidence of the expectations of its creditors. A further appeal was made to the European Court of Justice. It found that the commencement of the insolvency proceedings for Eurofood in Ireland gave the Irish court priority under EU law over the similar insolvency proceedings opened shortly thereafter in Italy.

The complex nature of *Eurofood IFSC Limited* resulted in the Irish Supreme Court referring to the ECJ five complex questions in respect of the COMI of a subsidiary. One question being where:

- (a) the registered offices of a parent company and its subsidiaries are in two different Member States;
- (b) the subsidiary conducts the administration of its interests on a regular basis in a manner ascertainable by third parties and in complete and regular respect for its own corporate identity in the Member State where its registered office is situated; and
- (c) the parent company is in a position, by virtue of its shareholding and power to appoint directors, to control and does in fact control the policy of the subsidiary, in determining the 'centre of main interests,' are the governing factors those referred to at (b) above or (c)?⁴²⁴

The ECJ ruled that when a debtor is a subsidiary company whose registered office is situated in a different Member State to that of its parent, the registered office presumption in Article 3(1) can be rebutted only if factors that are both objective and ascertainable by third parties enable it to be established that an actual circumstance exists that is different from that which locating it at the registered office would deem to reflect.⁴²⁵

⁴²³ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

⁴²⁴ *Re Eurofood, IFSC Ltd* [2005] BCC 1021, paragraph 44.

⁴²⁵ *Re Eurofood, IFSC Ltd* [2005] BCC 1021. Eurofood-ECJ, paragraph 37.

In determining the location of the COMI of a subsidiary, the courts must look at two factors.⁴²⁶ The first factor is the location where a debtor regularly administers its own interests, as ascertainable by third parties, and the country in which it is incorporated. The second factor arises from the location of the parent company which is able to control the policy decisions of the subsidiary. Where (as in the *Eurofood* proceedings) these factors point to different locations of the COMI, the court must determine the relative weight given to each factor.⁴²⁷

The case of *MPOTEC GmbH*⁴²⁸ illustrates the court's use of the headquarters functions test to locate the COMI of subsidiaries at the registered office of the controlling company. This case concerned an application to the commercial court of Nanterre, France to open main insolvency proceedings for the administration of MPOTEC GmbH, an insolvent company incorporated with its registered office in Germany but which was part of a French group. The French Commercial Court ruled that both subsidiaries, EMTEC Belgium and EMTEC Germany, had their COMI in France on the basis that the headquarter functions of MPOTEC GmbH was carried out in France. The court stressed that the place where the central administration is conducted must not be confused with the place where the company develops its business or owns its assets.⁴²⁹ It emphasised the need for transparent cooperation between main and secondary proceedings in the context of a group of companies, when the COMI is located in the jurisdiction in which the head offices of the controlling entity are located and secondary proceedings are opened.⁴³⁰

Finally, the Directive adopts the single-entity and universality principles for all European banking institutions and ensures that resolution measures by the home authority apply equally to all cross-border branches.⁴³¹ However, these principles do not apply to the case where a banking institution has wholly-owned subsidiaries in a different country within the EU. Such a subsidiary is considered as a legally separate entity with a separate license.⁴³² The European

⁴²⁶ *Re Eurofood, IFSC Ltd* [2005] BCC 1021. Eurofood-ECJ, paragraph 27.

⁴²⁷ *Re Eurofood, IFSC Ltd* [2005] BCC 1021. Eurofood-ECJ, paragraph 27.

⁴²⁸ *Re MPOTEC GmbH* [2006] BCC 681.

⁴²⁹ *Re MPOTEC GmbH* [2006] BCC 681 at 681-683.

⁴³⁰ *Re MPOTEC GmbH* [2006] BCC 681 at 686.

⁴³¹ Cihak & Nier, above n90, 20.

⁴³² *Ibid*, 22.

cases relating to applying COMI all involve subsidiaries of corporate groups indicating how significant the problem is.⁴³³

Once the COMI has been determined, there may also be cross-border issues between home and host country supervisory authorities. An international bank tends to operate through different types of foreign banking establishments such as branches, subsidiaries, and joint ventures.⁴³⁴ Branches are integral parts of a parent bank; subsidiaries are legally independent institutions incorporated in the country of operation and controlled by one foreign parent bank; and, joint ventures are legally independent banks incorporated in the host country and controlled by two or more parent institutions⁴³⁵ with the ability to move funds between jurisdictions.

Through these organisational structures, banks with international operations are able to conduct economic activities depending on the legal framework applied in the host and home countries.⁴³⁶ The dramatic liberalization of banking markets pre-crisis contrasts with the less willingness to liberalize legal and regulatory regimes in the aftermath of the banking crisis. This immense transformation of banking markets has provided further incentives for multinational banks to expand abroad.⁴³⁷ Indeed, the most efficient banks choose to expand through the acquisition of a host country bank.⁴³⁸ As a consequence, international banks penetrate foreign markets by providing cross-border lending, acquiring a domestic bank, or de novo investment.⁴³⁹ This has given rise to complex issues in international banking such as the spill-over interbank lending arising from a sovereign debt crisis to bank funding markets as in the current European sovereign debt crisis.⁴⁴⁰ These issues exacerbate the problems of international banks in crisis, particularly when they are faced with impending insolvency.

⁴³³ Westbrook, above n101, 326.

⁴³⁴ Lastra, above n105, 62.

⁴³⁵ Basel Committee of Banking Supervision, Committee of Banking Regulations and Supervisory Practices, *Report to the Governors on the Supervision of Banks' Foreign Establishment* (26 September 1975).

⁴³⁶ *Ibid.*, 63.

⁴³⁷ Maria Lehner, *Emerging Market Finance: The Role of Multinational Banks and Finance*, (D Economics Thesis, University of Munich, 2009) 6.

⁴³⁸ *Ibid.*, 8.

⁴³⁹ *Ibid.*, 6.

⁴⁴⁰ Boris Groendahl & Gavin Finch, 'Banks Cut Cross-border Lending Most Since Lehman: BIS', *Bloomberg News*, June 4, 2012, viewed at <<http://www.bloomberg.com/news/2012-06-03/banks-cut-cross-border-lending-most-since-lehman-bis.html>> on March 4, 2013.

Home countries are responsible for the supervision of branches of their domestic banking groups.⁴⁴¹ In spite of this, home country supervision can create difficulties with systemically damaging implications for the host country.⁴⁴² When a cross-border bank is separated into many legal entities, many foreign banking authorities applying resolution measures in their own jurisdiction create significant conflicts.⁴⁴³ The lack of cooperation between home and host supervisory authorities in bank crisis resolution stems from conflicting measures and interests, and arguably, the exclusion of subsidiaries from the Directive.

In the EU, there is disparity in the treatment of subsidiaries of transnational banks in domestic regimes. Furthermore, the reorganization of a complex cross-border bank might also be difficult in the absence of clear agreements between national authorities regarding the resolution of foreign subsidiaries.⁴⁴⁴ National laws diverge in the extent to which parent companies can support their subsidiaries.⁴⁴⁵ The interests of domestic and foreign authorities may not be aligned, and can limit the ability of a national authority to effectively resolve the failure of the foreign subsidiary.⁴⁴⁶ These issues complicate the resolution of parent and subsidiary banking groups in a fair and equitable manner.

There is also disparity in the treatment of subsidiaries at national level in terms of deposit guarantee schemes and conditions, and powers for guarantee. Before the crisis, group wide functions such as liquidity and risk management resulted in subsidiaries being unable to completely separate from the group. When subsidiaries are unable to separate completely from the rest of the group, the chance of a local rescue in the event of bank insolvency is minimized.⁴⁴⁷ Most importantly, certain subsidiaries may be critical to their host country's financial system. The legal separateness of the subsidiary may permit the parent bank to abandon the subsidiary in financial difficulties, irrespective of the impact on the host country's economy.⁴⁴⁸ It may be argued that the reform of the Directive should provide it

⁴⁴¹ Ibid, 5.

⁴⁴² John Goddard and Phil Molyneux, 'The Financial Crisis in Europe: Evolution, Policy Responses and Lessons for the Future', (2009) 17(4) *Journal of Financial Regulation* 362, 376.

⁴⁴³ Coleton, above n71, 74.

⁴⁴⁴ Bob Wessels, 'The Changing Landscape of Cross-border Insolvency Law in Europe', *Juridica International*, Nbr. XII, (November 2007), 116-124.

⁴⁴⁵ Hupkes, above n142, 378.

⁴⁴⁶ Cihak and Nier, above n90, 9-10.

⁴⁴⁷ Coleton, above n71, 74.

⁴⁴⁸ Cihak & Nier, above n90, 8.

with the scope to address the distinctiveness of subsidiaries of international banks and these problems.

The lack of cooperation between home and host authorities, ineffective crisis resolution, and inadequate home supervision were also significant factors which led, as an example, to the demise of the Icelandic banks.⁴⁴⁹ In the Icelandic banking crisis, the foreign subsidiaries and branches were subject to various home and host oversights regarding arrangements that were not transparent to depositors.⁴⁵⁰ The Icelandic banking crisis highlighted home and host country issues related to cross-border banking, the ineffectiveness of the home jurisdiction to provide adequate resolution actions, and the inability to respond to the crisis of financial institutions that had become too big for its national resources to save.⁴⁵¹ Many of those who suffered losses from the failure of these offshore subsidiaries were British citizens.⁴⁵² The failure of Icelandic banks which left the Icelandic authorities with the obligation, but not the fiscal capacity, to protect the insured depositors of overseas branches of the Icelandic banks, also illustrates the burden-sharing issues faced by the host country to branches of a failing foreign bank.⁴⁵³

The Basel Committee has since stated that cooperation would improve by taking a universalist approach to crisis resolution with greater convergence in national laws, by promoting a common understanding, more predictability, and reliable frameworks for responsive actions.⁴⁵⁴ The de Larossiere Report, a report mandated by the European Commission to provide advice on the future of the European financial regulation and supervision, stated that strengthened international collaboration in the supervision of large, complex cross-border financial groups is critical to address the supervisory failures of 2008 such as that of the Icelandic crisis.⁴⁵⁵

⁴⁴⁹ Garry Shinasi, 'US and EU Reform Efforts in Improving the Management of Systemic Financial Risk', paper prepared for 'An Ocean Apart? Creating Transatlantic Responses to the Financial Crisis', (Rome, Italy: September 10-11, 2009) at 12-14.

⁴⁵⁰ International Association of Deposit Insurers, 'Discussion Paper on Cross Border Insurance Raised by the Global Financial Crisis', March 2011, 30.

⁴⁵¹ Bank for International Settlements, above n80, 14.

⁴⁵² House of Commons Treasury Committee, above n75, 41.

⁴⁵³ Ibid, 5.

⁴⁵⁴ Bank for International Settlements, above n80, 20.

⁴⁵⁵ The De Larossiere Group, above n95, 61.

During the most recent financial crisis, there was an increase in financially distressed large, complex cross-border financial institutions requiring resolution. In the Lehman insolvency case, there were conflicting approaches between regulators across jurisdictions. The collapse demonstrated that solvent subsidiaries cannot survive when a major subsidiary is in extreme financial distress. The failure of Lehman and the Icelandic banks and the difficulties in unwinding them revealed that the global financial framework, and the Winding Up Directive, lacked adequate regulation with regard to the winding up or reorganization of institutions such as investment banks, and their resolution. Their failures illustrated that cross-border banks composed of subsidiaries must be targeted in bank insolvency law reform.⁴⁵⁶ In addition, the need for close coordination between home and host country supervisory authorities is essential for efficient crisis management, as well as for avoiding negative spillovers, distortions to competition, and regulatory arbitrage. There are still no clear multilateral arrangements for coordinating national responses to financial crises.⁴⁵⁷ In order to resolve cross-border conflict between home and host supervisory authorities, it may be argued that a possible solution is the harmonization of rules, powers and sanctions⁴⁵⁸ in supervisory regimes, an examination of which is beyond the scope of this thesis.

Banking regulation developed as a response to crises resulting from the nature of banking business as a fractional reserve system based on the management of credit and duration risks. In today's economy, this risk is increased as bank, capital and other financial markets become increasingly connected to a broader financial system than ever before.⁴⁵⁹ Some economists argue that regulation is necessary only in the presence of market failure or deficiencies.⁴⁶⁰ The magnitude of recent crises and evidence of banking systems' impacts on economic growth have generated proposals for reforms to banking regulation and supervision.⁴⁶¹ However, there is a lack of international regulation for dealing with cross-border issues in banking law.⁴⁶² The existing legal and regulatory arrangements are not designed to resolve problems in financial groups that operate through multiple, separate entities. There is no international insolvency framework for financial institutions.⁴⁶³ The next section will discuss

⁴⁵⁶ Coleton, above n71, 17.

⁴⁵⁷ Ibid, 66.

⁴⁵⁸ Ibid, 50.

⁴⁵⁹ Arner & Norton, above n9, 116.

⁴⁶⁰ Astem, above n77.

⁴⁶¹ Barth, Caprio, & Levine, above n78.

⁴⁶² Schobel, above n79, 182.

⁴⁶³ Bank for International Settlements, above n80, 4.

the issue of cross-border banking laws which would need to be considered for such a framework.

8. The Issue of Cross-Border Banking Laws

Cross-border banking laws are not explicitly addressed by the EU and those which do generally fail to address crucial cross-border issues concerning the regulation of banking activities. Cross-border banking activities may include transactions in a foreign country where the bank is not physically present. In these cases, it is not the bank structure that crosses between jurisdictions but the banking activity or service itself.⁴⁶⁴ The freedom of movement of money and financial securities across borders can lead to easy avoidance of liability for tax, by arranging for the transaction to take place in the jurisdiction of a bank subsidiary or a number of jurisdictions and subsidiaries.⁴⁶⁵ Complicated legal questions arise concerning the applicability of domestic law to international scenarios and cases.⁴⁶⁶ Domestic legislation has not addressed these issues and the tendency of judicial and administrative authorities to rule on a case-by-case basis exemplifies the inadequacies of national approaches in dealing with cross-border banking problems. While provisions exist to regulate the physical presence of a foreign bank through subsidiaries, branches, agencies and representative offices, there is no provision that states the conditions and circumstances governing a cross-border banking activity that falls under domestic banking laws.⁴⁶⁷

The uncertainty in international insolvency, and the determination of certain rights by the local domestic law, has created greater uncertainty in legal regimes in respect of the worldwide administration⁴⁶⁸ of an insolvent bank. Internationally, problems created by uncertainties over the content and choice of legal regimes⁴⁶⁹ are exacerbated by the inappropriateness of domestic law in the context of international insolvency. Principle-based

⁴⁶⁴ Schobel, above n79, 178.

⁴⁶⁵ Rosa Maria Lastra, 'Border Problems', (2010) 13 *Journal of International Economic Law* 705, 711.

⁴⁶⁶ Schobel, above n79.

⁴⁶⁷ Ibid. The GFC and the G20 have placed pressure on many tax havens such as in Switzerland and Luxembourg to become more transparent in an effort to avoid tax evasion, See Organisation for Economic and Community Development, 'Promoting Transparency and Exchange of Information for Tax Purposes', 19 January 2010, viewed at <<http://www.oecd.org/dataoecd/26/28/44431965.pdf>> on 5 September 2011.

⁴⁶⁸ Eva H.G. Hupkes, 'The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada', (Kluwer Law International, 2000).

⁴⁶⁹ United Nations Commission on International Trade Law, 'Receivables Financing, Analytical Commentary on the Draft Convention on Assignment of Receivables in International Trade', Note by the Secretariat, 34th Session, UN Doc No. A/CN.9/489, (2001), 'Analytical Commentary' on the Preamble, 4.

regulation using best practice, fails to address the legislative gaps that are exploited in risk-taking activities. Regulation addressing financial distress often comes too late and at too high a cost, and the legislative gaps prevalent in cross-border cases may also generate undesirable results.

At the European Union level, there is as yet no clear and predictable legal framework for cross-border banks to govern how these would be liquidated or reorganised in financial crisis to avoid undermining economic stability.⁴⁷⁰ At present, there is no international insolvency standard for banks⁴⁷¹ and there is no international legal insolvency regime that is applicable to banks. Arner and Norton noted that there is still insufficient consensus in respect of insolvency arrangements for any international framework to emerge.⁴⁷²

In the European Union, the fear of the economic consequences from the failure of large, multinational, interconnected financial institutions prompted unprecedented governmental actions to keep such failing firms in business.⁴⁷³ Policies need greater limitations, modifications and foresight in the identification of potentially systemic interconnections, and the potential link with systemic risk requires closer examination to limit the effects of the next financial crisis. To a much greater degree than other firms, the failure of a bank can result in collateral damage for others including its competitors, counterparties and market participants. When these banks are large, complex global financial institutions whose operations cross various countries, two of the main difficulties are that the insolvency process significantly destroys the banks' value and imposes collateral damage. While standard corporate insolvency procedures freeze the claims of creditors while liquidating assets and business operates insofar as it maximises firm value, banks need to maintain the confidence of creditors and risk asset loss if they are forced to sell these assets before maturity. The premature liquidation of a bank's assets and the freezing of creditor claims destroy much of the value of a bank.⁴⁷⁴ Effective insolvency provisions are required to enable the redirection

⁴⁷⁰ Rosa M. Lastra, 'Cross-border Issues in Banks and Implications for the UK', April 2008, viewed at <www.slidefinder.net/c/cross_border_issues_bank_resolution/222878580> on May 8, 21012.

⁴⁷¹ Michael H. Krimminger, 'Deposit Insurance and Bank Insolvency in a Changing World: Synergies and Challenges', *International Monetary Fund Conference*, May 28 2004, 10.

⁴⁷² Arner & Norton, above n9, 128.

⁴⁷³ Edward F. Greene, Knox L. Mellwain & Jenifer T. Scott, 'A Closer Look at Too Big To Fail', 5(2) (2010) *Capital Markets Law Journal* 117, 118.

⁴⁷⁴ Independent Commission on Banking, *Interim Report: Consultation on Reform Options*, Executive Summary (April 2011), 19.

of capital and the closure of inefficient enterprises, thereby improving governance and performance.⁴⁷⁵

The implications of cross-border insolvency for an international bank insolvency framework are influenced by the legal and regulatory difficulties of conflicting jurisdictional approaches.⁴⁷⁶ Arner stated that international cooperation and related institutional structures will become increasingly important as a result of economic and financial globalization.⁴⁷⁷ However, the divergent approach between jurisdictions has resulted in restrictive regulations⁴⁷⁸ that may adversely affect the development of an international legal framework for bank insolvencies.

It may be argued that the international framework for cross-border bank insolvency needs to further consider the global economic system, its legal instruments, and binding legal rules.⁴⁷⁹ There is no hard international law for regulation of investment banking in relation to monetary policy and more is needed in relation to domestic monetary policy.⁴⁸⁰ The extent to which levels of capital reserves, monetary supply regimes and international supervision of financial instruments are suitable for binding legal regulation, has generally not been studied. There has been no broad discussion of international cooperation in respect of monetary policy in the context of banking supervision.⁴⁸¹

The failure of large, complex, global financial conglomerates which triggered the systemic phase of a global financial crisis is one of the greatest failures of both international and domestic legal and regulatory systems.⁴⁸² The possibility of an international framework for international bank insolvency which changes the legal, regulatory and financial structures within which the global economic system operates is critical. Architects of bank insolvency law are confronted with various problems in designing a legal framework that resolves the

⁴⁷⁵ Arner & Norton, above n9, 113.

⁴⁷⁶ Kaufmann, above n20, 101.

⁴⁷⁷ Douglas W. Arner, *The Global Credit Crisis of 2008: Causes and Consequences*, 43(1) (2009) *The International Lawyer*, 91, 141.

⁴⁷⁸ Ibid.

⁴⁷⁹ Ibid.

⁴⁸⁰ Ibid.

⁴⁸¹ Thomas Cottier, 'Challenges Ahead in International Economic Law', (2009) 12 *Journal of International Economic Law* 3, 8.

⁴⁸² Douglas W. Arner, 'Adaptation and Resilience in Global Financial Regulation', (2011) 89 *North Carolina Law Review* 1579, 1623.

financial problems of an insolvent bank. Every banking crisis is unique. The immediate causes, the characteristics of the institutions, and the potential for contagion are different on a case-by-case basis.⁴⁸³ Individual jurisdictions will have to carefully consider the risks that such institutions will be allowed to undertake.⁴⁸⁴ These factors indicate that there can be no single international solution. Present problems will persist if there is a lack of international coordination and cooperation to ensure a level playing field and high regulatory standards across jurisdictions.

9. Conclusion

This chapter firstly examined the legal challenges surrounding the concept of COMI in the EU Insolvency Regulation, the need for revision and reform of the Regulation to address corporate groups, and the gap in the EU Directive on the Reorganisation and Winding-Up of Credit Institutions to address subsidiaries of large, complex financial institutions. The recent European Commission's Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000 on insolvency proceedings,⁴⁸⁵ stated that one of the five major shortcomings included that of COMI:

There are difficulties in determining which Member State is competent to open insolvency proceedings. While there is wide support for granting jurisdiction for opening main insolvency proceedings to the Member State where the debtor's COMI is located, there have been difficulties in applying the concept in practice. The Regulation's jurisdiction rules have also been criticized for allowing forum shopping by companies and natural persons through abusive COMI-relocation.

The proposal further stated that the concept of COMI would be retained because it ensures that the case will be handled in a jurisdiction with which there is a genuine connection with a debtor, rather than a jurisdiction that is chosen by incorporators. The proposal stated that:

The COMI approach is in line with international developments since it has been chosen as a jurisdictional standard by UNCITRAL in its Model Law on cross-border insolvency. In order

⁴⁸³ Hupkes, above n81.

⁴⁸⁴ Arner, above n472, 1620.

⁴⁸⁵ European Commission, *European Commission's Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings*.

to provide greater guidance to legal practitioners in determining COMI, the proposal complements the definition of COMI. In addition, a new recital clarifies the circumstances in which the presumption that the COMI of a legal person is looked at as the place of its registered office can be rebutted; the language of this recital is taken from the “Interdil” decision of the Court of Justice of the European Union.⁴⁸⁶

The chapter illustrates the concept of COMI in the EU Insolvency Regulation with the case study of *Interdil Srl*. The change that the concept of COMI has undergone from the *Eurofood* decision to the more recent decision of *Interdil* indicates that there are inconsistent factors in identifying the COMI of a corporate group. In a study using empirical data to assess the way in which courts have handled the issue of international jurisdiction under the EC Regulation,⁴⁸⁷ the presence of the registered office was rarely the sole connecting factor applied in determining jurisdiction.⁴⁸⁸ The study also found that where the presumption is applied, courts also emphasized additional connecting factors.⁴⁸⁹ This chapter has shown that in international bank insolvencies, the determination of COMI and the clarity of the COMI concept are complicated in a multijurisdictional context. The problems of application in international bank insolvencies arguably, will continue to remain the same if the COMI of a corporate group is not critically addressed in the near future.⁴⁹⁰ Likewise, the gap in the EU Directive for addressing subsidiaries of large, complex financial institutions poses significant problems with the opening of multiple proceedings. These issues which are magnified in a financial crisis and in times of economic stability tend to remain unforeseen. This chapter has highlighted that these issues pertaining to the EU Insolvency Regulation, international

⁴⁸⁶ The Proposal states that it ‘improves the procedural framework for determining jurisdiction of opening proceedings. The proposal requires the court to examine its jurisdiction ex officio prior to opening insolvency proceedings and to specify its decision on which grounds it based its jurisdiction. Furthermore, the proposal grants all foreign creditors a right to challenge the opening decision and ensures that these creditors are informed of the opening decision in order to be able to effectively exercise their rights. These changes aim at ensuring that proceedings are only opened if the Member State concerned actually has jurisdiction. It should therefore reduce the chances of forum shopping through abusive and non-genuine relocation of the COMI.’ See *European Commission’s Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings*, 6-7.

⁴⁸⁷ Mevorach, above n322, 349.

⁴⁸⁸ Ibid.

⁴⁸⁹ Ibid.

⁴⁹⁰ The Proposal states that it ‘creates a specific legal framework to deal with the insolvency of members of a group of companies while maintaining the entity-by-entity approach which underlies the current Insolvency Regulation. The proposal introduces an obligation to coordinate insolvency proceedings relating to different members of the same group of companies by obliging the liquidators and the courts involved to cooperate with each other in a similar way as this is proposed in the context of main and secondary proceedings.’ See *European Commission’s Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings*, 9.

banks and the concept of COMI are conclusive in indicating the reform that is needed to address cross-border conflicts.

CHAPTER 5: THE MODEL LAW, INTERNATIONAL BANKS AND COMI

Chapter Overview

This chapter examines the UNCITRAL Model Law on Cross-Border Insolvency as the second international insolvency regime, and the only international model for international insolvency. It addresses, in particular, the implications of the cross-border insolvency proceedings for international banks.

The chapter introduces the Model Law, and the relevant provisions of the Model Law pertaining to the cross-border insolvency of international banks. It considers the extent to which countries that have adopted the Model Law have included or excluded the application of the Model Law to banks and financial institutions and postulates reasons for exclusions. In any given country, financial institutions may or may not be governed by the Model Law. For example, in the United States, financial institutions are governed by Chapter 15 of the Bankruptcy Code which is discussed further in this chapter in Section 8.

The chapter develops the discussion of COMI introduced in previous chapters, and examines the factors determining COMI in the case of an international bank, and how the ambiguity in respect of the rebuttable presumption of COMI exacerbates the unpredictability in international bank insolvencies. The chapter also compares the Model Law and the EU Insolvency Regulation in relation to COMI.

It further examines the implications of COMI in complex cross-border insolvency proceedings, and explains why cross-border bank insolvencies are distinctive. There is also the need for forum selection and the potential for forum shopping, distinguishing the two. The determination of COMI is more complex and perplexing in bank insolvencies and arguably, the head office functions test is more predictable in this context.

The following case studies illustrate the divergent interpretations of COMI:

- *Stanford International Bank*
- *In Re Betcorp (in liquidation)*
- *McGrath & Anor as Liquidators of HIH Insurance Ltd*

In international bank insolvencies, the policy analysis by courts is made even more complicated by the issue of equality in distributional outcomes and the ensuing conflicts ensuing from the priority scheme that is used at the debtor's COMI, and the choice of law rules that are applied to determine these priority schemes. This is the theme throughout this chapter.

This chapter concludes by examining Chapter 15 of the US Bankruptcy Code and the approach of the US court to the determination of COMI to better understand the Model Law's use of the concept of COMI as a mechanism for determining jurisdiction in a domestic regime, and the implications for cross-border bank insolvency. It argues that the issue of addressing COMI by the Model Law needs to be aligned, and continuously realigned, with corresponding legislative reforms by its adopting domestic regimes. The case of *Re: SPHinx Ltd* highlights the inherent difference between insolvency regimes, and how this contributes to uncertainty in distributional outcomes.

5. Introduction

This chapter focuses on the UNCITRAL Model Law on Cross-Border Insolvency (Model Law) in relation to the implications of the cross-border insolvency proceedings for international banks. As indicated in Chapter 1, the UNCITRAL Model Law's Article 1(2) contains an optional clause whereby special insolvency regimes applicable to banking, financial and investment institutions may be excluded from its scope.⁴⁹¹ The Model Law does not attempt to harmonize local insolvency law. UNCITRAL defines harmonization as 'the process through which domestic laws may be modified to enhance predictability in cross-border commercial transactions.'⁴⁹²

As the Model Law is not binding on any state, its operation depends exclusively on how it is enacted locally.⁴⁹³ In the preamble, the Model Law provides that its Guide to Enactment 'would primarily be directed to executive branches of Governments and legislators preparing the necessary legislative revisions'⁴⁹⁴ and that 'such information might also assist States in considering which, if any, of the provisions should be varied in order to be adapted to the particular national circumstances.'⁴⁹⁵ In relation to cross-border insolvency proceedings of banks under the Model Law, the main issues that it addresses are the recognition of foreign proceedings, coordination of proceedings concerning the same debtor, rights of foreign creditors, rights and duties of foreign representatives, and cooperation between authorities in different states.⁴⁹⁶ Lastra noted that some aspects of the framework in the Model Law may not be appropriate for the insolvency of cross-border financial groups. With respect to such groups, features of significant relevance include COMI, cooperation, discretionary relief, and protocols. She further notes that the framework for cooperation set out in the Model Law has been very effectively supplemented through protocols on cooperation between insolvency

⁴⁹¹ United Nations Commission on International Trade Law, *United Nations Commission of International Trade Law Model Law on Cross-border Insolvency*, Article 1(2).

⁴⁹² United Nations Commission of International Trade Law, *Frequently Asked Questions- Origin, Mandate and Composition of UNCITRAL* viewed at <http://www.uncitral.org/uncitral/en/about/origin_faq.html> on September 18th, 2011.

⁴⁹³ Sandy Shandro, 'The Implementation of the UNCITRAL Model Law on Cross-border Insolvency in Great Britain', *INSOL World*, Second Quarter, 2006, 2, viewed at <<http://www.insol-europe.org/download/file/484>> on September 18th, 2011.

⁴⁹⁴ United Nations Commission of International Trade Law Model Law on Cross-border Insolvency, Part Two, II: Purpose of the Guide to Enactment. Courts can construe the provisions of the Model Law sections within the domestic legislation.

⁴⁹⁵ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Part one, Preamble.

⁴⁹⁶ *Ibid*, 214.

officials in individual cases. The protocols are formal agreements negotiated through professionals representing major interests in insolvency and typically approved by relevant courts.⁴⁹⁷ For example, the *Lehmans Protocol* was a response to the lack of applicable law which would be binding on all parties to the Lehman bankruptcy. The premise of the Lehmans Protocol is that the global reach of Lehman Brothers meant that its assets and activities spanning multiple jurisdictions were subject to the laws of those multiple jurisdictions. The major objectives of the Lehmans Protocol included minimising costs and maximising recoveries for all parties involved, and managing all individual cases consistently and effectively.⁴⁹⁸ Prior to the *Lehmans Protocol*, no protocol existed for proceedings that occurred in more than three jurisdictions.⁴⁹⁹

Many of the legal issues which the principle of COMI should answer are issues which arise from the failure of international laws, conflicts of laws, general insolvency laws and corporations' laws to address these adequately. The multiple countries that decide the COMI interpretation 'may deem it indeterminate.'⁵⁰⁰ This complicates the determination of COMI arising in cross-border insolvency cases. This chapter examines the choice of law rules that enable jurisdictions to interpret COMI, the concept of a group COMI which the UNCITRAL Working Group is developing, and how this is relevant to large, complex financial institutions. The Model Law does not attempt to assess 'which creditors should be afforded priority and the justifications for doing so'.⁵⁰¹ This chapter further examines the significant issue of international comity and distributional outcomes, and explains why it is necessary for international insolvency law to address this issue in international bank insolvency.

⁴⁹⁷ Ibid, 213.

⁴⁹⁸ Altman, above n114, 478; *Lehman Brothers Holding Inc. Cross-border Insolvency Protocol for the Lehman Groups of Companies*, (1 May 2009), 2.

⁴⁹⁹ Alvaraz & Marshal Holdings LLC., *Lehman Brothers International Protocol Proposal* (February 11, 2009), 38.

⁵⁰⁰ Mevorach, above n322, 333.

⁵⁰¹ United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004), 274.

5.1 UNCITRAL Model Law on Cross-Border Insolvency

The Model Law ‘reflects practices in cross-border insolvency matters that are characteristic of modern efficient insolvency systems’⁵⁰² and was eventually influenced by the discussions that resulted in the European Union Insolvency Regulation No. 1346/2000.⁵⁰³ The concept was taken from the Convention on Insolvency Proceedings of the EU for reasons of consistency.⁵⁰⁴ There are three key elements of the Model Law. Westbrook summarises these elements thus:

Firstly, it provides for expedited control of the debtor’s local assets and their protection from unilateral actions by creditors. It provides the local court with considerable discretion to grant relief to an administrator from a foreign main proceeding and this discretion is accompanied by a statutory mandate for cooperation. The domestic court is directed to use its broad powers to cooperate with foreign proceedings. Secondly, the structure permits very fast capture and protection of the debtor’s assets and operations through a local moratorium or stay that follows from the recognition process. The extent of the relief the local court will decide to grant is determined subsequently, once the court has more information about the case and the nature of the foreign process. Thirdly, while the statute permits a locally filed insolvency proceeding, its long term importance lies in the fact that it establishes a hierarchy of insolvency: the main proceeding versus any others.⁵⁰⁵

The Model Law refers to the jurisdiction in which the debtor has its centre of main interests (COMI) by applying the concept of COMI to determine the degree to which a court in one jurisdiction is obliged to grant recognition and assistance to insolvency proceedings commenced in another jurisdiction.⁵⁰⁶ For example, the foreign proceeding must be recognised as a foreign main proceeding if it is taking place in the state where the debtor has

⁵⁰² United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), 9.

⁵⁰³ Christopher Redmond, ‘The Model Law on Cross-border Insolvency’, viewed at <<https://insol.org/Rio20deJaneiroEducationalPapers/TheModelLawoncross-borderinsolvencyChrisRedmond.pdf>> on September 20, 2011, 1.

⁵⁰⁴ United Nations Commission on International Trade Law, Working Group V (Insolvency Law), Thirty-ninth session, Vienna, 6-10 December 2010, ‘The UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective’, Doc. No. A/CN.9/WG.V/WP.97Add.1, 6.

⁵⁰⁵ Jay Lawrence Westbrook, ‘The Elements of Coordination in International Corporate Insolvencies: What Cross-border Bank Insolvency Can Learn from Corporate Insolvency’ in Rosa M. Lastra (ed), *Cross-border Bank Insolvency*, above n105, 189.

⁵⁰⁶ Practical Law Company, Centre of Main Interests (COMI) viewed at <<http://www.crossborder.practicallaw.com/6-503-3605?source=relatedcontent>> on 11 September, 2011.

its COMI.⁵⁰⁷ Both the EU Insolvency Regulation and the Model Law are based on the concept of the “centre of main interests” and “establishment.” The debtor’s registered office, in the case of a company, is presumed to be the debtor’s COMI. As indicated in Chapter 1, the complexity in determining COMI is indicated by the many factors which have been considered by the courts.

5.2 Interpretation of the Model Law’s Article 8

The Model Law ‘expands the range of action of insolvency courts without imposing substantial obligations’ on those courts.⁵⁰⁸ The Model Law does not address the substantive law applicable to key transactions or assets, but leaves these issues to the national laws of the relevant jurisdiction. Article 8 of the Model Law provides that in the interpretation by courts of the Model Law,⁵⁰⁹ ‘regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.’ The issue that arises is whether the Model Law’s incorporation of Article 8 has been included in the domestic legislation. For example, the US, UK, and Australia have included Article 8 in their domestic legislation, while Canada has not. In *Ackers and Others v Saad Investments Company Ltd and Another*,⁵¹⁰ the court demonstrated the lack of understanding of the interpretive mandate. Rares J stated that:

Importantly the Model Law provides an interpretative article namely article 8. From that point of view it should have been obvious that the tool to interpret the statute which includes the Model Law is prescribed. However the court noted that the interpretation of conventions which should be approached in accordance with the Vienna Convention specifically noting that “it is an authoritative statement of customary international law for the purposes of construing a convention.”⁵¹¹

⁵⁰⁷ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 17(2)(a).

⁵⁰⁸ Paul B Stephan III, ‘The Futility of Unification and Harmonization in International Commercial Law’, *University of Virginia School of Law, Legal Studies Working Paper No. 99-10*, (June 1999), 32.

⁵⁰⁹ Ho, above n215, 656.

⁵¹⁰ *Ackers v Saad Investment Company* [2010] FCA 1221.

⁵¹¹ *Ackers v Saad Investment Company* [2010] FCA 1221.

In *Tannenbaum v Tannenbaum*, Logan J. noted that:

Even where an international convention or model law is adopted by Parliament in an Australian enactment, that enactment and the adopted convention or model law must be interpreted in accordance with Australian principles of statutory construction. It is via the application of those principles that it would be permissible to have regard to general principles for the interpretation of such international instruments set out in the Vienna Convention on the Law of Treaties 1969 [1974] ATS 2 and, via Art 32 of that convention, to United Nations Commission of International Trade Law (UNCITRAL) preparatory work in respect of the Model Law.⁵¹²

Conversely, Zeller maintains that a distinction between a model law and a convention must be made.⁵¹³ He further states that:

The statement that the “model law must be interpreted in accordance with Australian principles of statutory construction” especially linking the domestic methods to a harmonised approach is incorrect. The statement could arguably be interpreted as suggesting that a second approach is currently in use in Australia which is to be distinguished from the domestic approach. If that would be the case, then the statement is indeed correct as a transnational methodology applied in Australia which is in line with other countries would indeed contribute to a harmonised approach.⁵¹⁴

It may be argued that where there are striking similarities between the equivalent parts of domestic laws, a harmonised interpretation would be justified. In contrast, US courts have developed their statutory interpretation further than Australian courts in this respect.⁵¹⁵ In *Re Loy*,⁵¹⁶ the court stated that:

While section 1508 (Article 8 of the Model Law) provides the Court guidance in matters of statutory interpretation only, it does not grant the Court authority to adopt a provision in a foreign statute that is contrary to the text of Chapter 15.⁵¹⁷

⁵¹² *Tannenbaum v Tannenbaum* (2012) FCA 904 at 37.

⁵¹³ Bruno Zeller, ‘Statutory Interpretation: The Two Step Approach’, (2014) Vol. XVII *International Trade and Business Law Review* (forthcoming).

⁵¹⁴ *Ibid.*

⁵¹⁵ *Ibid.*

⁵¹⁶ *In Re Loy* 432 BR 55 (2010).

⁵¹⁷ *In Re Loy* 432 BR 55 (2010).

Although Article 8 may make comparative analysis an imperative, in the application of conventions, it is important ‘that courts and tribunals are following the mandate of harmonisation and uniformity’⁵¹⁸ in order for jurisdictions to have uniform outcomes. This issue is further discussed in Chapter 7.

5.3 The Concept of COMI in the Model Law

The Model Law adopts the concept of COMI as the mechanism for determining main and non-main proceedings.⁵¹⁹ It establishes the importance of the main proceeding over other proceedings. For example, after a foreign main proceeding has been opened, a local proceeding will generally govern only local assets, although most insolvency laws provide for implicitly worldwide jurisdiction over a debtor’s assets.⁵²⁰ A secondary insolvency proceeding can be opened only where there is a connection between the debtor and the jurisdiction.⁵²¹ The aim of a secondary proceeding is to ‘allow local creditors of a foreign debtor the opportunity to open an insolvency case in their native country, chiefly to enjoy the benefit of local insolvency law’.⁵²²

The Model Law provides legal authority for insolvency representatives in different jurisdictions to cooperate and coordinate concurrent insolvency proceedings. Where there are secondary or ancillary proceedings (proceedings that are not opened in the forum of the debtor’s COMI), in practice, they are subordinated to the principal bankruptcy proceeding when seeking assistance from another jurisdiction. These secondary proceedings can be opened only where the condition of a special connection between the debtor and the

⁵¹⁸ Zeller, above n513.

⁵¹⁹ Practical Law Company, above n506.

⁵²⁰ Westbrook, above n505, 189-190.

⁵²¹ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 28.

⁵²² John A. E. Pottow, ‘A New Role for Secondary Proceedings in International Bankruptcies’, 46 (2011) *Texas International Law Journal* 579, 580.

jurisdiction is satisfied.⁵²³ In the framework of the Model Law and the EU Regulation,⁵²⁴ the special connection is defined by the term “establishment.”⁵²⁵

In the Model Law, Article 2(f) defines an establishment as ‘any place of operations where the debtor carries out a non-transitory economic activity with human means and goods and services’.⁵²⁶ An establishment implies a permanent place of operations. However, this concept is as elusive as COMI in spite of its long-standing usage by courts and legislators in various countries.⁵²⁷

Under the Model Law, a foreign main proceeding is ‘a foreign proceeding taking place in the State where the debtor has its center of main interests’,⁵²⁸ whereas a non-main proceeding is ‘a foreign proceeding, other than a foreign main proceeding, taking place in a State where the debtor has an establishment within the meaning of subparagraph (f)’ of Article 2.⁵²⁹ Subparagraph (f) states that an establishment ‘means any place where the debtor carries out a non-transitory non-economic activity with human means and goods and services’.⁵³⁰

As indicated in Chapter 4, the EU Insolvency Regulation permits the national court to open main proceedings only if the company’s COMI is located in that jurisdiction.⁵³¹ While the Model Law has the same concept of COMI as the EU Insolvency Regulation to determine the jurisdiction of the main proceeding,⁵³² it states that the recognizing court should apply

⁵²³ Garrido, above n130, 473.

⁵²⁴ Jenny Clift, ‘The UNCITRAL Model Law on Cross-Border Insolvency-A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency’, (2004) 12 *Tulane Journal of International and Comparative Law* 307, 325-6.

⁵²⁵ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 2(f).

⁵²⁶ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, Article 2(f).

⁵²⁷ Garrido, above n130, 473.

⁵²⁸ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, Article 2(b).

⁵²⁹ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, Article 2(c).

⁵³⁰ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, Article 2(f).

⁵³¹ *European Union Insolvency Regulation, European Union Insolvency Regulation No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002), Article 3(1).

⁵³² United Nations Commission of International Trade Law, *Guide to Enactment of the UNCITRAL Model Law on Cross-border Insolvency*, Chapter IV, Main features of the Model Law, (31).

objective criteria in deciding whether to recognize the foreign proceedings.⁵³³ Under the EU Insolvency Regulation, ‘insolvency proceedings have the same effect in other EU states as they have in the law of the insolvency forum’.⁵³⁴ In contrast, the Model Law requires a decision from a relevant national court to recognize the foreign proceeding.⁵³⁵ The consequences of the recognition depend on the law of the relevant state. The law of the relevant state in which the national court has recognized the foreign proceeding determines the effects of the proceeding.⁵³⁶

For the purposes of the Model Law, a deliberate decision was taken not to define COMI. Under both the Model Law and the EU Regulation, once the court determines the main proceeding, actions taken in relation to the non-main proceedings are to be made consistent with remedies granted in the main proceedings.⁵³⁷ These rules help support the coordination goals of the Model Law by focusing resolution efforts on the main proceeding and provides for coordination of concurrent proceedings in multiple jurisdictions.⁵³⁸ Clift writes,

‘The basic principle of the Model Law with regard to relief is that recognition of foreign proceedings by the court of the enacting State grants effects that are considered necessary for the orderly and fair conduct of cross-border insolvency. The Model Law...adopts a neutral middle ground that specifies the effects, in terms of relief, that should automatically apply on recognition. At the same time, it defers to local law, providing that the scope, modification, or termination of the relief upon recognition are subject to provisions of the law of the enacting State that applies to such exceptions, limitations, modifications, or terminations.’⁵³⁹

⁵³³ United Nations Commission of International Trade Law Model Law on Cross-border Insolvency, *Guide to Enactment of the UNCITRAL Model Law on Cross-border Insolvency*, Chapter IV, Main features of the Model Law, (30).

⁵³⁴ *European Union Insolvency Regulation, European Union Insolvency Regulation, No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002), Article 17(1).

⁵³⁵ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, Article 17.

⁵³⁶ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, Article 20.

⁵³⁷ Paul H. Zumbro, ‘Cross-Border Insolvencies and International Protocols- An Imperfect but Effective Tool’, (2010) 11 *Business Law International* 157, 159.

⁵³⁸ Michael H. Krimminger, *Deposit Insurance and Bank Insolvency in a Changing World: Synergies and Challenges*, International Monetary Fund Conference (May 28, 2004).

⁵³⁹ Mevorach, above n322, 339-340.

The philosophy behind the Model Law is that if there is any rule in the laws of the enacting state that is less restrictive or more flexible than the Model Law, that specific rule prevails.⁵⁴⁰ This was illustrated in the case of *In Re Betcorp (in liquidation)* which is discussed further in this chapter, and was the first time that an Australian voluntary winding up had been recognized in the US and internationally as a ‘foreign main proceeding’.⁵⁴¹

Article 16 of the Model Law establishes presumptions on which a court is entitled to rely in determining COMI. It creates presumptions that allow the court to expedite evidentiary processes.⁵⁴² In the absence of proof to the contrary, Paragraph 3 provides that the debtor’s registered office is presumed to be the centre of the main interests.⁵⁴³ The presumption is rebuttable where a debtor has its registered office in one jurisdiction but its head office functions are conducted in another jurisdiction.⁵⁴⁴ The determination of COMI is complicated where head office functionality spans across multiple jurisdictions⁵⁴⁵ as with international banks. The UNCITRAL Legislative Guide defines COMI as ‘the place where the debtor conducts the administration of its interests on a regular basis, and that is therefore ascertainable by third parties.’⁵⁴⁶ Although there can be only one COMI, the practical effect is that a corporate entity can be registered in one jurisdiction while its COMI is in another jurisdiction.⁵⁴⁷ Arguably, several COMIs can also be located for a business enterprise group entity although entities of the business enterprise group⁵⁴⁸ are in a number of jurisdictions.⁵⁴⁹

⁵⁴⁰ André J. Berends, 'The UNCITRAL Model Law on Cross-Border Insolvency: A Comprehensive Overview', 6 (1998) *Tulane Journal of International and Comparative Law* 309, 321.

⁵⁴¹ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009).

⁵⁴² See *Ackers v Saad Investment Company Ltd (in liq)* (2010) 190 FCR 285; *Williams v Simpson* [2011] 2 NZLR 380; *In re Stanford International Bank Ltd* [2011] Ch 33.

⁵⁴³ *United Nations Commission of International Trade Law, Working Group V (Insolvency Law), Thirty-ninth session, Vienna, 6-10 December 2010, UN Doc. No. A/CN.9/WG.V/WP.95/Add.1.*

⁵⁴⁴ See *In re Stanford International Bank Ltd* [2011] Ch 33, *In re Sphinx* 351 BR 103; *In Re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd*. 374 BR 122 & 389 BR 325; *Re Collins & Aikman Corporation* [2005] EWHC 1754 (Ch); *In Re Ci4net.com Inc.* [2005] BCC 277.

⁵⁴⁵ Sean Gollin, *Heath & Whale on Insolvency* (LexisNexis New Zealand Ltd, 2011), 105.

⁵⁴⁶ United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004).

⁵⁴⁷ See *In re Stanford International Bank Ltd* [2011] Ch 33, *In re Sphinx* 351 BR 103; *In Re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd* 374 BR 122 & 389 BR 325; *Re Daisytex* [2003] BCC 562.

⁵⁴⁸ See the case of *Wagon Automotive Group* where there was more than one COMI for different parts of the group.

⁵⁴⁹ Sarra, above n35, 555.

5.4 The Application of the Model Law to Banks and Financial Institutions: Reasons for Exclusions

As mentioned, the Model Law refers to the possibility of excluding from its scope of application certain entities such as banks and insurance companies specially regulated with regard to insolvency under the laws of the enacting State.⁵⁵⁰ The UNCITRAL Working Group Paper states that:

Insolvency of banks and other financial institutions has been excluded so far from the scope of insolvency related work undertaken by UNCITRAL. The reason for these exclusions are that banks and other financial institutions are subject to special resolution regimes in many jurisdictions and that the winding down of financial institutions raises important public policy issues, especially if the institution is of systemic relevance.⁵⁵¹

The reason for the optional clause by which special bank insolvency regimes are applicable is that the special regulation for winding up credit institutions arises from

‘the particularly prompt and circumspect action called for in relation to such entities from the competent authorities. The Model Law might not be able to meet the demands for speedy adjudication posed by the financial markets’.⁵⁵²

According to the Legislative Guide, banks and insurance companies are typical subjects of special insolvency regimes and are heavily regulated because of the need to protect a large number of consumers or because of extraordinary actions that need to be undertaken with their insolvency.⁵⁵³ Wessels stated that for recognition purposes, the enacting State could treat a foreign proceeding relating to a bank as an ordinary insolvency proceeding in cases where the insolvency of the branch or assets of the foreign entity in the enacting State are excluded from the national regulatory scheme. The exclusion could also have imposed

⁵⁵⁰ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 25.

⁵⁵¹ United Nations Commission on International Trade Law, Working Group V (Insolvency Law) Thirty-eighth session, New York, 19-23 April-4 May 2010, Working Group Paper UN Doc. No. A/CN.9/WG.V/WP.93/Add.5, ‘Insolvency Law: Possible Future Work; Proposal by the delegation of Switzerland for preparation of a study on the feasibility of an instrument regarding the cross-border resolution of large and complex financial institutions,’ 2. See also Legislative Guide on Insolvency Law, p40 (2005); UNCITRAL Model Law on Cross-border Insolvency, Article 1(2), (1997).

⁵⁵² Bank of International Settlements, above n2, 15.

⁵⁵³ Campbell, above n195, 8-9.

limitations to ensure that it falls within the scope of the Model Law.⁵⁵⁴ The tendency by countries that have enacted the Model Law to exclude banks and financial institutions arises arguably, from the need for special rules to deal with bank insolvencies.

The various choices in deciding which insolvency law would be applicable to banks include implementation of a special bank insolvency law, inclusion of bank insolvency within the general banking laws of the jurisdiction or applying the general corporate insolvency law. There is also the debate about whether to use a judicial procedure as in the UK and Ireland, or to apply an administrative approach with court involvement that is restricted to appellate functions as in the US.⁵⁵⁵ In some jurisdictions, the insolvency of banks and financial institutions are regulated by banking laws as a particular subset of insolvency rules, which may be supplemented by general provisions that are applicable to all insolvency cases.⁵⁵⁶ For example, Australia enacted the Model Law under the *Cross-Border Insolvency Act 2008* (Cth). In Australia, the exclusion of financial institutions from the Model Law has been replaced with special insolvency frameworks for financial institutions at the Commonwealth Level.⁵⁵⁷ Australia's banking laws provide that bank depositors in Australia have first claim to the assets in relation to a foreign authorised deposit taking institutions (ADI) of the *Banking Act*.⁵⁵⁸ The definition of ADI is a corporate entity to which the Australian Prudential Authority (APRA) has granted authority to carry on banking business in Australia; and a foreign ADI refers to a foreign bank which has been so authorised. This ringfencing of assets with preference for a particular class of creditors illustrates national sovereignty and interest contrary to the *pari passu* principle that all claims of a similar type should be treated equally in insolvency.⁵⁵⁹ Furthermore, Article 13(1) in the Model Law states that foreign creditors are generally to have the same rights as local creditors. In other jurisdictions, the general insolvency regime also applies to banks and financial institutions with limited provisions

⁵⁵⁴ Bob Wessels, *Current Topics on International Insolvency Law* (Kluwer, 2004), 63.

⁵⁵⁵ Ibid. In the case of Lithuania, a combination of all three exists. See The World Law Guide, Legislation Lithuania, viewed at <<http://www.lexadin.nl/wlg/legis/nofr/oeur/lxwelit.htm>> on July 10, 2013..

⁵⁵⁶ Basel for International Settlements, *Report of the Contact Group on the Legal and Institutional Underpinnings of the International Financial System Insolvency Arrangements and Contract Enforceability*, (March, 2010), 15.

⁵⁵⁷ The Treasury, Australian Government, 'Enacting the Model Law in Australia: Issues for Consideration' viewed at <<http://archive.treasury.gov.au/documents/448/HTML/docshell.asp?URL=7Enacting.asp>> on 24 April, 2013.

⁵⁵⁸ Michael Murray & Rosalind Mason, 'Model Law on Cross-border Insolvency: Exclusion of Australian Banks', October-December (2008) *Australian Insolvency Journal* 4, 4. Under s13A(3) of the *Banking Act*, bank depositors in Australia have first claim to assets in Australia of that ADI.

⁵⁵⁹ Look Chan Ho, 'Goode's Swan Song to Corporate Insolvency Law' viewed at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=84566512> on November 11, 2013.

from case law.⁵⁶⁰ Many jurisdictions such as the UK have utilised the exclusions to implement specific provisions. For example, Article 1(2) of the British Model Law excludes specific credit institutions including a UK credit institution, an EEA institution, and a third country credit institution.⁵⁶¹ The variance in exclusions by different jurisdictions has created further inconsistencies in the law.⁵⁶²

In international bank insolvency cases, where concurrent insolvency proceedings and procedures are commenced in multiple jurisdictions, complex legal, jurisdictional, and regulatory problems can arise. In the Contact Group Legal and Institutional Underpinnings of the International Financial System's Paper on Insolvency Arrangements and Contract Enforceability,⁵⁶³ it was stated that:

If these regimes cannot be reconciled with one another on a specific matter during the course of proceedings, conflicts can occur. In the absence of an international insolvency regime addressing these types of conflicts, the problems arising are generally solved through cooperation between authorities on a pragmatic basis. However, such ad hoc solutions may not be sufficient in all cases where there exist two or more distinctly different legal regimes applicable on a concurrent basis, particularly when such differences refer to more fundamental aspects of the insolvency procedure.⁵⁶⁴

As indicated in Chapter 1, the uncertainty, unpredictability and unforeseen conflicts in insolvency proceedings are exacerbated by the absence of a definition of COMI which will be discussed in the next section.

6. International bank insolvencies and COMI

At present, the determination of a debtor's COMI is generally the most litigated issue in cross-border insolvency.⁵⁶⁵ A growing body of legal decisions have developed in countries where the Model Law is implemented. While some courts determine COMI based solely on the presumption that the registered office is the COMI, other jurisdictions review the specific facts and circumstances of a debtor's operation to determine if the registered office is the COMI or if the COMI is where the

⁵⁶⁰ Bank of International Settlements, above n2, 15.

⁵⁶¹ British Model Law, Cross-border Insolvency Regulations 2006 (implemented 4 April 2006), Article 1(2).

⁵⁶² Lastra, above n105, 216-217.

⁵⁶³ Bank of International Settlements, above n2.

⁵⁶⁴ Bank of International Settlements, above n2, A24.

⁵⁶⁵ Janger, above n277, 410.

primary business operations are conducted, the primary decisions take place, and which is readily ascertainable by creditors.⁵⁶⁶

In international bank insolvencies, it is critical that ‘international jurisdiction be based on a place known to the debtor’s potential creditors. This enables the legal risks which would have to be assumed in the case of insolvency to be calculated.’⁵⁶⁷ The uncertainty surrounding rebutting the presumption that is incorporated in the Model Law, the conflicting factors that are utilised by recognising jurisdictions to establish the COMI, and the time at which the recognising jurisdictions determine COMI⁵⁶⁸ contribute to the ambiguity of the definition of COMI. The various interpretations in respect of the rebuttable presumption and the strength in which the various jurisdictions will accord this presumption undermine the certainty.

This difficulty is exacerbated in international bank insolvencies because at the time creditors extend their credit they will not know the potential recognising jurisdiction and thus, which view will prevail regarding the presumption's strength. Furthermore, an important objective of the COMI concept is to provide certainty and foreseeability for creditors of the company at the time that these creditors enter into a transaction.⁵⁶⁹ Secondly, even the strongest interpretation of the presumption, i.e. as a true indication of COMI, provides creditors with little real guidance as the presumption can still be displaced by evidence that the debtor’s COMI is situated elsewhere.

The problem – as discussed above - arises from the lack of definition of some of the elements of COMI and the different interpretations of the concept in diverging jurisdictions and various courts.⁵⁷⁰ International banks operating through foreign branches and subsidiaries dealing with international transactions, as well as multi-bank syndicates comprising banks

⁵⁶⁶ Redmond, above n276, 24-25.

⁵⁶⁷ Virgos & Schmidt, above n197, 75.

⁵⁶⁸ Judith Wade, ‘The Centre of Main Interests Connecting Factor Affords Creditors No Certainty under the Model Law Regime’, (2011) 22(3) *International Company and Commercial Law Review* 102, 103.

⁵⁶⁹ United Nations Commission of International Trade Law, Working Group V (Insolvency Law) Forty-first session, New York, 30 April-4 May 2012, Working Group Paper UN Doc. No. A/CN.9/WG.V/WP.103/Add.1, ‘Interpretation and Application of Selected Concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to Centre of Main Interests (COMI), 123G, 5.

⁵⁷⁰ Garrido, above n130, 462.

from many countries,⁵⁷¹ have complicated the determination of COMI in cases of cross-border insolvency. These financial and banking groups – as noted – differ from corporate groups as they are highly and also differently regulated in each of the jurisdictions in which each entity of the financial group is registered, and the application of a group COMI could potentially prejudice creditors in jurisdictions where priorities differ or where there is ‘adequate protection.’ In respect of the difficulties of forum selection, Garrido argues that:

It is extremely difficult to find a completely predictable rule, uniformly interpreted, that would provide a totally certain solution to the problem of determining the forum for the opening of insolvency proceedings in the case of debtors with multiple international connections. The complexity of the connecting factors that are taken into account for the determination of the centre of main interests, and the high likelihood that there are international elements in the connecting factors, increase the difficulties in the determination of the appropriate insolvency regime.⁵⁷²

The difficulties that arise in the determination of uniform criteria for the identification of COMI⁵⁷³ have created conflicts between jurisdictions in insolvency proceedings. One criticism is that the COMI is too important to decide at the outset before all of the interested parties have had a chance to be heard. Another is that each entity in a corporate group will have its own COMI so that the reorganization or liquidation of a multinational group of companies will continue to be split between jurisdictions. In the case of cross-border banks, their banking activities are not explicitly addressed by national banking laws in many countries and this has created complex issues of law.⁵⁷⁴ This includes the possible uncertainty of determining the COMI of a multinational bank which can be prone to manipulation. It has been argued that the COMI standard adopted by the EU and the Model Law was meant to solve the problem, but recent cross-border bank insolvency cases have demonstrated that choice of law problems continue in universalist systems.⁵⁷⁵

⁵⁷¹ Moss & Segal, above n230. As indicated in chapter 3, multi-bank syndicates complicate the determination of COMI as many international banks operating through various foreign branches and subsidiaries may have many COMIs in conflicting jurisdictions such as in both Europe and the US.

⁵⁷² Ibid.

⁵⁷³ Sano, above n231, 94.

⁵⁷⁴ Schobel, above n79, 195.

⁵⁷⁵ Filho, above n234, 104-5.

In complex cross-border bank insolvency proceedings, as indicated in Chapter 3 and earlier in this chapter, a significant factor in determining the debtor's COMI is the location of the company's head office functions.⁵⁷⁶ In determining the location, courts tend to focus on the:

location of the debtor's headquarter; the debtor's nerve centre; the place of the debtor's central administration; or the place from which the debtor's head office functions are performed and upon the factors relevant to that determination.⁵⁷⁷

In the case of large, corporate debtors such as large, complex financial institutions that may be operating through several principal places of business, the standard where the head office functions are carried out is likely to provide greater certainty as to the real COMI of the debtor.⁵⁷⁸ Courts in Germany, France and England have followed the head office functions test in determining COMI.⁵⁷⁹

Moss and Smith claimed in 2002 that the Virgos-Schmit Report indicates that it is more appropriate to focus on where the head office functions are carried out rather than the location of the head office.⁵⁸⁰ In *Lennox Holdings*,⁵⁸¹ Judge Lewison considered whether the court should concentrate on the head office functions test in respect of the two Spanish subsidiaries of Lennox Holdings. The financing of the company, its major decisions and the administration of the company were conducted in England and through English suppliers, English directors and with English finance. The court decided against relying on the head office functions test, finding that 'the two Spanish companies do carry on business in the

⁵⁷⁶ Miguel Virgos & Etienne Schmidt, 'Report on the Convention on Insolvency Proceedings', Virgos Schmidt Report, paragraph 76 viewed at <<http://aei.pitt.edu/952/>> on May 22, 2011.

⁵⁷⁷ United Nations Commission of International Trade Law, Report of Working Group V (Insolvency Law), Forty-first session, New York, 30 April-4 May 2012, Working Group Paper UN Doc. No. A/CN.9/WG.V/WP.103/Add.1, 'Interpretation and Application of Selected Concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to Centre of Main Interests (COMI)', 123D, 4.

⁵⁷⁸ Hon. Samuel L. Bufford, 'Coordination of Insolvency Cases for International Enterprise Groups: A Proposal', 86 (2012) *American Bankruptcy Law Journal* 685, 716. Bufford states that 'the test for the location of an ECOMI of an enterprise group should be the country where its management headquarters or head office is located.'

⁵⁷⁹ The head office functions test has been applied in English, French and German courts under the judgement of *Re Eurofood, IFSC Ltd* [2005] BCC 1021, including *Re Daisytek-ISA Ltd* [2004] BPIR30; *Re Hettlage ZIP* 2004, 962; *Re Collins & Aikman Corporation* [2005] EWHC 1754 (Ch); *Re MPOTEC GmbH* [2006] BCC 681; and the *Eurotunnel case Eurotunnel Fin. Ltd, Tribunal de Commerce* [TDC] Commercial Court Paris, Aug 2, 2006(Fr.). The High Court of Justice, England also followed the head office functions test in *Re Lennox Holdings.PLC* [2009] BCC155.

⁵⁸⁰ Gabriel Moss and Smith, Commentary on Council Regulation 1346/2000 on Insolvency Proceedings, in: Gabriel Moss, Ian F. Fletcher and Stuart Isaacs (eds), *The EC Regulation on Insolvency Proceedings- A Commentary and Annotated Guide* (Oxford University Press, 2002).

⁵⁸¹ *Re Lennox Holdings* [2009] BCC 155. This case illustrates the consideration of the head office functions test pre-*Eurofood*.

member state where their registered office is situated and consequently the “mere fact” that its economic choices are or can be controlled by a parent company is not enough to rebut the presumption.⁵⁸² Subsequently, Judge Lewison has stated that in the *Lennox Holdings* case, he was wrong to the extent that he considered and applied the head office functions test and that pre-*Eurofood* decisions by English courts should no longer be followed in this respect.⁵⁸³

In international bank insolvencies, the timing relevant to determining the debtor’s COMI is also significant, in consideration of the opportunity for abuse of process by forum shopping which, arguably, may be more easily manipulated by large, complex financial institutions. As insolvency proceedings must be commenced where the debtor has its COMI at the time when insolvency proceedings are lodged, there is the opportunity to shift the COMI to where relevant debts were incurred and away from where creditors are located. However, attempts to shift COMI after proceedings have commenced will be ineffective.⁵⁸⁴ This is distinctive from forum selection whereby a strategically selected and well-established COMI can be beneficial to certain stakeholders in consideration of the specific circumstances of the insolvent bank, and can create value for certain stakeholders through the application of the judicial process of insolvency proceedings.⁵⁸⁵ For example, in the case of *HIH*, the court held that the turnover of assets to the Australian proceeding was permitted and thus, benefited Australian creditors with insurance policies, in the insolvency proceedings.⁵⁸⁶

Arguably, the lack of a statutory definition of COMI⁵⁸⁷ increases the potential that the COMI of a cross-border bank can be manipulated with improper motives in order to avoid contributing to maximising the debtor’s net assets. In the migration of COMI, there is also the issue that COMI can be shifted to a jurisdiction that would benefit a debtor at the expense of creditors or some creditors at the expense of others.⁵⁸⁸ For example, exceptional circumstances can occur whereby a COMI shift is an abuse of freedom of establishment when a company changes the jurisdiction to open main insolvency proceedings. The intention is not to maximise the net assets available to the creditor.⁵⁸⁹ In contrast, in the recent case of *In*

⁵⁸² *Re Lennox Holdings* [2009] BCC 155, paragraph 8.

⁵⁸³ *Re Stanford International Bank*, [2009] EWHC 1441 (Ch), paragraph 61.

⁵⁸⁴ *Webb and Butler*, above n243.

⁵⁸⁵ *Marshall and Pardiwala*, above n236, 312.

⁵⁸⁶ *HIH* [2008] UKHL 21 at 51.

⁵⁸⁷ COMI is not defined in the Model Law, EU Regulation, Chapter 15 of the US Bankruptcy Code or Chapter 47 of the Statutes of Canada 2005.

⁵⁸⁸ *Eidenmuller*, above n147, 1.

⁵⁸⁹ *Ibid*, 16.

re Patriot Coal, Patriot Coal transferred 98 of its subsidiaries to New York, approximately one month before filing for bankruptcy. In this case, Judge Chapman held that Patriot Coal and its subsidiaries

‘did not act in bad faith in filing their cases in the New York bankruptcy court, for purposes of determining whether transfer of venue was warranted in the interest of justice or for convenience of parties, where debtors believed that selected district was optimal venue for their cases and in the best interests of debtors, their creditors and other stakeholders, and estates, and that filing in one of other available districts would have inconvenienced most of their domestic and foreign creditors and materially increased costs and inefficiency of estates’ administration. In filing their cases in the New York bankruptcy court, was not in bad faith as it was warranted in the interest of justice.⁵⁹⁰

However, she stated that:

The fact that a single constituency may prefer a particular venue over the Debtor’s chosen forum is patently insufficient to warrant a transfer of venue in the interest of justice. In fact, a transfer on such facts would be particularly unjust in the face of an impression that the transfer is being made to advantage⁵⁹¹

Differences in insolvency regimes mean that certain jurisdictions will be more attractive to the debtor than others.⁵⁹² In respect of change of COMI, the change of registered office is unlikely to result in a genuine shift of COMI because the presumption that the COMI is the location of the head office is rebuttable on evidence.⁵⁹³ However, there is the potential that COMI, by migrating the assets and liabilities to another jurisdiction and proving that the transfer of the assets and liabilities, is valid as a matter of law in both the original and new jurisdictions. If this is not possible, the third option is to demonstrate that the administration is conducted in another jurisdiction as opposed to the country of incorporation.⁵⁹⁴ In *Betcorp*,

⁵⁹⁰ *In re Patriot Coal*, 482 BR 718, Bkrcty SDNY [2012], paragraph 8.

⁵⁹¹ *In re Patriot Coal*, 482 BR 718, Bkrcty SDNY [2012], paragraph 14.

⁵⁹² Webb and Butler, above n243; Macfarlanes, Restructuring and Insolvency Briefing: Centre of Main Interests viewed at <http://www.macfarlanes.com/media/280386/centre_of_main_interests_comi.pdf> on June 3rd, 2012.

⁵⁹³ *Re Stanford International Bank*, [2009] EWHC 1441 (Ch), paragraph 50. See also United Nations Commission of International Trade Law, Report of Working Group V (Insolvency Law) Forty-first session, New York, 30 April-4 May 2012, Working Group Paper UN Doc. No. A/CN.9/WG.V/WP.103/Add.1, ‘Interpretation and Application of Selected Concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to Centre of Main Interests (COMI)’, paragraph 123B which states that: ‘In the majority of cases, the debtor’s centre of main interests is likely to be the same location as its place of registration and no issue concerning rebuttal of the presumption will arise.’

⁵⁹⁴ Ringe, above n357, 5.

the court examined the debtor's administration, management and operations in addition to ascertaining whether reasonable and ordinary third parties can discern or perceive where the debtor is conducting these functions. As indicated later in this chapter, Betcorp was incorporated in the UK while its administrative and executive nerve centre resided in Australia. Judge Markell concluded that 'courts analyse a variety of factors to discern, objectively, where a particular debtor has its principal place of business'.⁵⁹⁵ The approach adopted in *Betcorp* was subsequently followed in *Yuval Ran* and *British American Insurance Co.*⁵⁹⁶

Whether a shift in COMI is recognised will depend on whether there has been a genuine shift of COMI that is ascertainable by third parties.⁵⁹⁷ Unlike the Model Law, in the EU Insolvency Regulation, if a bank shifts its COMI from one Member State to another, this activity is protected under freedom of establishment. A bank may move its real seat from one Member State to another if the change is to a more attractive regulatory environment which changes its COMI. The incentive for this move is that under EU Law, according to Article 4(1) of the Insolvency Regulation, with few exceptions, the law applicable to insolvency will be the law of the Member State where insolvency proceedings have been opened. Therefore, the significance of COMI is its role as a determinant of jurisdiction and choice of law.⁵⁹⁸

The shift to a new applicable insolvency regime should be made with the consideration that the new COMI is where creditors would be best protected. In spite of this, there have been cases in which the shifting of COMI amounts to an abuse of freedom of establishment. In the case of cross-border banks, there is also the potential for eve-of-bankruptcy reincorporation to occur such as in the case of *Bank of Credit and Commerce International*⁵⁹⁹ which moved its headquarters to Saudi Arabia before the bank filed for bankruptcy, as discussed in Chapter 3, section 5.1. In this case, the shift of COMI was not an attempt to forum shop for bankruptcy law but an attempt to flee personal criminal jurisdiction.⁶⁰⁰ The highly liquid assets of a bank are readily movable. Eve-of-bankruptcy asset transfers and intra-debtor

⁵⁹⁵ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009).

⁵⁹⁶ *In re Yuval Ran, Lavie v Ran* 607 F. 3d 1017 (5th Cir. 2010); *In re British American Insurance* 425 BR 884 (Bankr. SD Fla 2010).

⁵⁹⁷ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

⁵⁹⁸ Paschalis Paschalidis, *Freedom of Establishment and Private International Law for Corporations*, (Oxford University Press, 2012), 187.

⁵⁹⁹ *Bank of Credit and Commerce International SA* (No 9), Re [1994] 3All ER 784.

⁶⁰⁰ Pottow, above n182, 799.

transfers that exploit the choice of law rules of territorialism⁶⁰¹ can also shift COMI to the detriment of creditors. In the case of *National Warranty Insurance*,⁶⁰² US\$24 million of its reserves were wired to the Cayman Islands just prior to filing for winding up under Cayman Islands law.⁶⁰³ It may be argued that the lack of a developed concept of COMI in international law has created the possibility for this to occur in cross-border bank insolvency.

6.1 Divergent Interpretations

Although in the majority of cases, the debtor's COMI is likely to be the same location as its place of registration,⁶⁰⁴ the following cases demonstrate how the courts in the US and Ireland have considered the presumption of COMI being that of the registered office in determining COMI.

Stanford International Bank

The case of *Stanford International Bank* (SIB) illustrates the court's application of the Model Law in determining the COMI of a large, complex financial institution. The collapse of *Stanford International Bank* also illustrated how the lack of international co-operation in respect of COMI was to the detriment of creditors.⁶⁰⁵ Both the receivers and liquidators alleged that the insolvency proceedings, to which they had been respectively appointed, were the main proceedings for the purposes of the *Cross-Border Insolvency Regulations (2006)*.⁶⁰⁶ Both the receiver and the liquidators applied for recognition as foreign representatives under the Model Law. The major issues before the court were: who, if either, was the appropriate applicant as foreign representative and, which jurisdiction ought to be considered SIB's COMI?⁶⁰⁷ For the purposes of this chapter, only the issue of SIB's COMI will be discussed.

⁶⁰¹ Ibid, 800.

⁶⁰² *Re National Warranty Insurance Risk Retention Group*, 42 Bankruptcy Court Decisions 179 (2004).

⁶⁰³ Pottow, above n182, 801.

⁶⁰⁴ United Nations Commission of International Trade Law, Report of Working Group V (Insolvency Law) Forty-first session, New York, 30 April-4 May 2012, Working Group Paper UN Doc. No. A/CN.9/WG/V/WP.103/Add.1, 'Interpretation and Application of Selected Concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to Centre of Main Interests (COMI)', paragraph.123B, 1.

⁶⁰⁵ *Re Stanford International Bank*, Re [2009] EWHC 1441 (Ch).

⁶⁰⁶ *Re Stanford International Bank*, Re [2009] EWHC 1441 (Ch).

⁶⁰⁷ *Re Stanford International Bank*, Re [2009] EWHC 1441 (Ch) See also Fraser Hughes, 'The Stanford Bank Decisions in England and Quebec: Are We Moving Further Away From Common Principles?' (2010) 21(6) *International Company and Commercial Law Review* 205.

The decisions, one in England and one in Quebec, questioned the ability of national courts to develop a unified and cohesive approach to the interpretation of Article 15 of the Model Law.⁶⁰⁸ In the English decision, the court held that SIB's COMI was Antigua and that the Antiguan liquidators were the proper foreign representatives and not the US-appointed receiver. However, the two decisions of the Quebec court reached an opposite conclusion, largely on the basis of the court's view of the liquidator's conduct. Furthermore, a real and substantial connection was found with the United States, apparently without adequate consideration of the type of reasoning and statutory construction set out in the English decision.⁶⁰⁹

In the English decision, the court considered in determining COMI whether one should look at all connecting factors in evidence at the hearing or only at those that would have been objectively ascertainable and transparent. The determination of COMI was particularly relevant to SIB because of the nature of the allegations of fraud. The connecting factors that were objectively ascertainable by third parties might have greatly differed from those factors that were allegedly fraudulently concealed. On the facts of the case, Judge Gouling held that there was no sufficient connection as:

- i) The company in question was not made a defendant to the American proceedings, and there was no evidence that it has ever submitted to the federal jurisdiction;
- ii) It was not incorporated in the United States of America or any of their states or territories;
- iii) There was no evidence that the courts of the place of incorporation would themselves recognise the American decree as affecting English assets;
- iv) There was no evidence that the company carried on business in the United States of America or that the seat of its central management and control has been located there.⁶¹⁰

The court applied the reasoning of Jacobs AG, the Italian administrator, in the European Court of Justice decision in *Eurofood IFSC Ltd* in determining SIB's COMI. The court decided that the presumption of COMI coinciding with the location of the company's registered office was an applicable presumption. Jacobs AG argued that:

⁶⁰⁸ Hughes, See also *ibid*.

⁶⁰⁹ *Re Stanford International Bank*, Re [2009] EWHC 1441 (Ch), paragraph 99.

⁶¹⁰ *Re Stanford International Bank*, Re [2009] EWHC 1441 (Ch), paragraph 102.

In transnational business the registered office is often chosen for tax or regulatory reasons and has no real connection with the place where head office functions are actually carried out. That is particularly so in the case of groups of companies, where the head office functions for the subsidiary are often carried out at the place where the head office functions of the parent of the group are carried out."⁶¹¹

In addition, the court stated that one important purpose of COMI is that it provides certainty and foreseeability for a company's creditors at the time that they enter into a transaction. Since its registered office was in Antigua, it was presumed that its COMI was Antigua. It also concluded that the burden of rebutting the presumption lay on the receiver with objective factors that are also ascertainable by third parties, including the company's creditors.⁶¹²

In contrast, the Quebec decisions were based on a version of the *Canadian Bankruptcy and Insolvency Act*⁶¹³ which differed from the Model Law that was analysed in the English decision.⁶¹⁴ The English court noted that US jurisprudence was not qualified by a requirement that creditors be able to ascertain the COMI of the company, in contrast to the EC Regulation, which provided that COMI was the place where the debtor conducted the administration of its interests on a regular basis and was ascertainable by third parties.⁶¹⁵ There appeared to be little analysis of the concept of "real and substantial connection." Rather, the court dismissed the liquidators' application on the basis of the liquidators' conduct. The Quebec court decided that the receiver was the "foreign representative" and that the real and substantial connection was the United States. The court was of the view that for the Ponzi style frauds, the real and substantial connection was situated at the nerve centre of the fraud which was the United States.

The conflicting decisions of *Stanford* and the next case *In Re Betcorp* illustrate the jurisdictional conflict and lack of international cooperation in the decision of COMI that can arise in cases of international group insolvency.

⁶¹¹ *Stanford International Bank*, Re [2009] EWHC 1441 (Ch), paragraph 52.

⁶¹² *Re Stanford International Bank*, Re [2009] EWHC 1441 (Ch), paragraph 70.

⁶¹³ *Re Stanford International Bank Ltd*, et al (2009 QCCS 4109) and (2009 QCCS 4106).

⁶¹⁴ Chapter 47 adopts the concept of centre of main interests (COMI) to determine main or non-main proceedings. However, COMI is not defined in chapter 47.

⁶¹⁵ House Report on the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, H.R. Rep No.109-31, Pt1. at 105 (2005).

In Re Betcorp (in liquidation)

In 1998, Betcorp was formed as a company under Australian law. From its formation and until it ceased operating in 2006, its business activities concerned gaming operations through various affiliate and subsidiary entities. It began operations in Australia and later expanded its gaming operations into the US. After US law on online gambling made its business model unworkable, Betcorp ceased operations and its members voted to liquidate the company through a members' voluntary winding up under Australian law.⁶¹⁶ In 2006, before Betcorp had ceased operations, the Australian liquidators received a complaint from 1st Technology which claimed that Betcorp had infringed one of its patents used by internet gaming companies. The former filed proceedings against Betcorp in the US District Court. Betcorp's liquidator applied to have the Australian winding up recognised as a foreign main proceeding in the US Bankruptcy Court; subsequently, 1st Technology was required to approach an Australian court to pursue the patent infringement claim.⁶¹⁷

The central issues relevant to this chapter are:

- 1 whether the winding up under Part 5 of the *Corporations Act* (Cth) could be recognised as a foreign main proceeding as defined by Chapter 15 of the US Bankruptcy Code; and
- 2 whether the COMI of Betcorp was Australia.

Firstly, 1st Technology argued that Betcorp's winding up was not a foreign proceeding within the definition of Chapter 15 and that COMI should be determined with reference to the company's operational history, which was in the US. It argued that:

- (i) there was no lawsuit or legal proceeding pending in an Australian court which involved Betcorp's creditors;
- (ii) Betcorp was not in administration under Australian bankruptcy laws; and
- (iii) there was no legal process in which a judge directly supervised the liquidators' actions in the winding up.⁶¹⁸

⁶¹⁶ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009).

⁶¹⁷ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009).

⁶¹⁸ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 9.

The US Bankruptcy court stated that the text and interpretations of the Corporations Act indicated that the Australian voluntary winding up satisfied all of the elements of a “foreign proceeding” as defined in s101(23).⁶¹⁹

Chapter 15 of the US Bankruptcy Code incorporates the Model Law ‘to encourage cooperation between the United States and foreign countries with respect to transnational insolvency cases.’⁶²⁰ The Guide to Enactment provides interpretive guidance to the meaning of the provisions that are embodied in Chapter 15,⁶²¹ and allows courts to refer to this for support in interpreting legislation.⁶²² The scope of the Model Law’s definition of ‘proceedings’ in its Guide to Enactment states that:

To fall within the scope of the Model Law, a foreign insolvency proceeding needs to possess certain attributes. These include the following: basis in insolvency-related law of the originating State; involvement of creditors collectively; control or supervision of the assets and affairs of the debtor by a court or another official body; and reorganisation or liquidation of the debtor as the purpose of the proceeding...⁶²³

Chapter 15 section 101(23) states that:

‘The term “foreign proceeding” means a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation’.⁶²⁴

The US Bankruptcy Court applied a broad interpretation of ‘proceeding’,⁶²⁵ referring to the European Union Regulation on Insolvency Proceedings which stated that ‘insolvency

⁶¹⁹ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 9.

⁶²⁰ House Report on the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, H.R. Rep No.109-31, Pt1. at 105 (2005).

⁶²¹ United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004).

⁶²² United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004).

⁶²³ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-border Insolvency with Guide to Enactment*, 23, at 10, UN General Assembly, *UNCITRAL 30th session*, U.N. Doc. A/CN.9/442 (1997).

⁶²⁴ *Chapter 15*, United States Bankruptcy Code (Title 11- Bankruptcy enacted November 7, 1978), 11 USC 101(23).

⁶²⁵ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 12.

proceedings do not necessarily involve the intervention of a judicial authority'.⁶²⁶ The argument of 1st Technology was that a voluntary winding up did not constitute a proceeding because its commencement did not require an application or petition to any court.⁶²⁷

The *Corporations Act* 2001 (Cth) provisions allow, in appropriate cases, for the conversion of a voluntary winding up to a court-supervised external administration. While a voluntary winding up may never be considered by a judge, 'once the provisions of Part 5 of the *Corporations Act* are invoked, the process changes in ways which are beyond the debtor's control'.⁶²⁸ Australian case law further indicated that the voluntary winding was a legal process that constituted a 'proceeding'.⁶²⁹ The US Bankruptcy Court held that an Australian winding up was a proceeding that was administrative in character 'such that the assets and affairs of Betcorp were subject to control or supervision by a foreign court within the meaning of s101(23)'⁶³⁰ and that the necessary elements were satisfied. Furthermore, the interpretation of its domestic law under the *Corporations Act* (Cth) 2001 and the Model Law was persuasive.⁶³¹

Secondly, under the US Bankruptcy Code s1502(4), a foreign main proceeding is a 'foreign proceeding pending in the country where the debtor has its COMI'. The location of Betcorp's registered office and the place from which the winding up was being administered was Australia. The location of the liquidators of Betcorp was also in Australia. Its primary asset was the cash in its Australian bank account. However, the location of its creditors was in the United Kingdom, and its other creditor 1st Technology was located in the US. If the court were to determine the COMI based on operational history, there would be an increased probability of conflicting COMI determinations as courts may tend to attach more importance to their own jurisdictions, which may result in conflicting main proceedings.

The court found that Betcorp's COMI was Australia and stated that 'this is the place from which Betcorp conducts the administration of its interests', and this fact was ascertainable not

⁶²⁶ *European Union Insolvency Regulation, No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002).

⁶²⁷ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 14.

⁶²⁸ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 14.

⁶²⁹ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 15.

⁶³⁰ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 23.

⁶³¹ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 19.

only by third parties, but by 1st Technology itself'.⁶³² The cases from other jurisdictions supported a focus on the principle place of business.⁶³³ Judge Markell stated that:

Viewing Betcorp as of the time of the petition for recognition, almost all of the factors considered by courts lead to a determination that Betcorp's COMI is Australia. *See Bear Stearns*, 389 B.R. at 336 (listing potentially relevant factors such as: the locale of debtor's headquarters; its management; its assets; its creditors and the jurisdiction whose law would apply to most disputes). The location of Betcorp's location of those that manage Betcorp – the liquidators (since commencing the winding up divests the directors of their authority) – is Australia. Betcorp has no employees, save and except for those selected by the liquidators. Betcorp's primary asset; in fact, its only asset, is the cash in its Australian bank account. The voluntary winding up is being conducted pursuant to the Australian *Corporations Act*, and therefore this is the law that would apply to most disputes.⁶³⁴

He further stated that:

'Based on a consideration of all of the relevant factors and the evidence presented, the court finds that Betcorp's COMI is Australia. This is the place from which Betcorp conducts the administration of its interests, and this fact has proved ascertainable not only by third parties, but by 1st Technology itself (e.g., the letters from 1st Technology regarding alleged patent infringement, and submitting its proof of debt to the Australian liquidators). This finding is in line with recent English decisions under the EU Regulation finding that the identity of the country in which an individual debtor's debts were incurred was not a relevant consideration in establishing where COMI might be.'⁶³⁵

The Australian insolvency regime, the Model Law's recognition of foreign proceedings, and the policy analysis required to determine COMI in a foreign main proceeding were interpreted in ways that assisted international cooperation. The court considered the reasoning in *Ran* which stated that:

⁶³² *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 9.

⁶³³ See House Report, above n615, at 110, 29. The House Report stated that, 'Looking at these foreign cases is appropriate. Section 1508 states in interpreting phrases such as "center of main interests," the court shall consider how those phrases have been construed in other jurisdictions which have adopted similar statutes. This means looking not only at domestic cases, but also at cases decided by the courts of other countries. As stated in the legislative history, "not only are these sources persuasive, but they advance the crucial goal of uniformity of interpretation."

⁶³⁴ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 33.

⁶³⁵ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 33. *See also Shierson*, [2005], 33.EWCA (Civ) 974; *Official Receiver v. Eichler*, [2007] B.P.I.R. (Ch D.) 1636, 2007 WL 4947537 (Eng.).

If courts assess COMI with an eye to a debtor's operational history, there is an increased likelihood of conflicting COMI determinations, as courts may tend to attach greater importance to activities in their own countries, or may simply weigh the evidence differently. Giving consideration to a debtor's operational history increases the possibility of competing main proceedings, thus defeating the purpose of using the COMI construct. Requiring courts to give weight to the debtor's interests over the course of its operational history may destroy the uniformity and harmonization that is the goal of employing the COMI inquiry.

The presumption is that creditors will look to the law of the jurisdiction in which they perceive the debtor to be operating to resolve any difficulties they have with that debtor, regardless of whether such resolution is informal, administrative or judicial. In fact, an inquiry into the debtor's past interests could lead to a denial of recognition in a country where a debtor's interests are truly centered, merely because of past activities. This frustrates two of the purposes of the COMI inquiry – it decreases the effectiveness of the insolvency proceeding for which recognition is sought, and it may lead to a sub-optimal distribution of the debtor's assets, in as much as non-recognition where recognition is due may forestall needed inter-nation cooperation.'⁶³⁶

In international bank insolvencies, the policy analysis by courts is complicated by the issue of equality in distributional outcomes and the conflicts ensuing from the priority scheme that is used in the debtor's COMI, and the choice of law rules that are applied to determine these priority schemes.⁶³⁷ In Europe, the significant issue of deposit guarantee schemes which 'reimburse a limited amount of deposits to depositors whose bank has failed', has been magnified in the recent banking crises⁶³⁸ which is beyond the scope of this thesis. As the issue of distribution is one of the most complex legal issues in international insolvency,⁶³⁹ this issue will be examined throughout this chapter.

⁶³⁶ *In re Betcorp Limited (in Liquidation)* 400 BR 266 (Bankr D Nev 2009) at 32-33.

⁶³⁷ See European Commission, The EU Single Market: Deposit Guarantee Schemes, viewed at http://ec.europa.eu/internal_market/bank/guarantee/ on July 12, 2013.

⁶³⁸ *Ibid*, where it is stated that: 'On 12 July 2010, the Commission adopted a legislative proposal for a thorough revision of the Directive on Deposit Guarantee Schemes. It mainly deals with a harmonisation and simplification of protected deposits, a faster payout, and an improved financing of schemes. These proposed amendments follow urgent legislative changes that the Commission proposed in 2008 and that entered into force early 2009. The proposal is accompanied by a report.'

⁶³⁹ Jose Garrido, 'The Distributional Question in Insolvency: Comparative Aspects', 4 (1995) *International Insolvency Review* 25.

The choice of law rule applied by the court at the debtor's COMI determines the priority scheme⁶⁴⁰ which subjugates the distributional outcomes in secondary proceedings. The equality of distribution in the single priority scheme that is used in the debtor's COMI and the administration of a universal bankruptcy case from the debtor's COMI⁶⁴¹ are dependent on the unilateral cooperation of the ancillary court.⁶⁴² The choice of law rule at the debtor's COMI determines the priority scheme of the insolvency proceeding.⁶⁴³ These choices of law rules arguably include modified universalism, universalism and territorialism. For the purpose of this chapter, the distribution of assets keeping the choice of law rule in mind, will be discussed only in respect of these approaches in insolvency proceedings.

Under the modified universalism approach of the Model Law, a debtor's assets and claims are administered centrally under the insolvency law of the debtor's COMI. Modified universalism is a choice of law rule for the court at the debtor's COMI to use its own insolvency law to resolve legal issues.⁶⁴⁴ The Model Law uses the modified universalism approach which, while

‘accepting the premise of collection and distribution of assets worldwide, also allows for some flexibility in an otherwise rigid scheme by permitting secondary proceedings to be opened on a case-by-case basis...Such a system is much more readily implementable.’⁶⁴⁵

The law of the main jurisdiction is not recognised automatically in secondary jurisdictions, and the secondary jurisdictions decide whether to give recognition to the main jurisdiction and the main proceedings.⁶⁴⁶ The courts of the secondary jurisdiction consider, in particular, how foreign proceedings may impact upon local creditors.⁶⁴⁷ The next sections will analyse the theoretical approaches of universalism and territorialism in the context of insolvency claims.

⁶⁴⁰ Andrew T. Guzman, ‘International Bankruptcy: In Defense of Universalism’, 98 (2000) *Michigan Law Review* 2177, 2189-2191.

⁶⁴¹ Edward J. Janger, ‘Reciprocal Comity’, 46 (2010-2011) *Texas International Law Journal* 441, 456.

⁶⁴² *Ibid.*, 445.

⁶⁴³ Janger, above n277, 453.

⁶⁴⁴ Jay Lawrence Westbrook, ‘A Global Solution to Multinational Default’, 98 (2000) *Michigan Law Review* 2276, 2301-2301.

⁶⁴⁵ Jonathan M. Weiss, *Tax Claims in Transnational Insolvencies: A “Revenue Rule” Approach*, International Insolvency Institute, Tenth Annual International Insolvency Conference (June 7-8, 2010), 10.

⁶⁴⁶ Nigel John Howcroft, ‘Universal v Territorial Models for Cross-border Insolvency: the Theory, the Practice, and the Reality that Universalism Prevails’, 8 (2007-2008) *UC Davis Business Law Journal* 366, 370.

⁶⁴⁷ *Ibid.*

6.2 The Universalist Approach

The universalist approach would have all the insolvency claims adjudicated in the debtor's home country and apply the substantive laws of that jurisdiction to distribute all of the assets internationally.⁶⁴⁸ While the preference of most academic commentators would be a rule that the home country of the multinational provide the single forum, and controlling law, for handling all transnational insolvencies,⁶⁴⁹ there is also academic criticism of universalism concerning its unpredictability 'to all but the largest creditors of multinational companies'.⁶⁵⁰ From the debtor's perspective, universalism provides greater certainty in terms of the applicable rules, lower litigation costs, and a better system for reorganization compared to territorialism.⁶⁵¹ However, the territorialism approach provides greater national sovereignty as discussed in the next section and Chapter 6.

6.3 The Territorialist Approach

The territorialist approach encompasses the international law principle that each jurisdiction has the exclusive right to govern within its borders.⁶⁵² Territorial courts seize the assets that are within their control, distributing these in accordance with local rules.⁶⁵³ The basic objections to territorialism are indicated in Chapter 2 which includes the possible exploitation of choice of law rules to the detriment of creditors⁶⁵⁴ and the 'inverse of multinational cooperation'.⁶⁵⁵

7. The Conflict of Priority Systems

As indicated, the Model Law does not address the substantive law applicable to key transactions or assets, but leaves these issues to the national laws of the relevant jurisdiction. Under Articles 25-32,⁶⁵⁶ the Model Law permits secondary proceedings in each jurisdiction

⁶⁴⁸ Guzman, above n640, 2179.

⁶⁴⁹ Rasmussen, above n139, 26.

⁶⁵⁰ LoPucki, above n104, 696.

⁶⁵¹ Guzman, above n640, 2181.

⁶⁵² Guzman, above n640.

⁶⁵³ Westbrook, above n140, 513.

⁶⁵⁴ *Re Stanford International Bank*, [2009] EWHC 1441 (Ch).

⁶⁵⁵ Lore Unt, International Relations and International Insolvency Cooperation: Liberalism, Institutionalism, and Transnational Legal Dialogue 28 (1997) *Law and Policy International Business* 1037, 1040.

⁶⁵⁶ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 25-32.

and allows assets to be turned over to the main proceeding for distribution. This suggests that the primary court would decide distribution according to its choice of law rules or a protocol agreed to by the relevant courts.⁶⁵⁷ The primary court is allowed to provide relief subject to the conditions that they consider appropriate,⁶⁵⁸ and may pay special attention to the adequate protection of national creditors.⁶⁵⁹ The Model Law (and the EIR) makes an explicit point about the protection of local creditors which is directly connected to the question of priorities.⁶⁶⁰ However, in practice, ‘it is extremely unlikely that two priority systems would be completely identical.’⁶⁶¹ The problem is that there is a current lack of harmonization in respect of choice of laws rules and the priority system of creditors, which then reduces the predictability of outcomes in insolvency proceedings.⁶⁶²

It may be further argued that one of the most important legal issues not being addressed in the models of regulation in international insolvency and in domestic banking laws is the granting of “cross-priority” concerning the non-discriminatory treatment of foreign creditors.⁶⁶³ Most national legal systems, including Australia’s, have not developed a rule concerning the availability of local priorities to foreign creditors whose claims would qualify for priority treatment if they were local creditors. Westbrook notes that the treatment of priorities has not been sufficiently developed⁶⁶⁴ for this to occur. Internationally, this situation is exacerbated when the priorities of creditors receive vastly different treatment in various jurisdictions, and ‘there is no pretense to uniformity’.⁶⁶⁵ These variations create difficulties in international harmonization⁶⁶⁶ when high priority creditors in one jurisdiction may be low priority

⁶⁵⁷ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997). See also Jay Lawrence Westbrook, ‘Choice of Avoidance Law in Global Insolvencies’, 17 (1991) *Brooklyn Journal of International Law* 499, 537.

⁶⁵⁸ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 22(2).

⁶⁵⁹ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 21(2).

⁶⁶⁰ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Part 2, paragraph 20(d).

⁶⁶¹ Garrido, above n130, 479; Tung, above n308, 45-6.

⁶⁶² European Parliament Report, *Recommendations to the Commission on Insolvency Proceedings in the Context of EU Company Law*, (2011/2006(INI)), Motion for a European Parliament Solution (17 October 2011), AB.

⁶⁶³ Jay Lawrence Westbrook, ‘Universal Priorities’, 33 (1998) *Texas International Law Journal* 27, 31.

⁶⁶⁴ *Ibid.*, 29-30.

⁶⁶⁵ Allan L. Gropper, ‘The Payment of Priority Claims in Cross-border Insolvency Cases’, 46 (2011) *Texas International Law Journal* 559, 561. In Europe, progress has been made in respect of synthetic secondary proceedings Pottow states that ‘the treatment of claims was therefore the same economically as if a secondary proceeding has been opened ie they were synthetically resolved.’ See Pottow, above n203, 585. See *In re Collins v Aikman* [2006] EWHC (Ch) 1343 where synthetic secondary proceedings were successful.

⁶⁶⁶ Westbrook, above n663, 30.

creditors in another jurisdiction.⁶⁶⁷ This was illustrated in the case of *HIH* where the choice of law significantly changed the distributional outcome. The conflicts between various priority systems create a significant obstacle to the centralization of insolvency proceedings and the harmonization of insolvency laws.

McGrath & Anor as Liquidators of HIH Insurance Ltd

*In re HIH Insurance Ltd*⁶⁶⁸ the question was raised whether Australian law should control the asset distribution in a transnational insolvency. In 2001, four of the HIH group of Australian insurance companies presented winding-up petitions to the Supreme Court of New South Wales. Under the *Insurance Companies Act 1982* (UK), these companies were authorized to operate insurance business in the UK with the majority of assets and liabilities in Australia. The Supreme Court of NSW issued winding-up orders and appointed liquidators in Australia. Provisional liquidators were also appointed in England by the High Court. In 2005, the Australian court requested from the High Court that the English provisional liquidators be directed to remit the assets to the Australian liquidators for distribution. The judge declined on the ground that *pari passu* distribution in the Australian liquidation was not ‘substantially the same as under English law, in that the Australian scheme gave preference to insurance creditors to the prejudice of other creditors’.⁶⁶⁹

The English Court of Appeal dismissed an appeal. It held that if s426 of the *Insolvency Act (1986)* of the UK could authorize a transfer from the liquidators of an ancillary winding up to the liquidators of a principal winding up, the only issue would be whether the court should exercise its discretion or choice of jurisdiction. The effect of the transfer on creditors would be a material consideration, and the court would not exercise its discretion where the interests of creditors or a class of creditors would be disadvantaged.⁶⁷⁰ The court decided that:

‘the substantive rules of distribution under the English statutory scheme are mandatory and the court has no power to make an order which has the effect of dis-applying them. The power to

⁶⁶⁷ Kurt Hans Nadelmann, *Conflict of laws: International and Interstate Selected Essays* (The Hague, 1972), 286.

⁶⁶⁸ *McGrath* [2008] UKHL 21.

⁶⁶⁹ *McGrath* [2008] UKHL 21 at 11.

⁶⁷⁰ *McGrath v Riddell* [2006] EWCA Civ 732, paragraph 49.

make the order does not exist in English law and any power under Australian law could not be exercised by this court in a manner which was contrary to English law.’⁶⁷¹

The reason is that the effect of s526A of the Corporations Act (Cth) (2001) would be to direct a transfer of the English assets that would prejudice the interests of all the creditors except those of FAIG and Australian Insurance and Reinsurance Creditors of HIH, WMG and FAII and non-Australian insurance and reinsurance creditors of FAII.⁶⁷²

The Australian liquidators appealed to the House of Lords. The House of Lords held that the English courts were required to assist the Australian courts in exercising insolvency jurisdiction and had discretion to order the remission of assets to Australia. The English court could order remission of assets in England to a liquidator in a jurisdiction whose insolvency scheme did not accord with English law. The central issue in the case was whether the English court should remit the English assets for distribution in accordance with the Australian insolvency regime. In Australian law, insurance creditors would have greater priority than non-insurance creditors while under English law, insurance creditors do not have priority. If the English assets were sent to Australia, the outcome for creditors would be that, generally, insurance creditors would gain more and other creditors would lose.⁶⁷³ The controlling of assets by domestic law meant that insurance creditors with liabilities that were not in Australia and some non-insurance creditors would be worse off than under a distribution under an English insolvency regime. In this case, Lord Hoffman focused on the court’s application of comity in ancillary and secondary insolvency proceedings.⁶⁷⁴ The principle of modified universalism was applied to decide the applicable regime. Lord Hoffman stated that:

The primary rule of private international law which seems to me applicable in this case is the principle of (modified) universalism...That principle requires that English courts should, so far as consistent with justice and UK public policy, co-operate with the courts in the country of the principal liquidation to ensure that all the company’s assets are distributed to its creditors under a single scheme of distribution. That is the purpose of the power to direct remittal.⁶⁷⁵

⁶⁷¹ *McGrath v Riddell* [2006] EWCA Civ 732, paragraph 175.

⁶⁷² *McGrath v Riddell* [2006] EWCA Civ 732 at 56.

⁶⁷³ *McGrath* [2008] UKHL 21 at 2.

⁶⁷⁴ Janger, above n313, 441.

⁶⁷⁵ *McGrath* [2008] UKHL 21, [20-21]1WLR at 859-60.

The case of *HIH* illustrates the reciprocal comity that is required for international cooperation to effectively occur between jurisdictions. Lord Hoffman was strongly in favour of the cooperation between ancillary courts and the court of the debtor's COMI, although that court might treat creditors differently than would the ancillary court.⁶⁷⁶ Under the modified universalism principle, the priority scheme of the debtor's COMI controls the proceedings.⁶⁷⁷ The principle of modified universalism is based on the notion 'that there should be a unitary bankruptcy proceeding in the court of the bankrupt's domicile which receives world-wide recognition and it should apply universally to all the bankrupt's assets.'⁶⁷⁸ The main court must consider its impact on the ancillary jurisdictions, and the ancillary jurisdictions must cooperate with the main jurisdiction to achieve the best possible outcome for creditors.⁶⁷⁹ The doctrine of ancillary winding-up was based on the premise that the English court might misapply certain parts of the statutory scheme by authorizing the English liquidator to allow actions to be performed by the foreign liquidator according to foreign law, and foreign rules of conflict of laws⁶⁸⁰ that would ensure that all the assets would be distributed in a single system of distribution.⁶⁸¹

The next section examines the role of international comity in distributional outcomes in which conflicting variations also arise. As the distributional issue is one of the most complex in international insolvency, the theoretical approaches of modified universalism (the approach of the Model Law), universalism and territorialism in respect of the distribution of assets is analysed in the rest of the chapter. Examples of the different priorities are given to illustrate the widely differing outcomes for creditors in different jurisdictions. Traditional priorities are made more complicated by the different treatments of the claims of deposit insurance funds, largely because of the typical quantum of such claims.

⁶⁷⁶ *McGrath* [2008] UKHL 21, [20-21]1W.L.R. at 859-60. See *Rubin (and another Respondents) v Eurofinance (SA and others Appellants)* [2012] UKSC 46 which overturned has overturned this approach.

⁶⁷⁷ Janger, above n313, 453.

⁶⁷⁸ *McGrath* [2008] UKHL 21 at 6.

⁶⁷⁹ Janger, above n313, 458.

⁶⁸⁰ *McGrath* [2008] UKHL 21 at 19-20.

⁶⁸¹ *McGrath* [2008] UKHL 21 at 30.

7.1 Issues of International Comity in Distributional Outcomes

As indicated in Chapter 3, under the Model Law, one proceeding is recognized as the ‘main’ proceeding in cross-border insolvencies. The Model Law allows the turnover of assets to this main proceeding for distribution. However, the UNCITRAL Legislative Guide on Insolvency Law does not propose any priority rules and states that:

the provision of priority rights has the potential to foster unproductive debate on the assessment of which creditors should be afforded priority and the justifications for doing so.⁶⁸²

Article 13(1) of the Model Law states that ‘foreign creditors have the same rights regarding the opening and participation in, a proceeding under (name of State)...as creditors...in this State’.⁶⁸³ It has been stated that ‘the Model Law is driven by a strong commitment to UNCITRAL principles over “territorialist” principles.’⁶⁸⁴ In international bank insolvencies, where territorialist ringfencing occurs, branches of foreign banks will be regarded as separate entities and where necessary, be wound up as separate entities⁶⁸⁵ even though they may be integral parts of the financial group.⁶⁸⁶ The practice of ringfencing is permitted in some jurisdictions such as the US, to ensure that local creditors receive preferential treatment.⁶⁸⁷ In the US, when a foreign bank’s branches are ringfenced, these branches are regarded as a separate legal entity,⁶⁸⁸ and a US court would use ringfencing to satisfy domestic claims before remitting the surplus to the remaining creditors in foreign proceedings.⁶⁸⁹ For example, in *Samsun Logix Corp v Bank of China*, the court dismissed Samsun’s petition including an order for the Bank of China to turn over to Samsun any property of the judgment debtor’s that may be located outside the jurisdiction of New York.⁶⁹⁰

⁶⁸² United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004), 274.

⁶⁸³ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 13(1).

⁶⁸⁴ William F. Stutts, ‘Basel Committee Urges Cooperation Among Cross-border Bank Regulators’, *American Bankruptcy Institute Committee News*, vol. 7, no. 6, 2010 viewed at <<http://www.abiworld.org/committees/newsletters/international/vol7num6/basel.html>> on September 9, 2012.

⁶⁸⁵ Bob Wessels, ‘Mutual Trust, Comity, and Respect Among States in International Insolvency Matters’, (2005) *Norton Annual Survey of Bankruptcy Law* 21

⁶⁸⁶ Hupkes, above n142, 374.

⁶⁸⁷ Campbell, above n195, 5.

⁶⁸⁸ *New York Banking Law* §606 et seq.

⁶⁸⁹ Hupkes, above n142, 375.

⁶⁹⁰ *Samsun Logix Corp v Bank of China* [2011] NY Misc LEXIS 2268 (NY Supreme Court). This case illustrates the potential use of ringfencing by a national court to satisfy creditors’ claims.

Moreover, the international insolvency of financial groups is much more complex than the insolvency of single legal entities, largely because the domestic insolvency of these groups is extremely complex.⁶⁹¹ At the international level, the most serious problems arise from different priority systems and priority rules in national systems allowing domestic, secured creditors to obtain more than their equal share.⁶⁹² In the case of international banks with bank accounts, operations, inventory and customers worldwide, the territorialist approach would also produce multiple, conflicting decisions in the administration of an insolvency, and ‘dueling injunctions against the debtor and creditors in various jurisdictions.’⁶⁹³ Furthermore, the opening of parallel proceedings in various jurisdictions creates major difficulties when creditors who are the beneficiaries of a domestic priority assert that their rights to priority in distributions supersede any cooperation efforts. The inflexibility of the domestic insolvency laws of each jurisdiction in a territorialist system would further impede the cooperation to resolve these conflicts when regimes such as the US Bankruptcy Code⁶⁹⁴, which is examined further in this chapter, apply territorialism to further national sovereignty and evasion of a universal solution.⁶⁹⁵

Although the principle of comity compels courts to ‘increase the international legal ties that advance the rule of law among nations’,⁶⁹⁶ domestic courts tend to favour the territorial doctrine, and ensure that local priority creditors are satisfied with the proceeds of local assets before remitting the remaining assets to the foreign court.⁶⁹⁷ This was evidenced in the *HIH* case, in Lord Neuberger stated that:

In all those cases, it was made clear that the court had to be satisfied that the foreign liquidators would distribute *pari passu*, in accordance with the domestic insolvency regime. Of course, it can be said that those cases merely emphasise the importance of the *pari passu*

⁶⁹¹ Thomas, Baxter Jr., Hansen M. Joyce, & Joseph H. Summer, ‘Two Cheers for Territoriality: An Essay on International Bank Insolvency Law’, 78 (2004) *American Bankruptcy Law Journal* 57, 59.

⁶⁹² Kurt H. Nadelmann, ‘Discrimination in Foreign Bankruptcy Laws Against Non-Domestic Claims’, 5 (1973) *Lawyer of the Americas* 299, 300.

⁶⁹³ Westbrook, above n101, 325.

⁶⁹⁴ Jay Lawrence Westbrook, ‘A Global Solution to Multinational Default’, 98 (2000) *Michigan Law Review* 2276, 2307.

⁶⁹⁵ Kurt Hans Nadelmann, *Conflict of laws: International and Interstate Selected Essays* (The Hague, 1972), 286.

⁶⁹⁶ Douglass G. Boshkoff, ‘United States Judicial Assistance in Cross-Border Insolvencies’, (1987) 36(4) *International and Comparative Law Quarterly* 729, 731.

⁶⁹⁷ *McGrath* [2008] UKHL 21, [62], 1 WLR at 72.

principle, but they appear to me to indicate that the courts concerned were seeking to ensure that the principles of their local insolvency regime were honoured.⁶⁹⁸

The territorial effect creates the prospect of significant unequal treatment of creditors⁶⁹⁹ in cross-border insolvencies as it leads to prioritising local creditors over all other creditors.⁷⁰⁰ The approach has been criticized as protectionist,⁷⁰¹ creating a race for creditors to claim priorities, and to commence unnecessary secondary proceedings which increase costs and decrease total distributions⁷⁰² as well as unequal distributions among creditors depending on the location of the debtor's assets.⁷⁰³ Another rule that can effect total distributions is the rule of localism.

7.2 The Rule of Localism

In addition to territorialism, the rule of localism is a facet of territorialism that 'privileges the application of local rules that might often benefit foreign multinationals as much or more than the local contractor.'⁷⁰⁴ The term "localism" defines the application of local priority rules to locally-seized assets.⁷⁰⁵ Localism applies local rules to all domestic assets disregarding whether those assets have any significant relationship to the priority claims under national law, although creditors cannot expect that these assets would be distributed under domestic rules.⁷⁰⁶

However, localism does not favour local creditors. Westbrook argues that localism is unavoidable politically in jurisdictions that commit to local values and that the justification for its existence rests on the claim that it satisfies commercial expectations, and that this claim is highly questionable.⁷⁰⁷ The principle of localism determines the current law in many jurisdictions. In international bank insolvencies, a significant disadvantage of localism is that there is no connection between the assets that is distributed by the domestic court and the

⁶⁹⁸ *McGrath* [2008] UKHL 21, [62], 1 WLR at 73.

⁶⁹⁹ Ian Fletcher, 'L'enfer, C'est Les Autres: Evolving Approaches to the Treatment of Security Rights in Cross-border Insolvency', 34 *Texas International Law Journal* 489, 497.

⁷⁰⁰ Lee, above n157, 119.

⁷⁰¹ *Ibid.*, 118.

⁷⁰² *Ibid.*

⁷⁰³ *Ibid.*

⁷⁰⁴ *Ibid.*

⁷⁰⁵ Jay Lawrence Westbrook, 'Breaking Away: Local Priorities and Global Assets', 46 (2011) *Texas International Law Journal* 601, 602.

⁷⁰⁶ *Ibid.*, 602-3.

⁷⁰⁷ *Ibid.*, 603.

creditors who would benefit from such a distribution.⁷⁰⁸ This was illustrated in the Lehman Brothers case when funds totaling US\$8 billion were transferred from London to New York during the weekend that Lehman filed insolvency proceedings in both jurisdictions.⁷⁰⁹ Westbrook further argues that the lack of connection between the assets and the creditors was also evident in the *HIH* case previously discussed in this chapter, where there was no reasonable expectation that English law would be applied to the assets.⁷¹⁰ Westbrook also refers to the Lehman *Perpetual* cases to illustrate the inconsistencies that emerge from localism.⁷¹¹

Furthermore, the priority conflicts in international bank insolvency are exacerbated when there are secondary proceedings opened in these cases. Pottow states that ‘the purpose of a secondary proceeding is to allow local creditors of a foreign debtor the opportunity to open an insolvency case in their native country, chiefly to enjoy the benefit of local bankruptcy law’.⁷¹² He argues that the differences in priority law and secondary proceedings are intertwined.⁷¹³ Insolvency proceedings and the distribution of certain categories of creditors are inextricably linked.⁷¹⁴ The priority conflicts among creditors in an international insolvency will tend to result in the opening of a secondary proceeding.⁷¹⁵ The divergence between the main priority rules in the main and secondary proceedings creates further conflict.⁷¹⁶ Pottow further argues that there is ambiguity in the recognition of foreign priorities in a main proceeding, the application of foreign law in granting relief to petitioners,⁷¹⁷ and whether the priorities in the main proceeding need to be recognized in a secondary proceeding.⁷¹⁸ In *Collins v Aikman*,⁷¹⁹ the UK administrators in the main proceedings were enabled to prevent secondary proceedings by representing that if there were

⁷⁰⁸ Ibid, 606.

⁷⁰⁹ Lehman Brothers Bankruptcy News, Issue No. 5., September 20, 2008, viewed at <<http://bankrupt.com/lehman5.txt>> on October 10, 2012.

⁷¹⁰ Ibid, 610. The *Lehman Brothers* transfer illustrates the changes in international bank insolvency that are not addressed in current legal frameworks.

⁷¹¹ Ibid. See page 67 of this thesis for explanation of Lehman *Perpetual* cases.

⁷¹² Pottow, above n522, 580.

⁷¹³ Garrido, above n130, 486; Frederick Tung, ‘Is International Bankruptcy Possible?’, 23 (2001) *Michigan Journal of International Law* 31, 45-6.

⁷¹⁴ Ibid.

⁷¹⁵ Ibid, 584.

⁷¹⁶ Ibid, 599.

⁷¹⁷ Look Chan Ho, ‘Applying Foreign Law under the UNCITRAL Model Law on Cross-border Insolvency’, 24 (2009) *Butterworths Journal of International Banking and Financial Law* 655.

⁷¹⁸ Jay Lawrence Westbrook, ‘Priority Conflicts as a Barrier to Cooperation in Multinational Insolvencies’, 27 (2008-9) *Pennsylvania State International Law Review* 869, 869-870.

⁷¹⁹ *Collins v Aikman* [2006] EWCH 1343.

no secondary proceedings, then the respective financial positions of local creditors would be respected under the relevant local law.⁷²⁰ The English court gave direction for the administrators to give effect to such an assurance.⁷²¹

Examples of the different priorities to illustrate the widely differing outcomes for creditors in different jurisdictions include the following:

Insolvency set-off applies where there are mutual credits, mutual debits or other mutual dealings between the debtors and creditors, before liquidation commences. The creditor who is able to assert insolvency set-off rights receives a *pro tanto* priority (partial payment made over the claim) over other creditors.

Pre-preferential creditors are creditors whose claims arise after the winding-up order has been given, and are given a privileged status. Their claims are treated as part of liquidation expenses and are to be paid rather than proven, ranking ahead of preferential creditors.

Pre-liquidation creditors are creditors who can compel payment through their ability to potentially harm the insolvent estate including termination of contract and duress.⁷²²

Secured creditors are generally entitled to a priority payment from the collateral value which they hold. The residual claim that is not covered by the collateral value will be unsecured credit.⁷²³ The extent to which secured creditors are affected by insolvency proceedings varies in different jurisdictions.⁷²⁴ The next section examines Chapter 15 of the US Bankruptcy Code and COMI in order to better understand the Model Law's principle of COMI in a domestic regime, and the implications for cross-border bank insolvency.

⁷²⁰ *Collins v Aikman* [2006] EWCH 1343 at 8.

⁷²¹ *Collins v Aikman* [2006] EWCH 1343 at 42-49.

⁷²² Rizwaan Jameel Mokal, 'Priority as Pathology: The *Pari Passu* Myth', 60(3) (2001) *Cambridge Law Journal* 581, 586.

⁷²³ Lastra, above n105, 111.

⁷²⁴ *Ibid.*

8. Chapter 15 US Bankruptcy Code and COMI

The analysis of Chapter 15 of the US Bankruptcy Code is relevant as it illustrates the adoption of the UNCITRAL Model Law on Cross-border Insolvency in a domestic regime. The difficulties that have arisen under Chapter 15 can, arguably, diminish the effectiveness of the Model Law.⁷²⁵ The objective of Chapter 15 is ‘to incorporate the Model Law on Cross-border Insolvency so as to provide effective mechanisms for dealing with cases of cross-border insolvency.’⁷²⁶ The purposes of Chapter 15 are to:

- i. ‘enable representatives of foreign bankrupt entities to obtain relief from US bankruptcy courts in support of foreign insolvency proceedings;
- ii. provide a streamlined process for recognition of foreign proceedings.
- iii. foster communication and coordination among national courts with concurrent jurisdiction over an insolvent entity;
- iv. harmonize US bankruptcy law on cross-border insolvency with laws of other jurisdictions that have adopted similar laws.’⁷²⁷

Chapter 15 was designed so as to make recognition ‘as simple and expedient as possible.’⁷²⁸ The 2005 Bankruptcy Abuse and Consumer Protection Act (BAPCPA) change to the US Bankruptcy Code adopted many of the provisions of the Model Law.⁷²⁹ This adoption means that debtors undergoing foreign proceedings must show that their bankruptcy occurs in their COMI in order to receive full judicial cooperation from US courts and like the Model Law, specifically excludes banks.⁷³⁰ As the US Bankruptcy Code explicitly excludes domestic bank insolvencies, the courts derive their power through a combination of federal and state insolvency laws. A foreign bank insolvency is governed by specific or other provisions of the US Bankruptcy Code, or by federal and state insolvency laws.⁷³¹

⁷²⁵ Pedro Jose F. Bernando, ‘Cross-border Insolvency and the Challenges of the Global Corporation: Evaluating Globalization and Stakeholder Predictability through the UNCITRAL Model Law on Cross-border Insolvency and the European Union Insolvency Regulation’, 56 (2012) *Ateneo Law Journal* 799, 813. Bernando states that ‘particularly with respect to corporations registered abroad but have substantial business activities in the US, these difficulties have undermined, instead of enhanced, the purpose of both the UNCITRAL Model Law and the EU Regulation in providing an orderly resolution regime for cross-border insolvency.’

⁷²⁶ Chapter 15, *United States Bankruptcy Code* (Title 11- Bankruptcy enacted November 7, 1978), §1501(a).

⁷²⁷ Richard Levin, James L. Garrity, Jr., Susan Power Johnston, ‘The Maddoff Feeder Fund Cases-Chapter 15, Comity and Related Bankruptcy Issues’, (2012) 25 *International Law Practicum* 67.

⁷²⁸ Chapter 15, *United States Bankruptcy Code* (Title 11- Bankruptcy enacted November 7, 1978), §1502(3).

⁷²⁹ Robert R. Bliss & George G. Kaufmann, ‘A Comparison of US Corporate and Bank Insolvency Resolution’, (2006) *Economic Perspective*.

⁷³⁰ *Ibid*, 52.

⁷³¹ *Ibid*.

This chapter argues that the problem of addressing COMI using the Model Law needs to be aligned with ‘corresponding legislative reforms by the domestic regimes that have adopted it’,⁷³² such as the US Bankruptcy Code. It may be further argued that there needs to be continuous realignment as legislative reforms, similarly, evolve and progress in the regulatory environment.

The US Bankruptcy Code’s §1516(c) states that ‘an individual’s habitual residence is presumed to be the COMI.’⁷³³

‘The significance of the US approach is that where operations of a business enterprise group are highly integrated & centralized in the jurisdiction of one entity, US courts may find that the COMI of the other entities is in the same jurisdiction as the parent such that they may recognize administrative consolidation.’⁷³⁴

The regimes of the Model Law, EU Insolvency Regulation, and US Bankruptcy Code require that the debtor have a “place of operations that carries out non-transitory economic activity”⁷³⁵ at a location in order for that location to be recognized as an establishment⁷³⁶ in the determination of COMI. A ‘foreign main proceeding’ in §1502(4) is defined as “a foreign proceeding pending in a country where the debtor has the COMI.”⁷³⁷ In §1502(5) a ‘foreign non-main proceeding’ is defined as a ‘foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment’.⁷³⁸ Some courts interpret the domicile to be that which is ‘established by physical presence in a location

⁷³² Joanne Collette, ‘Chapter 15- it’s Time to Define COMI’, *Financier Worldwide*, February 2011, viewed at <www.financierworldwide.com> on December 26, 2012.

⁷³³ Chapter 15, *United States Bankruptcy Code* (Title 11- Bankruptcy enacted November 7, 1978), §1516(c).

⁷³⁴ Sarra, above n35, 561. Sarra states that ‘there are cases in which the business enterprise group should be reorganized as one proceeding and allow all members of the group to all have their COMI in one state.’ UNCITRAL uses the term ‘administrative coordination.’ See Legislative Guide Chapter 1, paragraphs 23-29.

⁷³⁵ Chapter 15, *United States Bankruptcy Code* (Title 11-Bankruptcy enacted November 7, 1978), §1502(2).

⁷³⁶ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 2(f); *European Union Insolvency Regulation, No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002), Article 2(h); Chapter 15, *United States Bankruptcy Code* (Title 11- Bankruptcy enacted November 7, 1978), §1502(2).

⁷³⁷ Chapter 15, *United States Bankruptcy Code* (Title 11- Bankruptcy enacted November 7, 1978), §1502(4).

⁷³⁸ Chapter 15, *United States Bankruptcy Code* (Title 11- Bankruptcy enacted November 7, 1978), §1502(5).

coupled with an intent to remain there indefinitely.⁷³⁹ The US definition of establishment is broader than that of the Model Law and the EC Regulation.⁷⁴⁰

Other factors considered by bankruptcy courts when determining COMI include:

(i) where the principal creditors are based⁷⁴¹ which may be indicative of where the finance function operations relating to the business is from.⁷⁴²

ii. 'the mere presence of a letterbox in a company's registered location will not constitute an establishment';⁷⁴³

iii. 'the evidence of some management of an asset in a jurisdiction may be sufficient to constitute an establishment';⁷⁴⁴

Other financial considerations include:

(iv) the presence of guarantees from a parent or related company in another jurisdiction;⁷⁴⁵ (v) onward provision of borrowing from a subsidiary to its parent may support a finding that a company is simply a "branch" or "conduit of the parent,"⁷⁴⁶ (vi) where financial information was subject to review and approval by another entity in a different jurisdiction;⁷⁴⁷ (vii) restrictions on the company's (or its directors) authority, for example requirements that commitments in excess of a relatively low threshold require prior authorisation by a parent in a different jurisdiction; ⁷⁴⁸ (viii) the operation and location of bank accounts through which business is transacted;⁷⁴⁹ (ix) the accounting laws and principles that the company's financial information complies with, and the location of its books of account;⁷⁵⁰ and (x) whether financial information was subject to review and approval by another entity in a different jurisdiction.⁷⁵¹

⁷³⁹ Levin, Garrity, Jr., Johnston, above n728, 79.

⁷⁴⁰ Alesia Ramney-Marinelli, 'Overview of Chapter 15 Ancillary and other Cross-border Cases', (2008) 82 *American Bankruptcy Journal* 269, 295.

⁷⁴¹ *Re Energy Group* 21 November 2009 (discussed at *Insolvency Intelligence* 2004, Vol. 17, 29).

⁷⁴² *Re Daisytek-ISA Ltd* [2004] BPIR30 at 565E.

⁷⁴³ *Re Eurofood, IFSC Ltd* [2005] BCC 1021 at 35-36.

⁷⁴⁴ *In re Betcorp Ltd.* 400 B.R. 266 at 292 (Bankr. D. Nev. 2009).

⁷⁴⁵ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

⁷⁴⁶ *Re Eurofood, IFSC Ltd* [2005] BCC 102 at 2 & 26.

⁷⁴⁷ *Re Daisytek-ISA Ltd* [2004] BPIR30 at 565E.

⁷⁴⁸ *Re Daisytek-ISA Ltd* [2004] BPIR30 at 565F.

⁷⁴⁹ *Re Daisytek-ISA Ltd* [2004] BPIR30 at 565E.

⁷⁵⁰ *Re Daisytek-ISA Ltd* [2004] BPIR30 at 565E.

⁷⁵¹ *Re Daisytek-ISA Ltd* [2004] BPIR30 at 565E.

Chapter 15, the Model Law, and the EC Regulation dismiss the notion that the mere presence of assets is sufficient to constitute an establishment. The aim of §1516(c) was to prevent forum shopping and abuse of bankruptcy havens.⁷⁵² In the US, large multinational companies generally have the freedom to choose the venue for filing a case under the Bankruptcy Code.⁷⁵³ The two main factors to potentially rebut the §1516(c) presumption are the head office functions and business operations tests which can prove problematic when determining the COMI for members of corporate groups. As Chapter 15 has no affiliate filing rule, a COMI determination would need to be made for all members of a corporate group that commence main or non-main proceedings in the same country.⁷⁵⁴ As the code does not define COMI, US courts have drawn ‘from international and European antecedents that also use the term’.⁷⁵⁵ Its legislative intent was to adhere to the spirit of the Model Law.⁷⁵⁶

The Chapter 15 COMI standard is relevant to international bank insolvencies as it has been argued that Chapter 15’s interpretation of COMI is ineffective in preventing debtors from engaging in forum shopping, since debtors have the opportunity to file bankruptcy in another jurisdiction before filing an ancillary petition in the US to ensure cooperation with the foreign court.⁷⁵⁷ Furthermore, Chapter 15 contains provisions that potentially prevent ‘foreign representatives in certain types of foreign proceedings from seeking or obtaining most forms of relief in US courts.’⁷⁵⁸ When it prevents the foreign representative from seeking comity or cooperation from any other court within the US, any rights are diminished to the collection or recovery of claims in filing an involuntary petition against the debtor.⁷⁵⁹ In Chapter 15 cases involving off-shore funds, where there is no objection to COMI, there is the issue of whether the courts are precluded from considering the submission of evidence.

Levin argues that some U.S. courts assert that they will not “rubber stamp” a petition for recognition, and especially if there is evidence that the COMI is not in the location of the

⁷⁵² Ramney-Marinelli, above n741, 272.

⁷⁵³ Gerard McCormack, ‘Jurisdictional Competition and Forum Shopping in Insolvency Proceedings’, (2009) 68(1) *Cambridge Law Journal* 169. 177.

⁷⁵⁴ *Ibid.*

⁷⁵⁵ Chapter 15, *United States Bankruptcy Code* (Title 11- Bankruptcy enacted November 7, 1978), §1508.

⁷⁵⁶ Gerard McCormack, ‘COMI and Comity in UK and US Insolvency Law’, (2012) 128(Jan) *Law Quarterly Review* 140, 141.

⁷⁵⁷ *Ibid.*, 319.

⁷⁵⁸ Ramney-Marinelli, above n741, 269.

⁷⁵⁹ *Ibid.*, 270.

debtor's registered offices, some courts will not grant recognition and the foreign representative needs to prove that the proceeding is either a foreign main or foreign non-main proceeding,⁷⁶⁰ and the onus is on the foreign representative to prove the COMI. It may be argued that in international bank insolvencies involving multiple courts and multiple jurisdictions, this creates inconsistency, uncertainty and further hinders the predictability that COMI seeks to achieve.

The landmark case of *Re: SPHinx Ltd*⁷⁶¹ 'threatened to undermine the very unanimity that is meant to be at the heart of the Model Law and the goal of uniform interpretation throughout the world reflected in §1508.'⁷⁶² It highlights the 'inherent differences in insolvency regimes'⁷⁶³ which is imperative to better understand the cross-border conflicts that this creates between national regimes.

The case concerned SPHinx, a corporation that was incorporated and registered in the Cayman Islands,⁷⁶⁴ and the SPHinx Funds 'consisted of buying and selling securities and commodities in a manner that tracked, under a license from Standard & Poor's, certain S&P Hedge Fund Indices.'⁷⁶⁵ The SPHinx Funds did not conduct any business or have any assets in the Cayman Islands.⁷⁶⁶ The hedge fund was conducted under a Delaware corporation in New York City, which was in a Chapter 11 liquidation proceeding.⁷⁶⁷ Most of the account managers retained for services to SPHinx Funds were in the United States, and no board

⁷⁶⁰ Levin, Garrity Jr. & Johnston, above n728, 77; *In Re Basis Yield Alpha Fund (Master)* 381 BR 37 (Bankr SDNY 2008) where the court was not bound by the presumption of §1516(c), and there was not sufficient evidence to prove that the COMI was in the Cayman Islands.

⁷⁶¹ *In re Sphinx*, 351 BR 103 (Bankr SDNY 2006).

⁷⁶² Alexandra C.C. Ragan, 'COMI Strikes a Discordant Note: Why US Courts Are Not in Complete Harmony Despite Chapter 15 Directives', 27 (2010) *Emory Bankruptcy Developments Journal* 117, 145.

⁷⁶³ Pedro Jose Bernardo, 'Cross-border Insolvency and the Challenges of the Global Corporation: Evaluating Globalisation and Stakeholder Predictability', (1999) 56 *Anteneo Law Journal* 799, 827.

⁷⁶⁴ *In re Sphinx*, 351 BR 103 (Bankr SDNY 2006) at 107.

⁷⁶⁵ *In re Sphinx*, 351 BR 103 (Bankr SDNY 2006) at 107.

⁷⁶⁶ *In re Sphinx*, 351 BR 103 (Bankr SDNY 2006) at 107.

⁷⁶⁷ *In re Sphinx*, 351 BR 103 (Bankr SDNY 2006) at 109. A Chapter 11 proceeding concerns: 'The chapter of the Bankruptcy Code providing (generally) for reorganization, usually involving a corporation or partnership. (A chapter 11 debtor usually proposes a plan of reorganization to keep its business alive and pay creditors over time. People in business or individuals can also seek relief in chapter 11)', See <<http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter11.aspx>>. In contrast, a 'Chapter 15 is a new chapter added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. It is the U.S. domestic adoption of the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law ("UNCITRAL") in 1997, and it replaces section 304 of the Bankruptcy Code. Because of the UNCITRAL source for Chapter 15, the U.S. interpretation must be coordinated with the interpretation given by other countries that have adopted it as internal law to promote a uniform and coordinated legal regime for cross-border insolvency cases,' see <<http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter15.aspx>>.

meetings occurred in the Cayman Islands.⁷⁶⁸ Refco Capital Markets (RCM), a client of SPHinx, was being liquidated as a Chapter 11 debtor, and sued SPHinx alleging that it obtained a \$312 million preference from RCM on SPHinx Funds' behalf. SPHinx proceeded to file for bankruptcy in the Cayman Islands and in the bankruptcy courts of New York, commenced Chapter 15 cases⁷⁶⁹ in which it requested that the Cayman Islands insolvency proceedings be recognized as a foreign 'main' proceeding under 1517(b)(1).⁷⁷⁰

The court reasoned that the COMI was in the Cayman Islands, as the relevant factors for COMI determination should be viewed in terms of their 'emphasis on protecting the reasonable interests of the parties in interest pursuant to fair procedures and the maximization of the debtor's value.'⁷⁷¹ Nevertheless, the court denied recognition as the foreign main proceedings because the application was intended to delay RefCo's claim. The court granted recognition of the Cayman Islands proceedings as foreign non-main proceedings.⁷⁷² This decision diverged significantly from the stricter European approach in determining COMI,⁷⁷³ and 'ignored the structure that Chapter 15 tries to impose'.⁷⁷⁴ Other courts have also not followed the ruling in *SPHinx*, and Bernardo argued that the language of Chapter 15 does not indicate that 'creditors may consent to a main proceeding in a place where COMI does not objectively lie or that creditors have to object to recognition in order for the courts to examine the facts'.⁷⁷⁵

The US approach to bank insolvency reflects this inconsistency⁷⁷⁶ since its treatment of foreign branches of US banks in the US is territorial, while its treatment of domestic banks with foreign branches is universal.⁷⁷⁷ In order to arrive at possible solutions, it may be argued that the inconsistencies within domestic regimes, and the conflicts that these create between jurisdictions, must also be resolved. Within domestic bank insolvency regimes, it may be further argued that injustices could occur when state laws provide a ring-fencing mechanism

⁷⁶⁸ *In re Sphinx*, 351 BR 103 (Bankr SDNY 2006) at 108.

⁷⁶⁹ *In re Sphinx*, 351 BR 103 (Bankr SDNY 2006) at 107.

⁷⁷⁰ *In re Sphinx*, 351 BR, 103 (Bankr SDNY 2006) at 107.

⁷⁷¹ *In re Sphinx*, 351 BR. 103 (Bankr SDNY 2006) at 108.

⁷⁷² *In re Sphinx*, 351 BR. 103 (Bankr SDNY 2006) at 107.

⁷⁷³ Bernardo, above n764, 819.

⁷⁷⁴ Benjamin J. Christenson, 'Best Let Sleeping Presumptions Lie: Interpretation of "Center of Main Interest" Under Chapter 15 of the Bankruptcy Code and an Appeal for Additional Complacency', (2010) 5 *University of Illinois Law Review* 1565, 1585.

⁷⁷⁵ Bernardo, above n764.

⁷⁷⁶ Robert R. Bliss & George G. Kaufmann, 'US Corporate and Bank Insolvency Regimes: A Comparison and Evaluation', (2007) 2 *Virginia Law and Business Review* 143, 170.

⁷⁷⁷ *Ibid.*

that gives regulators a wide scope to liquidate all of the domestic assets of the foreign bank to the advantage of domestic claimants against the branch.⁷⁷⁸ The US domestic insolvency laws grant authority to the state to seize all of the assets of the foreign bank that are located within the state. During liquidation, the distribution is firstly paid to the creditor claims that arise from the transaction of business with the state branch. It is only after claims against the branch are satisfied, that any excess proceeds are then paid over to the liquidators of any of the foreign bank's US branches or offices. When these claims are met, the remaining proceeds are returned to the principal office of the foreign bank.⁷⁷⁹ During liquidation, the treatment of foreign banks with US branches creates unnecessary injustice to the creditors of any of the foreign bank's US branches or offices. If a foreign bank with US branches fails, US regulators can seize as many assets as possible in the US in order to distribute these to all domestic depositors and creditors of the branches (including uninsured claimants) before distributing the surplus to foreign courts for distribution to foreign creditors. When a US bank with foreign offices becomes bankrupt, 'the FDIC asserts claims over the world-wide assets of the bank' and distributes those assets under depositor preference rules that give priority to domestic depositors.⁷⁸⁰

In both the provisions of Chapter 15 and the US domestic insolvency law, the abovementioned diminishment of claims may result in diminished returns to creditors of a foreign bank's US branches or offices. Furthermore, its bankruptcy and bank insolvency laws implicitly assume that a single venue is sufficient for resolving a single firm. However, this assumption is unlikely to be applicable to large, complex financial institutions. As indicated, the commencement of parallel proceedings can lead to complexities, with creditors bearing the subsequent costs. Bliss and Kaufmann affirm that by applying territorialism, one court can be the leading court in guiding the resolution. On the other hand, by applying universalism, separate proceedings in each jurisdiction can be conducted using the assets under each jurisdiction's control for the benefit of local creditors.⁷⁸¹ In order for US law to have a stronger structure for dealing with insolvency proceedings, another issue is the lack of

⁷⁷⁸ Steven L. Schwarz, 'The Confused US Framework for Foreign Bank Insolvency: An Open Research Agenda', (2005) 81 *International Review of Law and Economics* 81, 88.

⁷⁷⁹ Cleary Gottlieb Steen & Hamilton LLP, Davis Polk & Wardwell LLP, Sullivan & Cromwell LLP, 'White Paper on the Separate Entity Doctrine as Applied to the US Branches of Foreign Headquartered (Non-US) Banks', April 18, 2012, viewed at <http://www.cgsh.com/white_paper_on_the_separate_entity_doctrine/> on 12 December 2012, 5.

⁷⁸⁰ Ibid.

⁷⁸¹ Bliss & Kaufmann, above n777.

structure in the law to address both a bank and its parent holding company during these proceedings.⁷⁸² This issue is beyond the scope of this thesis. The next section will compare the concept of COMI in the Model Law and the EU Insolvency Regulation.

9. Further Comparison of the Concept of COMI in the Model Law and the EU Insolvency Regulation

As indicated, while both the Model Law and the EU Insolvency Regulation aim to promote predictability of laws and proceedings,⁷⁸³ the different determination of COMI influences the divergent interpretations and decisions that ensue from judicial interpretation of the concept.

In the UNCITRAL Model Law on Cross-border Insolvency, the Judicial Perspective states that a review of cases dealing with the issue of COMI indicates that one area of conflict is:-

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Should the centre of main interests be interpreted differently under the Model Law and the EC Regulation, given the different purposes for which that test is used?⁷⁸⁵

Under the Model Law, the determination of a debtor's COMI is central to its legal framework as this decides the main proceeding.⁷⁸⁶ Article 20 states that, upon recognition by the forum

⁷⁸² Ibid.

⁷⁸³ Bernardo, above n764, 815.

⁷⁸⁴ See *The UNCITRAL Model Law on Cross-border Insolvency: the Judicial Perspective*, (United Nations, 2012), 31 where it states that:

(a) On whom does the onus of proof lie to rebut the "registered office" presumption?

(b) Should "centre of main interests" be interpreted differently under the Model Law and the EC Regulation, given the different purposes for which that test is used?

(c) What objectively ascertainable circumstances can be taken into account in determining where the "centre of main interests" is located? In particular:

(i) Should the issue be addressed by reference to the principal place of business (or "nerve centre"), or by reference to what those dealing with the company would regard as the actual place where coordination, direction and control of the debtor occurred?

(ii) What factors are ascertainable objectively by third parties in the sense contemplated by *Eurofood*? In particular, at what time does the inquiry into the centre of main interests occur? Is it at the time the debtor is trading with third parties, at the time it is placed into a collective insolvency proceeding or at the time of the recognition hearing?

(iii) Can the court take into account attempts by the debtor to seek a better forum, from its perspective, in determining whether recognition should be granted?

⁷⁸⁵ United Nations Commission on International Trade Law, Working Group V (Insolvency Law), Thirty-ninth session, Vienna, 6-10 December 2010, '*The UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective*', UN Doc. No. A/CN.9/WG.V/WP.97Add.1, 31.

that the foreign proceeding is a foreign main proceeding, commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed and execution must be extended as a matter of right to the applying debtor. In contrast, under the Insolvency Regulation, the COMI is to be ascertainable by third parties.⁷⁸⁷ In both regimes, the premise underlying the opening of local proceedings is the protection of assets when insolvency proceedings of a single corporate entity have been opened either as main or non-main proceedings in another jurisdiction.⁷⁸⁸

The Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No.1346/2000 on Insolvency Proceedings states that Recital 13 should be deleted, and replaced with Recital 13(a) which states that the centre of main interests of a company or a legal person should be at the place of its registered office.⁷⁸⁹ The European courts have tended to interpret COMI using the real seat theoretical approach. The civil law real seat theory of jurisdictional competence contrasts with the state of incorporation theory traditionally adopted by the common law. The real seat theory ensures that the insolvency case will be handled in the most appropriate jurisdiction and is less concerned with the place of registration. This is significant as creditors are the main concern in cases of insolvency.⁷⁹⁰

Courts in the EU are not permitted to review the jurisdiction of the court that opens insolvency proceedings if the COMI of the debtor lies within its territorial jurisdiction. In contrast to the Model Law which is applicable in the jurisdictions that have enacted it, European courts are dealing with their own international jurisdiction to open insolvency proceedings.⁷⁹¹

⁷⁸⁶ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 20.

⁷⁸⁷ European Commission Regulation, Recital 13; *In Re Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Masters Fund, Ltd* 389B.R. 325 (United States District Court) at 129, *Interdil Srl in liquidation*, [2012] Bus LR 1582, 1593 [59] and [51] [52].

⁷⁸⁸ Bernardo, above n764, 832.

⁷⁸⁹ European Commission, *European Commission's Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings* (December 12, 2012), COMI (2012) 744 Final, 16.

⁷⁹⁰ Mevorach, above n322, 333.

⁷⁹¹ Bob Wessels, 'International Jurisdiction to Open Insolvency Proceedings in Europe, In Particular Against Groups of Companies' viewed at <www.iiiglobal.org> on March 24, 2013.

The divergent approaches of the EU Insolvency Regulation and the Model Law represent the reality of commercial enterprises that operate in multiple jurisdictions.⁷⁹² Tollenaar argues that the costs of pragmatism and cooperation in decisional law and governmental policy can alleviate the differences that divide the Insolvency Regulation and the Model Law. He further states that:

The statutory standards that guide the determination of a corporation's COMI are fluid and open to judicial interpretation. The absence of specific statutory standards has allowed courts to declare COMI status in opposition to similar declarations by other competing courts, especially with corporate groups involving parent-subsidiary relationships. The result, particularly under the EU Regulation, has been a "first to file/first to win" race, as courts were likely to declare COMI status on behalf of debtors that were beneficial to domestic interests.⁷⁹³

The challenges that the EU Insolvency Regulation and the UNCITRAL Model Law encounter concerning the determination of COMI is of increasing significance, as corporate groups have established subsidiaries in jurisdictions that span both the EU Insolvency Regulation and the UNCITRAL Model Law, as well as jurisdictions that have their own distinct insolvency regimes and continue to do so. In consideration of the COMI of a cross-border bank, it may be argued that the judgment in *Stanford International Bank* regarding the appropriateness of the head office functions test applied to the concept of COMI should be considered.⁷⁹⁴ This included that:

From recital 13 in the Preamble itself, which states that the "centre of main interests" "should correspond to the place where the debtor conducts the administration of his interests on a regular basis", in other words, in the case of a corporation, where its head office functions are exercised. Recital 13 continues "and [which] is therefore ascertainable by third parties"; in other words, it is because the corporation's head office functions are exercised in a particular member state that the centre of main interests is ascertainable there."⁷⁹⁵

⁷⁹² Tollenaar, above n350.

⁷⁹³ Bernardo, above n764, 813.

⁷⁹⁴ Bufford, above n279, 716 where Bufford states that 'the test for the location of an ECOMI of an enterprise group should be the country where its management headquarters or head office is located.'

⁷⁹⁵ *Re Stanford Internatianol Bank* [2011] Ch 33, 67 [53] to 54].

The next section will further discuss the concept of group COMI which the UNCITRAL Working Group is developing as:

‘Some of these questions of jurisdiction relate to the difficulty of applying the concept of COMI to an enterprise group in order to bring all group members within the jurisdiction of one court.’⁷⁹⁶

The concept of group COMI has the potential to address the COMI of a cross-border bank. The UNCITRAL Insolvency Working Group has the objective of providing guidelines relating to issues arising from the COMI of single-entity and corporate groups.⁷⁹⁷

9.1 The concept of group COMI

Firstly, the concept of COMI is significant when considering the cross-border treatment of corporate groups as it may determine whether courts will grant recognition to the corporate group within the definition of COMI.⁷⁹⁸ In the treatment of corporate groups, the issue is whether COMI can be defined so as to allow all members of the corporate group to have their COMI in one jurisdiction, although their registered offices are in various jurisdictions which involve economic activity.⁷⁹⁹ Cooper states that:

Notwithstanding the growing need for solutions to enable the insolvency of groups to be dealt with efficiently and cost effectively, the failure of any organization, including the EU and the UNCITRAL Working Group charged with considering the treatment of economic groups in

⁷⁹⁶ Jenny Clift, ‘Transnational Corporations’, United Nations Conference on Trade and Development, Division on Investment and Enterprise, New York and Geneva 2011, Volume 20 (1), April 2011, 138.

⁷⁹⁷ United Nations Commission of International Trade Law, Working Group V (Insolvency Law), Thirty-ninth session, Vienna, 6-10 December 2010, UN Doc. No. A/CN.9/WG.V/WP.95/Add.1 where the general discussion in the report stated that: ‘The Working Group recalled that the mandate given by the Commission with respect to the topic concerning the interpretation and application of selected concepts of the Model Law relating to COMI was based on the “United States” proposal as described in paragraph 8 of document A/CN.9/WG.V/WP.93/Add.1 to provide guidance on the interpretation and application of selected concepts of the UNCITRAL Model Insolvency Law relating to centre of main interests and possibly to develop a model law or provisions on insolvency law addressing selected international issues, including jurisdiction, access and recognition, in a manner that would not preclude the development of a convention”.1’ *Official Records of the General Assembly, Sixty-fifth Session, Supplement No. 17 (A/65/17)*, paragraph 259 (a).

⁷⁹⁸ Sarra, above n35, 555; See *In Re Gyrotrac (USA) Inc.* 441 BR 470 (2010) which was the first appellate decision to consider group COMI. In this case, the Quebec Court of Appeal applied the COMI principle in order to determine whether the Gyrotrac Group was subject to a foreign main proceeding. The Court of Appeal held that the determination of COMI was fact specific and it upheld the decision of the lower court that the COMI was in the US. While it referred to the general commercial activities and management of the group, it had considered the COMI of each individual debtor.

⁷⁹⁹ *Ibid.*

insolvency, to define the COMI of a group giving clear unequivocal jurisdiction to the court of one state over the jurisdictions in which other member companies are domiciled may determine that this problem remains in the “too hard” box.⁸⁰⁰

Although a group definition of COMI may assist in global workouts, Sarra notes that it may be difficult to apply creditors’ rights in various jurisdictions where corporate groups registered in those jurisdictions may inappropriately extend domestic law in those jurisdictions and may seek a remedy in respect of the particular business entity in that jurisdiction.⁸⁰¹ Sarra further argues that there could be recognition that COMI may lie in multiple jurisdictions, and protocols to facilitate cases where it is more efficient to administer the proceeding in the home jurisdiction of the parent company on a consolidated basis may be utilized.⁸⁰² The UNCITRAL Working Group has acknowledged that any adoption of insolvency proceedings that grants recognition to corporate groups would need to define the levels of integration within the group,⁸⁰³ which would also be a factor relevant to a cross-border banking group. At present, the consensus at UNCITRAL level is that

‘a corporate group does not possess a group COMI distinct from the COMI of its constituent members. Neither was it possible to determine any other useful definition, such as a centre of influence or control, which would similarly assist a court faced with handling possibly insolvency or reorganisation proceedings against financially troubled members of an enterprise group.’⁸⁰⁴

The relevant issues pertaining to corporate groups lies outside the scope of Chapter 15 of the US Bankruptcy Code, and as indicated in Chapter 4, the EC Insolvency Regulation does not

⁸⁰⁰ Cooper, above n172, 16. Unlike the EU Regulation, the Model Law follows a weaker ‘modified universalism’ which seeks to allow for recognition of ‘foreign’ insolvency proceedings reaching across borders, while still respecting the role of domestic laws and courts. Accordingly, in 2005, ‘the Working Group eventually focused on facilitating coordination and cooperation between courts (and representatives) handling insolvency proceedings against different members of an enterprise group.’⁸⁰⁰ These recommendations were for a two-step evaluation of the insolvency of enterprise groups. Firstly, the relevant issues were to be limited to a group insolvency at the domestic level, and subsequently, the same and other cross-border issues were to be extended to the international level. Once the evaluation is finalized, the recommendations should become part of the Legislative Guide on Insolvency Law, and be available for implementation by local jurisdictions.⁸⁰⁰ The Working Group’s recommendations reaffirm the application of Model Law principles to enterprise groups, without purporting to suggest particular methods for solving the vexing problems inherent in groups.⁸⁰⁰

⁸⁰¹ Ibid, 562.

⁸⁰² Ibid.

⁸⁰³ Ibid.

⁸⁰⁴ Cooper, above n172, 10. See also United Nations Commission of International Trade Law, Working Group V (Insolvency Law) Forty-third session, New York, 15 April-19 April 2013, Working Group Paper UN Doc. No. A/CN.9/WG.V/WP.114, ‘Interpretation and Application of Selected Concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to Centre of Main Interests (COMI)’, paragraph 60.

directly address corporate groups, but does so indirectly by adapting single provisions where necessary to address issues that are typical of corporate groups.⁸⁰⁵ It would be difficult to arrive at a group definition of COMI that ‘could be used to limit the commencement of parallel proceedings or simplify the number of laws that might apply to insolvency proceedings in different states with respect to members of the same group’,⁸⁰⁶ ‘difficulty in applying the recognition regime to the COMI of a corporate group, and that such ‘a rule could be useful to facilitate coordination of multiple insolvency proceedings with respect to group members.’⁸⁰⁷

The universalism or territorialism approach is also applied when deciding whether the international bank is a single or separate entity. The single-entity doctrine is based on comity, the recognition of foreign decisions. The separate entity doctrine is based on a ring-fencing approach that favors the treatment of local creditors of multinational entities over creditors located in other jurisdictions.⁸⁰⁸ For example, in the BCCI case, the US authorities used the ringfencing approach to keep the assets in the US in order to satisfy US creditors.⁸⁰⁹ The single-entity approach to liquidation means that there is only one competent court to decide on the bankruptcy of the bank (unity), and that the bankruptcy law of the country in which the insolvency has been initiated is effective in all other countries in which the bank’s parent entity has assets or branches (universality).

The universality principle assigns extraterritorial effect to the adjudication of insolvency. The universality theory assumes that a complex financial group forms a single economic entity. This is not always valid in an insolvency context where the group is split into its many legal entities and where foreign branches are sometimes liquidated as separate units.⁸¹⁰ Under the single-entity approach, all assets and liabilities of the parent bank and its foreign branches are wound up as one legal entity. This unitary system renders it impossible to start simple insolvency proceedings against a domestic branch of a bank that has its head office in

⁸⁰⁵ Sano, above n231, 99.

⁸⁰⁶ United Nations Commission of International Trade Law, Working Group V (Insolvency Law) Forty-first session, New York, 30 April-4 May 2012, UN Doc. No. A/CN.9/WG.V/WP.103/Add.1, ‘Interpretation and Application of Selected Concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to Centre of Main Interests (COMI)’, paragraph 60, 15.

⁸⁰⁷ Ibid.

⁸⁰⁸ Ioseliani, above n97, 26.

⁸⁰⁹ Hupkes, above n468, 143.

⁸¹⁰ Daniel Xuberbuhler, ‘The Financial Industry in the 21st century. Introduction’, Swiss Federal Banking Commission, 21 September 2000 viewed at <<http://bis.org/review/rr000921c.pdf>> on October 8th, 2012.

a foreign country.⁸¹¹ In contrast, the separate-entity approach to liquidation means that insolvency proceedings are effective only in the country in which they are initiated, and therefore there is a plurality of separate proceedings which need to be initiated in every country where the insolvent bank holds realizable assets or branches. The principle of territoriality assigns territorial effect to the adjudication of insolvency. In contrast, under a separate-entity approach, the domestic branch of a foreign bank receives a liquidation preference, as local assets are segregated to benefit local creditors.⁸¹²

Furthermore, the insolvency context of international banks leads to two major problems. Firstly, there is the issue of whether the insolvent firms should be resolved as a single entity or whether each of the several jurisdictions in which the creditors and assets are located should be treated separately, regardless of the jurisdiction in which the creditors and assets are located. The second issue is whether to conduct multiple proceedings in each relevant jurisdiction or have one jurisdiction lead the proceedings, and have all the other jurisdictions defer to this main proceeding.⁸¹³ The legal challenges presented to international banks in these issues were illustrated in BCCI and most recently, Lehman Brothers. The legal challenges of comity in the Lehman Brothers insolvency will be discussed, followed by that of ringfencing.

The various Lehman principals were engaged in negotiations regarding the Lehman's Protocol: a protocol of unprecedented scope. The problems began with the refusal by Lehman Brothers Holdings Europe (LBHE) and Lehman Brothers Japan (LBJ) to sign a protocol that would, arguably, preserve the general value of the Lehman enterprise.⁸¹⁴ The difficulties of resolving a cross-border bank collapse such as Lehman Brothers, when the general principles of comity are preferred by domestic creditors and arguably, the administrators of these jurisdictions, illustrate the impediments to a fully effective protocol. The lack of cooperation between Lehman affiliates to sign a protocol demonstrates the inability of a protocol to handle a large-scale international bank insolvency adequately. The

⁸¹¹ Lastra, above n12, 90.

⁸¹² Ibid, 91.

⁸¹³ Kaufmann, above n20.

⁸¹⁴ Sexton, above n145, 822. The scale and scope of the protocol had not been attempted in cross-border insolvency protocols before.

disparate resolution methods and outcomes across jurisdictions cause uncertainty and dislocation, so that similarly situated creditors finish with very different outcomes.⁸¹⁵

The legal challenges presented by ringfencing involved the conflict between Lehman Brothers and its London affiliate. The instinct to ringfence assets in local offices immediately was illustrated with the transfer of US\$8billion in funds from a Lehman Brothers affiliated brokerage to New York, a few hours before Lehman Brothers declared its insolvency. Lehman's London affiliate was left with no funds and insufficient resources to pay its employees. Foreign clients of the London affiliate were also left with no funds, and many US hedge funds and other institutions were not able to access their funds or assets.⁸¹⁶ Furthermore, because of Lehman's operational structure, it was not immediately clear which funds belonged to which legal entity or necessarily who had priority claim to assets in the insolvency.⁸¹⁷ Ultimately, 'the outcome of jurisdictional differences on the single/separate entity approach may not seem equitable to all creditors'.⁸¹⁸

10. Conclusion

This chapter has shown that the Model Law has the potential to facilitate unification and centralization in insolvency proceedings.⁸¹⁹ Mevorach specifically states that:

'the handling of insolvency proceedings of international corporations can be greatly facilitated by implementing an international regime in a uniform manner. In this way, conflicts between jurisdictions and laws can be diminished.'⁸²⁰

Bernardo argues that ensuring predictability for creditors might not be effective because of the high discretion that is assumed by national authorities particularly in the determination of

⁸¹⁵ Ibid, 13.

⁸¹⁶ Cumming & Eisenbeis, above n74, 13.

⁸¹⁷ Ibid, 12.

⁸¹⁸ Bank of International Settlements, above n2, 3.

⁸¹⁹ Mevorach, above n24, 517.

⁸²⁰ Ibid.

COMI,⁸²¹ and ‘the inability of existing regimes to resolve corporate groups’⁸²² such as international banks. The final chapter will examine these arguments in greater detail.

In international bank insolvencies, it may be argued that in addition to these two issues, the major obstacle to international cooperation that the Model Law promotes concerns national sovereignty, the various rules governing priorities or preferences among creditors in the distribution of the value realized in insolvency proceedings, and domestic self-interest. The territorial concept of sovereign interest⁸²³ and the bias towards domestic creditors⁸²⁴ override the incentives for international comity. When courts attempt to cooperate to maximize value and fairness in a multinational case, the problem of protecting the sovereign interest and the domestic priority system arises, as does the issue of whether the court is so bound by the local system that it prevents international cooperation with a foreign court.⁸²⁵ The sovereign nature of security will also continue to create priority conflicts when different national priority rules can dramatically change the status of secured creditors.⁸²⁶

As indicated, although courts should accord priority treatment to foreign creditors who meet the priority requirements of national law,⁸²⁷ in practice, courts tend to ignore the foreign creditors’ entitlement to priority status and instead, protect local creditors from the risk that local priorities will be granted recognition in a foreign insolvency.⁸²⁸

In consideration of the issues discussed in this chapter, it may be argued that one of the most important legal issues not being addressed in the models of regulation in international insolvency and in domestic banking laws is the granting of “cross-priority” concerning the non-discriminatory treatment of foreign creditors. Most national legal systems have not developed a rule concerning the availability of local priorities to foreign creditors whose claims would qualify for priority treatment if they were local creditors.⁸²⁹ Internationally, this situation is exacerbated when the priorities of creditors receive vastly different treatment

⁸²¹ Bernardo, above n764, 802.

⁸²² Ibid.

⁸²³ Baxter Jr., Joyce & Summer, above n691, 60.

⁸²⁴ Ibid, 86.

⁸²⁵ Westbrook, above n706.

⁸²⁶ John K Londot, ‘Handling Priority Rules Conflicts in International Bankruptcy: Assessing the International Bar Association’s Concordant’, (1996-1997) 13 *Bankruptcy Developments Journal* 163, 170.

⁸²⁷ Westbrook, above n663, 29-31.

⁸²⁸ Ibid, 29; Jay Lawrence Westbrook, ‘Choice of Avoidance Law in Global Insolvencies’, (1991) 17 *Brooklyn Journal of International Law* 499, 513-514.

⁸²⁹ Westbrook, above n663, 29-30.

under various jurisdictions, and ‘there is no pretense to uniformity’.⁸³⁰ The clash between various priority systems creates a significant obstacle to the unification and harmonization of laws that the Model Law seeks to achieve. These variations create difficulties in international harmonization⁸³¹ when high priority creditors in one jurisdiction may be low priority creditors in another jurisdiction.⁸³²

In respect of the issue of COMI, ‘the divergence in the tests applied by different courts raises significant challenges for future cross-border insolvency cases’⁸³³ such as international banks. For example, while the US approach concerns the command and control test, the EU approach rejects this test in determining the COMI.⁸³⁴ It has been argued that recognition of an enterprise group COMI such as in international bank insolvencies,

‘could be an inappropriate extension of domestic law in one jurisdiction and could prejudice creditors in those jurisdictions where priorities or preferences differ or where there are statutory protections under the jurisdictions in which the subsidiaries are located.’⁸³⁵

The abuse of process in forum shopping can also worsen the prejudice against creditors in jurisdictions where preferences differ, and cause unnecessary injustice and inequality. As stated by UNCITRAL:

‘the lack of such regimes has often resulted in inadequate and uncoordinated approaches to cross-border insolvency that are not only unpredictable and time-consuming in their application, but lack both transparency and the tools necessary to address the disparities and, in some cases, conflicts that may occur between national laws and insolvency regimes. These factors have impeded the protection of the value of the assets of financially troubled businesses and hampered their rescue.’⁸³⁶

⁸³⁰ Gropper, above n665, 561.

⁸³¹ Westbrook, above n663, 31.

⁸³² Kurt Hans Nadelmann, *Conflict of laws: International and Interstate Selected Essays* (The Hague, 1972), 286.

⁸³³ Sarra, above n35, 558.

⁸³⁴ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

⁸³⁵ Sarra, above n35, 561.

⁸³⁶ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Relevance to International Trade, viewed at <http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html> on December 1, 2012.

This is particularly significant for international banks such as global systemically important financial institutions (G-SIFIs) whose insolvency can impact on many jurisdictions, and the repercussions of which can still affect the global economy and financial markets many years later.

The conflicts that have been examined in this chapter will be further developed in the final chapter that examines international harmonization and cooperation, the failure of national regimes to deal with cross-border bank insolvencies, and the most appropriate solution that can balance national sovereignty and international objectives. Ultimately, the objectives of the Model Law and the progress in developing COMI requires that the conflicts between jurisdictions be resolved, but particularly, in international bank insolvencies, as indicated, this is impeded by sovereign interest. Arguably, the unity approach that is needed to resolve these conflicts may be impossible, but this chapter has shown that the Model Law has the potential to assist in resolving the conflicts arising from international bank insolvencies by developing the principle of COMI, and monitoring these conflicts.

The final chapter will consider and develop the previous chapters, and propose that the most appropriate solution – at least theoretically - to address the conflicts in cross-border bank insolvencies is an international convention supported by the collaboration and cooperation with other international bodies, and existing international insolvency regimes such as the Model Law.

CHAPTER 6: THE CONCEPT OF AN INTERNATIONAL CONVENTION ON CROSS-BORDER BANK INSOLVENCY

Chapter Overview

The purpose of this penultimate chapter is to discuss the concept of an international convention that will establish consistent, enforceable rules with the potential to solve the conflicts between jurisdictions concerning COMI and priority schemes in international bank insolvencies. This chapter provides a further discussion of COMI by focusing on its role in determining the priority scheme of the principal jurisdiction.

It is understood that UNCITRAL, when drafting the Model Law, discussed the feasibility of drafting a convention. However, political reality forced UNCITRAL to abandon such a resolution to cross-border insolvency laws, resulting in a compromise: the drafting of a model law.

This chapter begins by discussing the international initiatives to develop harmonisation of laws, such as the Model International Insolvency Cooperation Act (MIICA), the Cross-border Insolvency Concordant, and the ALI Principles.⁸³⁷ The Cross-border Insolvency Concordant is an interim measure until a treaty or convention comes into force. This chapter develops the comparison of the EU Insolvency Regulation and the UNCITRAL Model Law on Cross-border Insolvency introduced in Chapters 4 and 5, and examines the weaknesses in these frameworks. It discusses the proposals of the UNCITRAL Insolvency Working Group regarding possible future work for an international convention. This chapter draws inspiration from these proposals to consider a similar concept in cross-border bank insolvency and provides the background for the conclusion of the thesis, in Chapter 7. In doing so, this thesis argues that an international convention to achieve harmonization of laws is the most appropriate solution to cross-border bank insolvency cases which involve multiple insolvency proceedings and conflicting jurisdictions.

⁸³⁷ John A. Barrett & Timothy E. Powers, 'Proposal for Consultative Draft of Model International Insolvency Cooperation Act for Adoption by Domestic Legislation with or without modification, 17 (1989) *International Business Lawyer* 323. (hereafter MIICA), Committee J- Insolvency and Creditor's Rights, International Bar Association, Cross-border Insolvency Concordant (Sept. 1995 ed.), International Insolvency Institute/American Law Institute Global Principles for Cooperation in International Insolvency Cases ALI Principles as presented to the Annual Meeting of the American Law Institute - Washington, D.C., May 23, 2012 and to the Annual Meeting of the International Insolvency Institute - Paris, June 22, 2012.

The chapter discusses the ideology of universalism in which there is a single international insolvency court and single international insolvency law, and why this is infeasible at present. The case of *Re Maxwell Communications Corp.* demonstrates the coordinated judicial decision-making process to decide the governing law. The conclusion of the chapter examines the possibility of harmonization of laws to address the weaknesses in the current legal architecture.

6. Introduction

The purpose of this thesis is to find the most appropriate solutions to the conflicts between national legal systems in international bank insolvencies and specifically, in respect of COMI (the centre of the debtor's main interests). The conclusion, Chapter 7, will suggest that greater harmonization should be sought in order to resolve international conflicts, and discusses how this can contribute to the conflicts between jurisdictions and the debate surrounding COMI.

This chapter illustrates the choice of law problems that has been created by private international law⁸³⁸ concerning jurisdictional issues. As the principles of private international law have been ineffective in resolving the multi-jurisdictional conflicts in cross-border bank insolvencies and in respect of COMI, national systems of private international law have integrated universalist ideas to provide mechanisms for judicial assistance and cooperation across borders.⁸³⁹ However, as a multinational bank operates as an integrated global unit,⁸⁴⁰ the conflicts have created additional problems which are due to the lack of harmonization of conflicts rules.⁸⁴¹ In order to assist the harmonization of conflicts rules and have consistent, enforceable international rules, this chapter argues that an international convention is the most appropriate instrument to utilize.

There is a stark contrast between the ideal theoretical solution of a single international court and a single international insolvency law, and the reality of national sovereignty. Pottow argues that the application of national sovereignty, in which the sovereign jurisdiction has the right to exercise jurisdictional claim over assets,⁸⁴² ensures that states have a prevalent tendency to enforce their own laws.⁸⁴³ In insolvency, this stems from the normative rules that reflect different policies as to procedures and claims⁸⁴⁴ of jurisdictions. Furthermore, sovereign-specific interests may conflict with the creditors' objective of maximized asset return.⁸⁴⁵ This chapter argues that a compromise between international agreement and national sovereignty must be reached, in order to initiate international policy to assist in resolving the conflicts in cross-border bank insolvencies.

⁸³⁸ Whincorp & Keyes, above n21, 188.

⁸³⁹ Ibid.

⁸⁴⁰ Hupkes, above n468, 14.

⁸⁴¹ Einhom, above n70, 34.

⁸⁴² John A. Pottow, 104 'Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to "Local Interests"', (2006) *Michigan Law Review* 1899, 1915.

⁸⁴³ Ibid.

⁸⁴⁴ Ibid, 1917.

⁸⁴⁵ Ibid, 1991.

6.1 Initiatives towards Harmonization of Cross-border Insolvency Proceedings

In 1989, the Model International Insolvency Cooperation Act (MIICA) was developed by Committee J of the International Bar Association, and approved by the Council of the Section on Business Law and the Council of the International Bar Association. The proposed statute was intended for adoption by domestic regimes, and ‘provides for mechanisms by which courts may assist and act in aid of insolvency proceedings being conducted in other jurisdictions’.⁸⁴⁶ The members of Committee J ‘concluded that worldwide enactment of domestic legislation encouraging international cooperation’ would address the lack of cooperation.⁸⁴⁷ The goal of the MICCA was to achieve universality,⁸⁴⁸ providing an equitable distribution of assets among domestic and foreign creditors, or equitable administration in a reorganisation or rehabilitation proceeding.⁸⁴⁹ At present, the numerous country reports concerning the enactment of MIICA demonstrates the uncertainty of its potential benefits.⁸⁵⁰ Although the intention was to reform domestic insolvency legislations, the MIICA is not an active instrument. Ironically, its objective of achieving universality whereby a single international court exercises jurisdiction over insolvency proceedings was, arguably, its greatest impediment.⁸⁵¹

In the 1990s, another initiative of Committee J was the Cross-border Insolvency Concordant premised on rules of private international law.⁸⁵² The purpose of the Concordant was as a framework to harmonize cross-border insolvency proceedings. The principles of the Concordant are an interim

⁸⁴⁶ Barrett & Powers, above n838, 323.

⁸⁴⁷ Bruce Leonard, Jay A. Carfagnini & Richard H. McLaren, ‘Can there be International Cooperation in Foreign Bankruptcies? A Canadian Explanation of Alternative Models’, (1998) 23 *Review of International Business Lawyer* 28, 39-40.

⁸⁴⁸ Barret & Powers, above n838, 324. The MIICA Statement of General Principles explains: ‘The ultimate goal of legislation for international insolvency cooperation is universality which envisions a single administration providing protection of the insolvent debtor’s estate from dismemberment, and an equitable distribution of assets among both domestic and foreign members in liquidation, or the equitable administration of the estate in reorganization, composition or rehabilitation proceeding. Insofar as possible, such universality should be the guiding principle of all efforts towards international insolvency cooperation, for it alone is truly compatible with the realization of equal treatment of all creditors, debtors, assets and liabilities, and the swift and effective administration of the estate. Within the parameters of this overarching principle, mechanisms must be provided for the recognition of foreign representatives, the stay of local proceedings, the production of documents and testimony, the integration of asset distribution and other forms of ancillary relief. In a world of increasing global integration and growth of true multinational business entities, these principles are the indispensable elements in attaining equity and fairness in international insolvency proceedings.’

⁸⁴⁹ Ibid, 323.

⁸⁵⁰ Elizabeth K. Somers, ‘The Model International Insolvency Cooperation Act: An International Proposal for Domestic Legislation’, (2011) 6(4) *American University Law Review* 677, 700.

⁸⁵¹ P.R. Thulasidass, ‘Role of Public International Law in Cross-border Insolvency Regime: An Overview’, July 2012, viewed at http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=thulasidhass_thulasidhass on February 26, 2013, 11.

⁸⁵² Committee J- Insolvency and Creditor’s Rights, International Bar Association, Cross-border Insolvency Concordant (Sept. 1995 ed.), 22.

measure until the formal adoption of treaties and/or statutes by commercial jurisdictions.⁸⁵³ The Concordant is the only legal instrument that facilitates the orderly settlement of cross-border insolvency cases, but it is uncertain whether domestic regimes are willing to cooperate in future cases.⁸⁵⁴

The Global Principles for Cooperation in International Insolvency Cases ‘reflect a non-binding statement, drafted in a manner to be used in civil law as well as common law jurisdictions, and aim to cover all the jurisdictions in the world. To a large extent, these principles build further on The American Law Institute’s Principles of Cooperation among the member states of the North American Free Trade Agreement (NAFTA). Those principles evolved from The American Law Institute’s Transnational Insolvency Project, conducted between 1993 and 2000, for which the reporter was Professor Jay L. Westbrook. The overriding objective of the principles concerns:

Enabling courts and insolvency administrators to operate effectively and efficiently in international insolvency cases with the goals of maximising value of the debtor’s global assets, preserving where appropriate the debtor’s business, and furthering the just administration of the proceeding.⁸⁵⁵

It further states that

‘a court should, by actively managing an international insolvency case, coordinate and harmonize the proceedings, before it with those in other states except where there are genuine and substantial reasons for doing otherwise and then only to the extent considered to be appropriate in those circumstances.⁸⁵⁶ And that ‘To become formally applicable by national courts, it would be necessary for the Global Rules to become embodied in an international convention or model law to which a significant number of states might, in due course, become contracting or enacting parties’.⁸⁵⁷

⁸⁵³ Committee J- Insolvency and Creditor’s Rights, International Bar Association, Cross-border Insolvency Concordant (Sept. 1995 ed.), 2-3.

⁸⁵⁴ Committee J- Insolvency and Creditor’s Rights, International Bar Association, Cross-border Insolvency Concordant (Sept. 1995 ed.), 2-3/

⁸⁵⁵ Committee J- Insolvency and Creditor’s Rights, International Bar Association, Cross-border Insolvency Concordant (Sept. 1995 ed.), Principle 1.

⁸⁵⁶ Committee J- Insolvency and Creditor’s Rights, International Bar Association, Cross-border Insolvency Concordant (Sept. 1995 ed.), Principle 4.

⁸⁵⁷ International Insolvency Institute/American Law Institute Global Principles for Cooperation in International Insolvency Cases ALI Principles as presented to the Annual Meeting of the American Law Institute - Washington, D.C., May 23, 2012 and to the Annual Meeting of the International Insolvency Institute - Paris, June 22, 2012, 221.

7. The Reality of the EU Insolvency Regulation and the Model Law

This thesis, when comparing the EU Insolvency Regulation and the Model Law in Chapters 4 and 5, has shown that a primary shortcoming is the failure of the current frameworks to address large, complex financial institutions that can be classified as ‘corporate enterprise groups that have operating assets in multiple jurisdictions but have highly integrated structures’.⁸⁵⁸ In October 2011, the European Parliament recommended a revision of the Insolvency Regulation, including the harmonization of certain aspects of insolvency law, and an improved coordination of insolvency proceedings concerning corporate groups. The revisions of the EU Insolvency Regulation will, arguably, pave the way for the design of an international legal framework for group insolvencies.⁸⁵⁹ In respect of group insolvency, the proposal by INSOL Europe to amend the EU Insolvency Regulation includes that substantive consolidation should be permitted for entities in an enterprise group case in appropriate circumstances,⁸⁶⁰ that each member entity in the enterprise group commence its case in the state where its own COMI is located,⁸⁶¹ and that each legal entity should have its own separate insolvency case.⁸⁶² The proposal further states that the provisions from the UNCITRAL Model Law should be incorporated for improved functioning of EU insolvency proceedings.⁸⁶³

In the development of group insolvency, the Model Law, as the only international model for international insolvency, is of particular importance. The EU Regulation has only a limited ability to regulate all cross-border insolvency cases because it applies only to cases within the EU. The cross-border insolvency cases involving EU and non-EU jurisdictions are also outside its remit.⁸⁶⁴ Furthermore, the lack of uniformity is also evidenced within the EU, between those member states that have adopted all or most of the Model Law provisions and those which apply flexible rules of non-EU insolvency courts.⁸⁶⁵ UNCITRAL recognized that an international approach to group insolvencies is needed,⁸⁶⁶ and incorporated its recommendations in Part III of the Legislative Guide

⁸⁵⁸ Sexton, above n145, 838.

⁸⁵⁹ Bufford, above n279, 747.

⁸⁶⁰ INSOL Europe, Proposals by INSOL Europe: Revision of the European Insolvency Regulation (May 2012), 98.

⁸⁶¹ *Ibid.*, 92.

⁸⁶² *Ibid.*

⁸⁶³ *Ibid.*, 110.

⁸⁶⁴ Sexton, above n145.

⁸⁶⁵ INSOL Europe, Joint International Insolvency Seminar: Revision of the European Insolvency Regulation, Discussion of Chapter VII- Incorporation of the UNCITRAL Model Law viewed at <<http://www.insol-europe.org/technical-content/revision-of-the-european-insolvency-regulation-proposals-by-insol-europe/>> on February 20, 2013.

⁸⁶⁶ United Nations Commission of International Trade Law, Working Group V (Insolvency Law), Report of Working Group V (Insolvency Law), New York, Thirty-Sixth Session, 2009, U.N. Doc. A/CN.9/671, 55 (May 25, 2009).

on Insolvency Law.⁸⁶⁷ However, both of these regimes ‘proved to have significant shortcomings, particularly in the very large cases of the last several years involving corporate groups’.⁸⁶⁸ The case of *Lehman Brothers*, the largest insolvency case filed in the US, further illustrates the multiplicity of proceedings and the ensuing complexity of international bank insolvencies. The collapse of Lehman instigated

‘the opening of nearly 80 different insolvency proceedings commenced in more than 16 different jurisdictions, each of which has to be treated separately and each of which will differ in its form and scope, in accordance with the applicable law. While some of the states involved have adopted the UNCITRAL Model Law and therefore have at their disposal some mechanisms that might be used to facilitate coordinated administration of these different proceedings, many do not.’⁸⁶⁹

Furthermore, the courts in the US and Britain issued contradictory orders regarding the disposition of assets.⁸⁷⁰ Although both jurisdictions adopted the Model Law, and the Lehman Protocol was given effect, a significant conflict still arose.⁸⁷¹ It may be argued that the current frameworks require a greater holistic perspective that addresses the cross-border enterprise as a whole, relying on the interconnections between individual yet integrated domestic entities. It may be further argued that the economic upheaval of the 2008 financial crisis has created the background for potentially more cross-border bank insolvencies in the not-too-distant future and therefore, it is imperative that there be further development of the integration and interconnectedness of groups in the current frameworks.

⁸⁶⁷ United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004), Part III.

⁸⁶⁸ Sexton, above n145, 815.

⁸⁶⁹ Clift, above n797, 131.

⁸⁷⁰ *In re Lehman Brothers Holdings Inc. Case No. 08-1355*, Report of Anton Valukas Examiner; *In re Lehman Brothers Inc. Case No. 08-01420*, Trustees Preliminary Investigation Report and Recommendations.

⁸⁷¹ Sexton, above n145, 814.

8. The Inspiration for an International Convention in Cross-border Bank Insolvency

This thesis draws inspiration from the following proposals for a possible international convention in the field of insolvency law, and further study as to large, complex financial institutions. In a UNCITRAL Insolvency Working group session, the *Union Internationale des Avocats* (UIA)⁸⁷² proposed:

a possible international convention in the field of international insolvency law, which might cover the following issues currently addressed by the UNCITRAL Model Law on Cross-border Insolvency:

- i. granting of access to courts to foreign insolvency representatives;
- ii. recognition of foreign insolvency proceedings (with the effect of granting the foreign proceeding the rights of a national proceeding or triggering a secondary proceeding);
- iii. cooperation and communication between insolvency representatives and courts.⁸⁷³

The proposal further suggests that if agreement on those issues seems possible, the international convention might also contain provisions on direct competence and applicable law, which could be part of a separate protocol'.⁸⁷⁴ At the April 2010 UNCITRAL Insolvency Working Group session, the International Bar Association (IBA) presented a proposal for the Working Group to begin drafting an international convention 'to facilitate joint administration of cross-border insolvency proceedings, including those of corporate groups'.⁸⁷⁵ Various international and national delegations strongly supported this recommendation, noting that domestic insolvency law reform was inadequate to enable coordination and cooperation in cross-border insolvency cases.⁸⁷⁶ The proposal stated that:

The absence of enforceable, reliable, consistent international rules affording coordination, cooperation, and communication among courts and between those administering cross-border

⁸⁷² United Nations Commission on International Trade Law, Working Group V (Insolvency Law), *UNCITRAL Legislative Guide on Insolvency Law: Thirty-Seventh Session*, Vienna, UN Doc A/CN.9/686 [9] (9-13 November 2009), paragraph 127-130. See also United Nations Commission of International Trade Law, Working Group V (Insolvency Law), Thirty-eighth session, New York, 19-23 April 2010, UN Doc. No. A/CN.9/WG.V/WP.93/Add.6, *Insolvency Law: Possible Future Work.*, Greg Bauer, 'SIRC Committee Update: UNCITRAL Working Group V calls for International Insolvency Convention', 4(2) (2010) *Insolvency and Restructuring International* 24.

⁸⁷³ United Nations Commission of International Trade Law, Report of Working Group V (Insolvency Law), Vienna, Thirty-Seventh Session, 9-13th November, 2009, UN Doc. No. A/CN.9/686, 22.

⁸⁷⁴ Jenny Clift, 'Developing an International Regime for Transnational Corporations: the Importance of Insolvency Law to Sustainable Recovery and Development', 20(1) 2011 *Transnational Corporations* 118, 127.

⁸⁷⁵ Greg Bauer, UNCITRAL Working Group V Calls for International Insolvency Convention, (2010) 4(2) *Insolvency and Restructuring International* 24.

⁸⁷⁶ *Ibid.*

multinational enterprise group insolvency proceedings has led to jurisdictional conflicts, wasteful litigation and competition for assets and control by national courts and insolvency administrators. A convention on international (procedural) aspects of cross-border insolvency proceedings would address these issues.⁸⁷⁷

At the same Working Group session, the Swiss delegation proposed that a study be conducted of the feasibility of an instrument for the resolution of the cross-border insolvencies of large and complex financial institutions. The proposal stated that:

Insolvency of banks and other financial institutions has been excluded so far from the scope of insolvency related work undertaken by UNCITRAL. The reason for these exclusions are that banks and other financial institutions are subject to special resolution regimes in many jurisdictions and that the winding down of financial institutions raises important public policy issues, especially if the institution is of systemic relevance.⁸⁷⁸

At the UNCITRAL Working Group V (Insolvency Law) session in November 2012, the Working Group acknowledged that future work should also include implementations of principles to give guidance to legislatures and expand the work to include other groups from an insolvency perspective. The Working Group discussed the monitoring role of UNCITRAL concerning large, complex financial institutions while working harmoniously with other international bodies such as the Basel Committee, IMF, and the World Bank to avoid duplications, and also discussed whether to expand the scope of the Model Law to include banks. The issues of cross-border cooperation and the group structure were possibly at the heart of the problems. The Working Group also debated whether the Model Law should expand its scope to include banks, given the implications of the most recent international financial crisis⁸⁷⁹

As the EU Insolvency Regulation is being revised and reformed, arguably, the Model Law also needs to broaden the scope of its insolvency work. The future revisions of the EU Insolvency Regulation are likely to lead the international reforms concerning group insolvencies, arguably placing substantial pressure on the Model Law for further procedures addressing international group insolvency issues.⁸⁸⁰

⁸⁷⁷ United Nations Commission of International Trade Law, Report of Working Group V (Insolvency Law), Thirty-eighth session, New York, 19-23 April 2010, UN Doc. No. A/CN.9/WG.V/WP.93.

⁸⁷⁸ United Nations Commission of International Trade Law, Report of Working Group V (Insolvency Law), Thirty-eighth session, New York, 19-23 April 2010, Document No. A/CN.9/WG.V/WP.93.

⁸⁷⁹ Author's note on file; author attended the United Nations Commission of International Trade Law, Working Group V (Insolvency Law), Forty-second session, November 26-30 2012, Vienna.

⁸⁸⁰ Bufford, above n278, 747.

This thesis argues that an international convention to achieve harmonization of laws is the most appropriate solution in cross-border bank insolvency cases which involve multiple insolvency proceedings and conflicting jurisdictions. An international convention would have the capacity to establish and enforce predictable and consistent international rules that would enable coordination, cooperation, and communication between and among courts as well as administrators of cross-border group insolvency proceedings. A convention that addresses the close relationship between insolvency law and national judicial and civil procedure law,⁸⁸¹ and the variations that exist state-by-state could be achieved by undertaking a comparative legal study of jurisdictions.

The current cross-border legal issues being addressed, such as those abovementioned in the UIA proposal, are also applicable to those in cross-border bank insolvency albeit with greater complexity and scope. This greater complexity and scope stems from the multijurisdictional nature of international banks that have complex legal structures. It may be argued that, first and foremost, conflicts between jurisdictions need to be resolved before the objectives of legislation of hard law, international law, and an international insolvency regime can be achieved.

The next section discusses the universalist ideal of a single forum and single law, in order to better understand the ideology towards which universalism is moving.

8.1 The Universalist Approach: The Ideal of a Single International Insolvency Court

In theory, a single system of international insolvency courts and a single international insolvency law would focus on a single set of priorities and distribution method, ensuring equality of legal rights in the distribution of assets internationally and creating a uniform set of conflicts rules⁸⁸² that would govern a multinational insolvency case. It would also create a single system of transfer-avoidance rules that can protect creditors from unfair strategic behaviour from debtors and other creditors. A single international insolvency law could produce greater consistency, uniformity and predictability in insolvency outcomes.⁸⁸³ It has been argued that equality of distribution, discussed in Chapter 5, is achievable by also utilizing the single priority scheme of the debtor's COMI'.⁸⁸⁴ This would be whereby there is only one COMI and the principal court of the debtor's COMI determines the governing law that distributes the debtor's assets worldwide.⁸⁸⁵

⁸⁸¹ Clift, above n524; Christoph G. Paulus, 'A Vision of the European Insolvency Law' viewed at <<http://www.iiiglobal.org/component/jdownloads/finish/39/3906.html>> July 3rd, 2013.

⁸⁸² Westbrook, above n695, 2287-2291.

⁸⁸³ Ibid, 2292-2293.

⁸⁸⁴ Jay Lawrence Westbrook, 'Universalism and Choice of Law', 23 (2004-2005) *Pennsylvania State International Law Review* 625, 625-626.

⁸⁸⁵ Ibid, 632.

When the debtor is subject to a single insolvency procedure and single insolvency law, creditors can better predict the pricing and availability of credit to debtors. The predictability in the universalism doctrine also has positive economic implications.⁸⁸⁶ However, the weakness of the universalist approach to identifying the home country is that this is difficult to substantiate in the case of corporate groups. LoPucki states that nearly every corporate group conducts business through subsidiaries in different jurisdictions. The universalist approach cannot distinguish whether the subsidiary's home country is the jurisdiction in which the parent operates the subsidiary, or the jurisdiction in which the subsidiary is incorporated and in which all its assets and operations are located. As indicated in Chapter 4, this is illustrated by the cases of *Daisytek*, *Enron Directo* and *Eurofoods*.⁸⁸⁷

The imperative for an international convention has been created by three factors. Firstly, private international law fails to establish standardized, consistent rules that all states can enforce.⁸⁸⁸ Secondly, there is a lack of international legislation to provide a mechanism to resolve these conflicts. Thirdly, the unpredictability and uncertainty surrounding these conflicts has created the imperative for an international convention in cross-border bank insolvency. Internationally, although the critical need for an international insolvency regime is acknowledged,⁸⁸⁹ there has been 'consistent failure'⁸⁹⁰ to realize a global treaty or convention in insolvency. Hupkes states that the development of an international insolvency mechanism for financial institutions that would implicate the loss of national sovereignty for major countries is not realistic, disregarding how desirable in theory.⁸⁹¹ In the short term, while there are significant obstacles to realizing an international insolvency regime, the multi-jurisdictional conflicts concerning international banks involving multiple legal systems⁸⁹² require an instrument in which international agreement and domestic considerations co-exist. In the long term, this would pave the way forward for the ideal future of an international insolvency regime in which 'universalism is the future of international bankruptcy, and the future may come sooner than we imagine.'⁸⁹³

⁸⁸⁶ Westbrook, above n140, 466.

⁸⁸⁷ Lynn M. LoPucki, 'Universalism Unravels', 79 (2005) *American Bankruptcy Law Journal* 143, 159.

⁸⁸⁸ Ian Fletcher, 'International Insolvency: A Case for Study and Treatment', 27(2) 1993 *International Lawyer* 429, 433.

⁸⁸⁹ Westbrook, above n695, 2276.

⁸⁹⁰ United Commission of International Trade Law, *UNCITRAL Practice Guide on Cross-border Insolvency Cooperation*, (date of adoption 1 July 2009), November 2010, 8.

⁸⁹¹ Hupkes, above n88, 219.

⁸⁹² Institute of International Finance, 'Making Resolution Robust- Completing the Legal and Institutional Framework for Effective Cross-border Resolution of Financial Institutions', June 2012, viewed at <www.iif.com> on April 8th, 2013.

⁸⁹³ Westbrook, above n695, 2328.

The next section will examine the obstacles that an international convention would need to address, and the compromise between national sovereignty and international agreement that must be reached.

8.2 The Obstacle of National Sovereignty

The major impediment to the conclusion of an international convention concerns national sovereignty. The benefits of cross-border insolvency laws can only be attained by implementing ‘a formalised system that is attentive to the distinct interests of the effective administration of foreign-located assets and the maintenance of state sovereignty that competes in cross-border insolvencies’.⁸⁹⁴ The adaptation of the provisions of an international convention into the domestic laws of states has profound implications for international law, but it involves the co-existence of national sovereignty and international policy.

In the most recent financial crisis, the failures of international banks and the complexity of the ensuing jurisdictional conflicts highlighted the ‘inadequacy of national level governments’ to implement international policy reforms that would adequately deal with this.⁸⁹⁵ The economic underpinning of insolvency has resulted in national sovereignty and strong resistance in order to prevent their sovereignty from being undermined. In recent times, traditional views of sovereignty have given way to a growing consensus on the need for comity. However, ‘the nations of the world are unlikely to endorse complete agreement’ even with regard to the criteria that would determine the proper forum for insolvency in cases where a debtor’s activities had given rise to substantial contacts of various kinds with a plurality of jurisdictions.⁸⁹⁶ The plurality of jurisdictions is complicated in cross-border bank insolvency whereby complex and perplex jurisdictional questions refer to the domestic regime which cannot provide adequate solutions, such as the issue of distributional outcomes. This has been recognized as the most important legal issue in insolvency.⁸⁹⁷

Nevertheless, where there is lack of coordinated decision-making between jurisdictions, the lack of predictable choices can enable debtors and creditors to strategically maximize their priorities in insolvency.⁸⁹⁸ Janger argues that the greater the incentive that creditors have to ‘play jurisdictional distribution games’,⁸⁹⁹ the more difficult it is for the principal court to coordinate decision-making regarding asset value maximization. The greater the difference between national distribution

⁸⁹⁴ Mike Perry, ‘Lining-Up At the Border: Renewing the Call for a Canada-US Insolvency Convention in the 21st Century’, (2000) 10 *Duke Journal of Comparative and International Law* 469, 477.

⁸⁹⁵ Bank of International Settlements, BIS Working Papers No. 397, *Financial Globalisation and the Financial Crisis* (December 2012), 10.

⁸⁹⁶ Fletcher, above n7, 433.

⁸⁹⁷ Janger, above n313, 441.

⁸⁹⁸ Claudia Todler, ‘Managing Failure in the Global Economy: the UNCITRAL Model Law on Cross-border Insolvency’, 22 (1999) *Boston College International and Comparative Law* 389, 391.

⁸⁹⁹ Janger, above n313, 456.

schemes, the greater the incentive for creditors to dispute whether assets will be administered locally or centrally.

8.3 The Compromise between the Ideal and the Reality

It is only when a compromise can be reached between the ideal solution of a single international insolvency court and single international insolvency law, and the reality of national sovereignty, that an international agreement can occur. The reality is that since the global financial crisis, the conflicts that ensued in the increase of international bank insolvencies has instigated the critical need for ‘advanced legislative and judicial coordination of insolvency matters’⁹⁰⁰ in an international convention designed to coordinate and enforce consistent international rules.

At a time where the most prominent feature of banking regulation is convergence as jurisdictions around the world converge closer ‘in terms of the content of prudential regulation and the techniques used’,⁹⁰¹ the rapid internationalisation of banks has also created the opportunity for new regulatory responses in regulatory and soft law, as well as influencing the manner in which courts deal with jurisdictional issues.⁹⁰² Clift states that:

There is growing international convergence not only around the goals of insolvency law, but also the types of mechanisms that should be available to achieve those goals.⁹⁰³

Historically, there have been very few international conventions specifically dealing with transnational insolvencies, and none to which the United States has been a signatory.⁹⁰⁴ The majority of insolvency treaties are bilateral.⁹⁰⁵ In bilateral treaties, the competing interests between national sovereignty and asset administration may be resolved by the host country ceding jurisdiction to the insolvency laws of the insolvent’s home jurisdiction, the host jurisdiction retaining jurisdiction, or both jurisdictions adopting harmonized insolvency proceedings.⁹⁰⁶ For example, it has been argued that ‘the third option of well-defined uniform insolvency proceedings provides the only solution that

⁹⁰⁰ Perry, above n895, 469.

⁹⁰¹ Ross Cranston, *Principles of Banking Law*, (Oxford University Press, 1997), 68.

⁹⁰² Ross Cranston, *Principles of Banking Law*, (Oxford University Press, 2002), 1.

⁹⁰³ Clift, above n875, 124.

⁹⁰⁴ Ian Fletcher, ‘International Insolvency: A Case for Study and Treatment’, 27(2) 1993 *International Lawyer* 429, 433.

⁹⁰⁵ Ibid, 437. For example, see Paul J. Omar, ‘Cross-border Insolvency Law and Practice in France’, International Insolvency Institute Academic Forum Collection, February 11, 2002 viewed at <<http://www.iiiglobal.org/component/jdownloads/finish/668/6066.html>> on August 3>, 2013 which states that ‘France is a signatory to four bilateral treaties dealing with insolvency that at the time of writing are still in force.’ These being treaties between France and Belgium of 8 July 1899, Italy of 3 June 1930, Monaco of 13 September 1950 and Austria of 27 February 1979.

⁹⁰⁶ Ibid, 477.

can reconcile the international legal dysfunction inherent in the coexistence of bankruptcy laws with the doctrine of jurisdictional sovereignty'.⁹⁰⁷ Already in 1993, Fletcher argued that

‘the difficulty of obtaining wide-scale international agreement to any but the most limited of practical proposals for cross-border collaboration quickly becomes obvious in the face of divergent national laws which penetrate deeply into the socioeconomic bedrock of sovereign states’.⁹⁰⁸

Although international conventions are the most effective way to achieve harmonization, ‘fuelled by politics, differences in legal systems and legal understanding, and untranslatability of concepts at the linguistic level, international conventions face interminable delays at the drafting stage’.⁹⁰⁹ Once there is consensus, it may take years to implement considering the multitude of bureaucratic processes at the state level for ratification, and the number of ratifications required for it to be enforceable. Certain jurisdictions may also choose to ignore specific provisions which would not be ascertainable with a convention.⁹¹⁰ This is a critical consideration as the instrument also needs to reflect the consensus of the international community so as to make the application practicable.⁹¹¹

On the other hand, the shortcomings of model laws, while ‘politically attractive’, indicate that the legal certainty that is an objective of harmonizing instruments is not imparted. Indira Carr argues that while promoting flexibility, this is to the detriment of other essential characteristics. She states that:

Model laws, by adopting an open framework, leave gaps to be filled in by the enacting state or the applicable law thus reintroducing a substantial degree of legal risk for those engaged in commercial ventures in spite of their stated goal of reducing legal uncertainty through harmonization. Perhaps it is time to reassess ways of achieving effective and successful harmonization given the march of globalization.⁹¹²

According to Janger, a ‘one case many laws’ regime that prompts the court at the debtor's COMI to favor the scheme that would have applied if assets and claims had been administered territorially (not applying its own national priority scheme) will enable coordination without compromising

⁹⁰⁷ Ibid.

⁹⁰⁸ Ibid, 430.

⁹⁰⁹ Ibid.

⁹¹⁰ Ibid.

⁹¹¹ Paul J. Omar, ‘The UNCITRAL Insolvency Initiative: A Five Year Review’, (2002) 6 (Oct) *Insolvency Lawyer* 228.

⁹¹² Indira Carr, ‘Of Conventions, Model Laws, and Harmonisation’, (2002) 8(4) *International Trade Law & Regulation* 105, 105-108.

fairness.⁹¹³ On the other hand, Westbrook argues that coordination is best accomplished by administering a universal insolvency case from the debtor's COMI, and that fair and equal distribution is best accomplished by utilizing the single priority scheme from the debtor's COMI.⁹¹⁴ Under this modified universalism approach, courts of ancillary jurisdictions have limited participation to the extent of assisting the main forum.⁹¹⁵

According to the EU Insolvency Regulation, the concept of a debtor's COMI excludes the consideration of other factors in determining international jurisdiction, such as the determining factor of the location of the debtor's assets. However, the location of the debtor's assets may be the determining factor for opening parallel proceedings (secondary proceedings or particular proceedings, i.e. territorially limited proceedings).⁹¹⁶ As indicated in Chapter 3, in the EU Insolvency Regulation, 'a debtor can only have one COMI in which the proceedings may be opened'.⁹¹⁷ The Virgos-Schmidt Report states that the Regulation 'does not provide any express rule to resolve cases where the courts of two Regulation States concurrently claim jurisdiction in accordance with Article 3(1), though the Report expresses the view that such conflicts of jurisdiction, must be an exception given the necessary uniform nature of the criteria of the jurisdiction used'.⁹¹⁸

However, in cross-border bank insolvencies, the multiple openings of insolvency proceedings premised on the need to seize its assets in each of the jurisdictions⁹¹⁹ where these are located, creates complex choice of law issues. This gives rise to several issues, in particular those concerning the coordination between multiple jurisdictions and the inadequate protection of creditors.⁹²⁰ The 'profound impact' on the treatment of participants in international insolvencies and the effect on jurisdictions in terms of risk and future investment and trading objectives⁹²¹ are significant incentives to finding solutions. The court must determine the law by a choice-of-law analysis of validity and distribution priorities. In international insolvency, the tendency is that one legal regime will govern the claim amount, while another legal regime will govern its distribution priorities. Nevertheless, the court in a territorialist jurisdiction will always choose its own law as the governing law to determine distribution priorities.⁹²² In the adjudication of claims, Westbrook argues that the inequitable

⁹¹³ Janger, above n277, 108.

⁹¹⁴ Westbrook, above n695, 2309.

⁹¹⁵ Janger, above n313, 447.

⁹¹⁶ Alexander J. Belohlavek, 'Centre of Main Interest (COMI) and Jurisdiction of National Courts in Insolvency Matters', 50(2) 2008 *International Journal of Law and Management* 53, 65.

⁹¹⁷ Dicey, Morris and Collins, above n53, 1629.

⁹¹⁸ Ibid, 1630.

⁹¹⁹ Westbrook, above n140, 625.

⁹²⁰ Dobah Care, 'Le Systeme Canadien et le Systeme Europeen', LLM Thesis, Universite de Montreal (June 2007).

⁹²¹ Paul J. Omar, 'The Landscape of International Insolvency Law', (2002) 11 *INSOL International Insolvency Review* 173, 198.

⁹²² Ibid.

distribution to creditors and unnecessary delay are avoided by parties subject to these claims. He further argues that cross-border insolvency must address:

- i. the need for harmonized effect of proceedings initiated in one state on assets located in another;
- ii. the need to share information and to promote cross-border judicial cooperation;
- iii. the need for creditor participation in insolvency proceedings; and
- iv. the need to predict which applicable law and which choice of forum will govern⁹²³

It may be further argued that in cross-border bank insolvency, the conflicts surrounding distributional outcomes and the debtor's COMI necessitates predictability in the governing choice of law and choice of forum.

'Without total clarity about this fundamental matter, so that parties dealing with a debtor are able at all times to identify the whereabouts of that party's proper forum of insolvency, there will be abundant potential for injustice through defeat of creditors' reasonable expectations as to the venue for any insolvency proceedings that might involve the debtor, and as to the system of law by which such proceedings would be governed'.⁹²⁴

In the past, a major characteristic of conflict of laws was that states developed individualistic solutions to the diverse problems caused by various sovereign states. This had the effect of creating numerous systems of conflicts of laws. Although there have been attempts to address this dilemma by use of multilateral treaties and conventions,⁹²⁵ there is no 'jurisdiction-neutral' model that provides a standard that tests the similarity of laws, and a mechanism whereby uniform treatment of creditors can be addressed. Furthermore, 'while the appeal of the universalist model has tended to gain favor among those seeking to produce a framework for international governance of international insolvencies, it has been necessary to find a realistic way of responding to the inescapable fact that the national laws of insolvency...remain diverse and unharmonized for the foreseeable future.'⁹²⁶

In *re Maxwell Communications Corp*⁹²⁷, the issue of which law was applicable to a bankruptcy preference instigated extensive litigation in the US and England. However, 'a clear choice of law rule incorporated into the state's insolvency system could have avoided the expense and delay of

⁹²³ Todler, above n899, 417.

⁹²⁴ Ibid.

⁹²⁵ Ian Fletcher, "L'Enfer, C'est Les Autres": Evolving Approaches to the Treatment of Security Rights in Cross-border Insolvency', *Texas International Law Journal* 489, 497.

⁹²⁶ Ibid.

⁹²⁷ *Re Maxwell Communications Corp plc* (No 2) [1992] BCC 757].

litigation'.⁹²⁸ The structure gave rise to dual insolvency proceedings: a Chapter 11 bankruptcy in the US and an administration in the UK.⁹²⁹ The US bankruptcy judge appointed an examiner to harmonize the two nations' insolvency laws for the benefit of all of Maxwell's creditors. After initial problems, this innovation enabled a high level of international cooperation and a significant degree of harmonization of the laws of the two countries. The *Maxwell* case demonstrated the effective and efficient outcomes of coordinated and collaborative judicial decision making to decide the governing law. The affected parties agreed to the scheme despite differences in the two nations' bankruptcy laws. The distribution mechanism which was established enabled Maxwell's assets to be pooled in their entirety and sold as going concerns, thereby maximizing the asset return to creditors. As there was no requirement for a creditor to file its claim in both jurisdictions, this eliminated much of the inefficiency typically prevalent in multi-jurisdiction proceedings. The US Court of Appeal stated that:

This collaborative effort exemplifies the "spirit of cooperation" with which tribunals, guided by comity, should approach cases touching the laws and interests of more than one country.⁹³⁰

In consideration of this, it may be argued that specific solutions to determining the priority scheme depend on the 'convergence of national laws, adoption of an international substantive rule, or adoption of an international choice-of-law, choice-of-forum rule.'⁹³¹ A combination of these approaches in an international insolvency regime may be a specific solution.⁹³² At present, the incoherence in international insolvencies destroys asset value because creditors are not treated uniformly, equitably and efficiently.⁹³³

Hence, this chapter has argued that although each jurisdiction has its own unique set of rules,⁹³⁴ the judicial preferences given to local creditors by courts are not adequate to enforce insolvency agreements. This has been a consistent barrier to implementation of an international insolvency convention⁹³⁵, and needs to be addressed. The conclusion of this thesis, in Chapter 7 will analyse a possible solution as to harmonization of insolvency proceedings, harmonization of laws in order to develop the principle of COMI, and a possible definition of the COMI of a cross-border bank.

⁹²⁸ *Re Maxwell Communications Corp plc* (No 2) [1992] BCC 757] at 392.

⁹²⁹ Janger, above n313, 454-456.

⁹³⁰ *Re Maxwell Communications Corp plc* (No 2) [1992] BCC 757].

⁹³¹ Westbrook, above n695, 2318.

⁹³² *Ibid.*

⁹³³ Elizabeth K. Somers, 'The Model International Insolvency Cooperation Act', (2011) 6(4) *American University International Law Review* 677, 70-701.

⁹³⁴ *Ibid.*, 594.

⁹³⁵ United Nations Enable, Chapter V: National Law and the Convention, Incorporating the Convention into Domestic Law, viewed at < <http://www.un.org/disabilities/default.asp?id=235>> on February 21, 2013.

8.4 The COMI of global systemically important financial institutions (G-SIFIs): the basis for a special principle of COMI

In consideration of the above factors that are relevant to defining and determining COMI, it is important to note that the most significant difference between cross-border bank insolvency from cross-border insolvency is the contagion effect and systemic consequences⁹³⁶ than can ensue from the failure of large, complex financial institutions which has been discussed in chapter 1. The presence of large numbers of retail bank depositors, the hundreds of thousands of businesses and consumers who rely on the continued existence of these institutions for their cash management, access to their working capital including the ability to pay wages and essential suppliers and other financial services,⁹³⁷ and the national government's guarantee of deposits distinguishes these institutions from all other institutions. The latter also makes them more sensitive to political interference.

It has been argued that COMI is a 'law of unintended consequences' with unforeseen cross-border jurisdictional and legal conflicts. It may be further argued that national regulatory regimes need to address the COMI in the insolvency of cross-border banks and in particular, global systemically important financial institutions (G-SIFIs) that are tightly regulated and subject to these regimes. In cross-border bank insolvency, it is imperative for national regulatory regimes to consider and address the severe financial distress that could ensue from the choice of the debtor's COMI, specifically in the context of cross-border banks that can easily shift and manipulate COMI advantageously. National banking regulatory regimes should anticipate and deal with these potential issues, and the unintended consequences of these issues.

In the case of cross-border bank insolvency, the determination of COMI would consider the common elements in the existing work of the Model Law and the future work in respect of the COMI of enterprise groups which is otherwise beyond the scope of this thesis. Arguably, the present economic climate has made the implications of cross-border bank insolvencies more detrimental than that of enterprise groups as illustrated by the global contagion from the most recent financial crises. Therefore, this thesis will further discuss how national regulatory regimes can address COMI in the final chapter (chapter 7).

⁹³⁶ Lastra, above n105.

⁹³⁷ Hupkes, above n142,

9. Conclusion

In conclusion, this chapter reiterates that the substantive differences in insolvency laws remains as a significant barrier to international and judicial cooperation.⁹³⁸ Furthermore, courts cannot rely on converging public policies which vary across jurisdictions⁹³⁹ nor the ambiguity in priority systems that is created by the different distribution methods for various beneficiaries.⁹⁴⁰ The objective of an international convention that encourages coordination in judicial decision-making can be significantly undermined by the obstacles to reaching international consensus and which determine the success or otherwise of a treaty.⁹⁴¹ Once ratified, an international convention would become part of a state's national legislation or treaty law, thereby potentially simplifying the procedures in complex cross-border insolvencies. This chapter argued that although a single international insolvency court and a single international insolvency law is the ideal, in consideration of national sovereignty, this is at present, not a realistic solution. The conflicts between jurisdictions surrounding COMI in relation to the priority scheme of creditors, is complicated by the legal systems and rules governing the proceedings and the allocated preferences.⁹⁴² While harmonization deprives national regimes of their sovereignty to implement policies in respect of creditor constituencies, the harmonization of insolvency laws may eliminate differences in priority schemes.⁹⁴³

Ultimately, the development of international legal rules must consider that, realistically, the same thinking can only produce the same results. In other fields, international legal rules are in place today that were seemingly not possible ten years ago, and would have been unimaginable ten years before that.⁹⁴⁴ The conclusion of the thesis will discuss these possible solutions, so as to bridge the gaps that the research questions have discovered.

⁹³⁸ John K Londot, 'Handling Priority Rules Conflicts in International Bankruptcy: Assessing the International Bar Association's Concordant', (1996-1997) 13 *Bankruptcy Developments Journal* 163, 165.

⁹⁴⁰ Westbrook, above n140, 508-9.

⁹⁴¹ Ibid.

⁹⁴² LoPucki, above n888, 158.

⁹⁴³ Westbrook, above n695, 2318.

⁹⁴⁴ Ibid.

CHAPTER 7: CONCLUSION

Chapter Overview

The main purpose of this chapter is to summarise the research, the critical issues that have been identified and analysed in answering the research questions which included the gaps that need to be addressed, and the potential solutions that have emerged.

The first section discusses the main jurisdictional conflict between national sovereignty and uniform outcomes.

The second section describes the research setting.

The third section articulates the main findings of the research, and further discusses the critical issues of the study in accordance with the research questions.

These are:

- i. What are the doctrinal perspectives and principles relating to COMI in international bank insolvencies?
- ii. What are the conflicts between national legal systems in international bank insolvencies concerning COMI?
- iii. What are the critical issues and the lacunas in the EU legal framework and the UNCITRAL Model Law on Cross-border Insolvency in respect of cross-border bank insolvencies?
- iv. How should these conflicts be resolved?

The implications of the research are discussed including the new knowledge that the research contributes regarding the legal frameworks of the EU Insolvency Regulation and the UNCITRAL Model Law on Cross-border Insolvency. The contribution to knowledge and suggested recommendations for future research ensuing from this study conclude this chapter.

7. Introduction

The territorial limitation of general insolvency laws of the home jurisdiction of an insolvent internationally active bank may produce many cross-border issues.⁹⁴⁵ Although ‘the function of private international law is complete when it has chosen the appropriate system of law’,⁹⁴⁶ the essence, nature and scope of private international law is not adequate to deal with the insolvencies of international banks. As private international law varies from country to country,⁹⁴⁷ this exacerbates the jurisdictional conflict in international bank insolvencies. In international bank insolvencies, the close connection between the conflicting issues and the jurisdiction in terms of territory or rules renders the law more difficult to apply as it is more difficult to resolve problems on an international scale and achieve both uniform outcomes and fairness to creditors.⁹⁴⁸ Generally, the various branches of an international bank will have a close connection with its territory and rules in a multi-jurisdictional context.

In international bank insolvency, when there is a banking crisis, the principle of territorial sovereignty of other states can be overridden by governments interested in the assets and liabilities of the international bank.⁹⁴⁹ While national governments are the principal regulators of international finance and the makers of international policies,⁹⁵⁰ nationalistic self-interest can cause major difficulties when attempts are made to arrive at uniform and fair conflict of laws solutions.⁹⁵¹ In international bank insolvencies, this limitation is also influenced by the political function of courts in determining the jurisdiction to commence insolvency proceedings.⁹⁵² In international bank insolvencies,

‘in the absence of political cooperation between states by treaty or convention, the ad hoc and pragmatic techniques applied by courts may not be workable if the domestic court does not recognise or permit the enforcement of the foreign judgement or law, if the application of foreign law causes conflicts, and if national interests are seen to supersede international concerns.’⁹⁵³

⁹⁴⁵ Eirwin Nierop & Mikael Stenstrom, European Central Bank, ‘*Cross-border Aspects of Insolvency Proceedings for Credit Institutions- A Legal Perspective*’, International Seminar on Legal and Regulatory Aspects of Financial Stability, June 21-23, 2002, 4.

⁹⁴⁶ Ibid.

⁹⁴⁷ J.J. Fawcett, J. M. Caruthers, Sir Peter North, ‘Cheshire, North & Fawcett: Private International Law’ (Oxford University Press, 2008), 8.

⁹⁴⁸ Nierop & Stenstrom, above n950, 4.

⁹⁴⁹ Qureshi & Ziegler, above n60, 363.

⁹⁵⁰ Ibid.

⁹⁵¹ Dicey, Morris and Collins, above n53.

⁹⁵² Ibid.

⁹⁵³ Ralf Michaels, ‘Recognition and Enforcement of Foreign Judgements’, Max Planck Institute of Public and International Law, *Max Planck Encyclopedia of Public International Law*, (Oxford University Press, 2009), 1.

This adverse consequence of the jurisdiction being able to select rules tends to benefit certain interests to the detriment of others.⁹⁵⁴ The consequence stems from the analysis of the banking group in terms of general jurisdiction which regards states interests as relevant to private international law. This approach examines the relationship between the state and the banking group, and questions whether the exercise of jurisdiction over the group can be justified, in terms of state policy or political rights.⁹⁵⁵ One shortcoming of this approach is that it does not consider the complexity, conflicts and difficulties prevalent in international bank insolvencies or their complex legal structures which may be formed to evade state policy.⁹⁵⁶ The recent, large international bank insolvencies demonstrated that an international approach to private international law is needed that is less conceptual, more economically efficient, more predictable, and more unified.

7.1 Outline of the Research Setting

Internationally, the progress towards a solution to the problems of non-harmonization arising from the cross-border insolvency of international banks is gaining increasing momentum. However, the EU Insolvency Regulation and the Model Law have still not addressed the cross-border aspects of large, complex financial institutions within their scope. The differences in substantive law between national regimes occur because of the economic structure of the market (Chapter 1), the underlying policies of the legal systems (Chapter 2), the order of private law, and the protected interests in the system of insolvency law (Chapters 3, 4, 5 and 6).⁹⁵⁷ The doctrinal perspectives of universalism and territorialism are unable to solve the complex cross-border aspects of international bank insolvencies and the conflicts arising from them.

In consideration of this, the main purpose of this research was to discover the issues of non-conformity and suggest an international legal instrument to resolve the conflicts between jurisdictions in cross-border bank insolvencies concerning COMI, home and host country conflicts, and the distributional outcomes to creditors. In addition, other significant issues concerning the gaps in the EU Insolvency Regulation and the Model Law in addressing large, complex financial institutions have also been discovered and examined in this study. Foremost, the significance of maintaining international coordination and cooperation by all nations has been included as a major objective of this research. The numerous case studies of globally systemically important financial institutions illustrate the importance of this factor in resolving jurisdictional conflicts.

⁹⁵⁴ Ibid.

⁹⁵⁵ Ibid.

⁹⁵⁶ Ibid.

⁹⁵⁷ Wessels, above n43, 5.

While the issue of cross-border insolvency has been extensively studied, the cross-border insolvency of international banks has been less so. At present, none of the research has attempted to address the jurisdictional conflicts in international bank insolvencies. Therefore, this research aims to investigate the various conflicts that arise from the cross-border aspects of international bank insolvencies, and demonstrate why these must be addressed in the revision and reform of international insolvency law. The interpretation of the principle of COMI is also utilised to resolve the conflicts surrounding COMI in cross-border bank insolvencies.

7.2 The Main Findings of the Research

This thesis (Chapters 3, 4, and 5) examined the principle of COMI in international bank insolvencies, the role of private international law in determining international jurisdiction, and the complex issues of law that arise from COMI in cross-border bank insolvency proceedings. This has been further addressed by the discussion of COMI in the EU Insolvency Regulation and the UNCITRAL Model Law on Cross-Border Insolvency (Chapters 4 and 5), as well as the doctrinal perspectives of universalism, territorialism, and modified universalism.

Historically, the universalist system has been linked to the predictability of insolvency regimes and the protecting of creditors expectations.⁹⁵⁸ Through the evaluation of both perspectives (Chapters 2, Chapter 5), this study has shown that the universalist approach of one forum and one law (Chapter 6), utilising a single insolvency procedure⁹⁵⁹, is the ideal system for addressing the conflicts arising from COMI in international bank insolvencies.

The research has demonstrated that the concept of universalism is, theoretically, the more desirable and simpler doctrinal approach in the academic debate. Furthermore, the legal literature tends to generally, not advocate the principle of territoriality and the majority of academic scholars and commentators favour the universalist doctrinal approach in this debate.⁹⁶⁰ However, the problem of unification of all private international laws would be required for universalism to truly work.⁹⁶¹ In reality, the success of this solution is complicated, if not made impossible by the issue of national sovereignty, since nation states would be required to cede their territorial interests for one single governing forum and law. However, this is not to say that universalism cannot succeed as exemplified by the Court of Justice dealing with war crimes and crimes against humanity.

⁹⁵⁸ Garrido, above n130, 463.

⁹⁵⁹ Ibid, 469.

⁹⁶⁰ Ibid, 469.

⁹⁶¹ Ibid, 470.

However, there are very few international instruments that deal with cross-border insolvency.⁹⁶² The doctrine of comity (which is the guiding principle for the COMI concept) is seemingly ineffectual in resolving conflicts between jurisdictions when national sovereignty is at stake. Ironically, the comity doctrine originated as an attempt to reconcile the concept of national sovereignty with the ongoing practice of applying foreign law in applicable cases (chapter 3).⁹⁶³ In alignment with the objectives of comity, the principles of cooperation and coordination between nation states are needed to ensure that the courts reach a practical and equitable solution in conflict avoidance, in otherwise potentially complex cross-border insolvency cases (chapter 6).⁹⁶⁴ This study has shown that the path towards universalism has been paved by the private international law principles of unity and universality of the EU Insolvency Regulation⁹⁶⁵ and the modified universalist approach of the Model Law, and the development of COMI within these frameworks. The strengths and weaknesses of these two international insolvency regimes have been identified and examined in terms of the implications of COMI (Chapters 4 and 5), in order to identify the gaps in the frameworks concerning the cross-border insolvency of international banks.

The study furthermore has shown that the failure of an international bank creates conflicts in insolvency laws as well as jurisdictional conflicts between courts in the application of those laws. As indicated in Chapter 2 of this study, the COMI of a multinational bank in a cross-border insolvency determines which court has jurisdiction to open the main insolvency proceedings and, consequently, the law applicable to such proceedings.⁹⁶⁶ This study has shown that when the conflicts between jurisdictions increase, the difficulties of determining the COMI are exacerbated. In international bank insolvencies, significant assets and liabilities are at issue, and there are competing local interests where there is likely to be a contest over home country status.⁹⁶⁷ Additionally, this study has examined the complex issues of law concerning COMI when a cross-border bank with banking activities operates in different jurisdictions in insolvency proceedings. It is becoming increasingly likely that a bank in financial distress will have operations in various jurisdictions.⁹⁶⁸ In the determination of COMI in cross-border bank insolvency, the research indicates that such choice of law problems still continue within the jurisdictions that have adopted the COMI standard according to the EU Insolvency Regulation and the Model Law.

⁹⁶² Clift, above n525, 309.

⁹⁶³ Pearce, above n190, 526.

⁹⁶⁴ Wessels, above n43, 18.

⁹⁶⁵ Bank of International Settlements, above n2, A40.

⁹⁶⁶ Menjucq & Dammann, above n8.

⁹⁶⁷ Ibid, 50.

⁹⁶⁸ Campbell, above n195, 1.

In international bank insolvencies, there is also the potential conflict that arises when national supervisory authorities are likely to focus on domestic interests.⁹⁶⁹ The self-interest of national regimes can have adverse repercussions on the distributional outcomes of international bank insolvencies. Once COMI has been determined, the issue of conflicting supervisory approaches between the home and host countries of cross-border banks arises. The numerous cases concerning the failure of large, complex financial institutions such as *Bank of Credit Commerce International*, *Lehman Brothers* and *Stanford International Bank* demonstrate that conflicts between national legal systems are easily created by complex legal structures of international banks, between the various jurisdictions (Chapters 3, 4 and 5).

The conflicts arising from differences between legal systems pursuing the same objectives in insolvency law⁹⁷⁰ are largely dominated by the concept of national territorial sovereignty. Therefore, in order to implement effective international policies, the most significant obstacle to overcome is the conflict between national sovereignty and international agreement (Chapter 6). At a critical point when national interests override international objectives, the conflicts consistently remain problematic, with little potential for the creation of solutions. These conflicts have exposed the need for standard international rules to govern the failure of banks and financial institutions⁹⁷¹ and to effectively deal with the challenges posed by COMI. The main findings which the study identified and examined will be summarised firstly, in respect of the EU Insolvency Regulation and secondly, the Model Law. Many countries within the EU have not adopted the Model Law.

At present, if a debtor has its COMI outside of the EU, courts of the individual Member States have the discretion to decide whether a foreign proceeding or representative should be recognised.⁹⁷² This study has discovered that, by not addressing the cross-border insolvency of corporate groups and financial groups in particular, this exacerbates the legal problems associated with group insolvency cases involving assets and liabilities in more than one EU Member State.⁹⁷³ Although the EU Insolvency Regulation is leading the reform of approaches to cross-border insolvency, this study identified that the implementation of its Article 3(1) and the principle of COMI as a ground for opening main insolvency proceedings, can create significant problems for cross-border bank insolvencies. As indicated, Article 3(1) of the Directive concerns international regulatory authority and the principle of unity. Exclusive jurisdiction is provided to the home Member State's judicial or

⁹⁶⁹ International Monetary Fund, above n18, 11.

⁹⁷⁰ Giorgio Corno, 'Cross-Border Insolvency: the EU Community Law Approach', (2003) 1 *Business Law International* 3.

⁹⁷¹ Krimminger, above n336, 379.

⁹⁷² Laura Bolger, 'No Frontiers: An Analysis of the EC Regulation and the UNCITRAL Model Law on Cross-border Insolvency', July 2012 viewed at <http://www.consulegis.com/wp-content/uploads/2013/06/Laura.Bolger_Paper.pdf> on June 3rd, 2013.

⁹⁷³ *Ibid*, 757.

administrative authorities to decide on the implementation of bank reorganisation. The assets of the bank in its home Member State include the assets of branches in a host state jurisdiction.⁹⁷⁴ All worldwide creditors can prove their claims in the unified proceeding.⁹⁷⁵ The theory of universalism posits that COMI can work only when there is one court to open a single set of insolvency proceedings, leading to a worldwide insolvency proceeding. However, the determination of a specific COMI for each individual firm is impractical in the case of international banks. These financial groups have operations in different jurisdictions and can engineer insolvency proceedings in the most attractive jurisdiction; allowing forum shopping to occur. There is also the risk that several courts will take on insolvency jurisdiction in a particular case on the basis of different interpretations of Article 3(1).⁹⁷⁶ Although the Directive outlines a set of private international law rules regarding cross-border bank insolvency, there are no international harmonized standards for banks.⁹⁷⁷

This study acknowledged that the shortcomings of the EU Winding Up Directive in terms of its scope, for example in its exclusion of subsidiaries; failures in procedure; and failings in substance such as the disparity that exists at national level in the form and substance of insolvency law, lend themselves to a less than optimal cross-border insolvency regime.⁹⁷⁸ Since the onset of the recent financial crisis, the limited scope of the EU Directive to deal with the subsidiaries of a cross-border banking group has been a significant gap in the EU legal framework. The European cases relating to applying COMI all involve subsidiaries of corporate groups indicating how significant the problem is.⁹⁷⁹ Furthermore, the landmark European cases of *Enron Directo Sociedad Ulimitada*⁹⁸⁰, *Eurofood IFSC Ltd*⁹⁸¹, and *Daisytek*⁹⁸² illustrate the difficulty of applying COMI involving subsidiaries in corporate groups. When large, complex financial institutions with numerous branches and operationally integrated subsidiaries complicate the insolvencies,⁹⁸³ the EU legal framework does not have adequate mechanisms to deal effectively and efficiently with cross-border aspects of the financial group and consequently, results in hampering the effectiveness and efficiency of the resolution of these issues.

When there are many subsidiaries, as in the case of international banks, secondary proceedings can be opened in different jurisdictions; multiple office-holders can result and cause the office-holders in the

⁹⁷⁴ Ibid, 305.

⁹⁷⁵ Ibid, 306.

⁹⁷⁶ Omar, above n347, 177.

⁹⁷⁷ *European Union Insolvency Regulation, No. 1346/2000* of 19 May 2000 on Insolvency Proceedings, (entered into force on 31 May 2002).

⁹⁷⁸ Coleton, above n71, 74.

⁹⁷⁹ Westbrook, above n101, 326.

⁹⁸⁰ *Enron Directo Sociedad Limitada* (unreported case and judgement).

⁹⁸¹ *Re Eurofood, IFSC Ltd* [2005] BCC 1021.

⁹⁸² *Re Daisytek* [2003] BCC 562.

⁹⁸³ Ibid.

main proceeding to lose their grip on the foreign assets and operations.⁹⁸⁴ Furthermore, sweeping the COMIs of local subsidiaries into a single jurisdiction can severely prejudice the rights of affected parties.⁹⁸⁵ The exclusion of subsidiaries of international banks from the Directive will not promote the coordination and cooperation between home and host supervisory authorities in bank crisis resolution which have conflicting measures and interests. The research has shown that in the EU, there is disparity in the treatment of subsidiaries of international banks in domestic regimes.⁹⁸⁶ The ramifications of this disparity include the re-organisation of a complex cross-border bank which might be difficult in the absence of clear agreements between national authorities regarding the resolution of foreign subsidiaries.⁹⁸⁷

This study has also shown that in the EU Insolvency Regulation, significant conflicts are created by the lack of a specific provision to address the question if and when two different courts in two different Member States both open main proceedings, both equally convinced that the COMI is in their respective jurisdiction.⁹⁸⁸ As indicated, this has international implications when most national insolvency systems such as the United States, United Kingdom and Canada claim jurisdiction over the assets of a filing debtor wherever located, including assets located in different jurisdictions (Chapter 2).⁹⁸⁹ This was illustrated when multiple foreign proceedings were filed, including the main proceeding of Lehman Brothers International Europe (LBIE) which controlled most of Lehman's European assets.⁹⁹⁰ In consideration of the above findings, the EU legal framework needs to address these gaps for greater effectiveness, efficiency, and legitimacy in international bank insolvencies within the EU. The current world economy and the sovereign insolvency within Europe are further reasons to strengthen the case for addressing, in particular, international financial groups such as international banks within the legal framework.

The research identified why the absence of a definition of COMI creates uncertainty, unpredictability and unforeseen conflicts in cross-border bank insolvency proceedings. The uncertainty surrounding rebutting the presumption that is incorporated in the Model Law, the conflicting factors that are utilised by recognising jurisdictions to establish the COMI and the time at which the recognising jurisdictions determine COMI⁹⁹¹ contribute to the ambiguity of the definition of COMI (Chapter 3).

⁹⁸⁴ Tollenaar, above n350, 66.

⁹⁸⁵ *Ibid.*, 68.

⁹⁸⁶ Westbrook, above n101, 326.

⁹⁸⁷ Michael Krimminger, 'Banking in a Changing World: Issues and Questions in the Resolution of Cross-border Banks', 2005 viewed at <<http://chifl.shufe.edu.cn/upload/htmleditor/File/120331104212.pdf>> on June 10, 2013. See also footnote 77.

⁹⁸⁸ Wessels, above n132, 19.

⁹⁸⁹ Wood, above n133, 50-51.

⁹⁹⁰ *Ibid.*

⁹⁹¹ Judith Wade, 'The Centre of Main Interests Connecting Factor Affords creditors no certainty under the Model Law Regime', (2011) 22(3) *International Company and Commercial Law Review* 102, 103.

When creditors do not know the potential recognising jurisdiction, the objective of the COMI principle to provide creditors with certainty and foreseeability⁹⁹² is significantly undermined. As financial and banking groups are regulated differently in each of the jurisdictions in which its entities are registered, the application of a group COMI could potentially prejudice creditors in various jurisdictions who receive vastly different treatment.⁹⁹³ The research indicates that these variations hinder international harmonization⁹⁹⁴ when the differences in the priority schemes of creditor ranking between jurisdictions are seemingly irreconcilable.

In consideration of the uncertainty and ambiguity surrounding a definition of COMI, and as at present, the determination of a debtor's COMI is the most litigated issue in cross-border insolvency,⁹⁹⁵ this study explored the growing body of decisions that have developed in countries in which the EU Insolvency Regulation or the Model Law are implemented. While some courts determine COMI based solely on the presumption that the registered office is the COMI, other jurisdictions review the specific facts and circumstances of a debtor's operations to determine if the registered office is the COMI or if the COMI is where the primary business operations are conducted, the primary decisions are made, and which is readily ascertainable by creditors.⁹⁹⁶

The absence of a definition of COMI has resulted in uncertainty, unpredictability and unforeseen conflicts in insolvency proceedings (Chapter 3). In international bank insolvencies, it is critical that:

‘international jurisdiction be based on a place known to the debtor's potential creditors. This enables the legal risks which would have to be assumed in the case of insolvency to be calculated.’⁹⁹⁷

The uncertainty surrounding the rebuttal of the presumption that is incorporated in the Model Law, the conflicting factors that are utilised by recognising jurisdictions to establish the COMI, and the time at which the recognising jurisdictions determine COMI,⁹⁹⁸ contribute to COMI's ambiguity. The different interpretations of the rebuttable presumption and the regularity with which the various jurisdictions apply it undermine the certainty. This difficulty is exacerbated in international bank insolvencies because at the time creditors extend their credit, they will not know the recognising

⁹⁹² United Nations Commission of International Trade Law, Working Group V (Insolvency Law) Forty-first session, New York, 30 April-4 May 2012, UN Doc. No. A/CN.9/WG.V/WP.103/Add.1, ‘Interpretation and application of selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to centre of main interests (COMI), 123G, 5.

⁹⁹³ Allan L. Gropper, ‘The Payment of Priority Claims in Cross-border Insolvency Cases’, 46 (2011) *Texas International Law Journal* 559, 561.

⁹⁹⁴ Westbrook, above n663, 31.

⁹⁹⁵ Janger, above n277, 410.

⁹⁹⁶ *Ibid*, 24-25.

⁹⁹⁷ Virgos & Schmidt, above n197.

⁹⁹⁸ Wade, above n568, 103.

jurisdiction and thus, which view of the presumption will prevail. This conflicts with an important objective of COMI: to provide certainty for creditors at the time that they enter into a transaction.⁹⁹⁹ Secondly, it is extremely difficult to have a uniform interpretation for COMI that would provide a certain solution to the issue of determining the forum for the opening of insolvency proceedings in the case of an international bank consisting of many international and integrated connections.¹⁰⁰⁰ This provides creditors with little assurance that the presumption of COMI will not be displaced by evidence that it is in a different jurisdiction from what they had expected.

International banks operating through foreign branches and subsidiaries dealing with international transactions, as well as multi-bank syndicates comprising banks from many countries,¹⁰⁰¹ have complicated the determination of COMI. In respect of this, Garrido argues that:

It is extremely difficult to find a completely predictable rule, uniformly interpreted, that would provide a totally certain solution to the problem of determining the forum for the opening of insolvency proceedings in the case of debtors with multiple international connections. The complexity of the connecting factors that are taken into account for the determination of the centre of main interests, and the high likelihood that there are international elements in the connecting factors, increase the difficulties in the determination of the appropriate insolvency regime.¹⁰⁰²

The research indicates that the current lack of a clear definition of COMI in the Model Law has significant implications for international bank insolvencies. As there is no statutory definition of COMI,¹⁰⁰³ the COMI shifts of a cross-border bank can be manipulated. When COMI shifts do not contribute to maximising the debtor's net assets, but evidently benefit the debtor at the expense of creditors, it constitutes an abuse of law.¹⁰⁰⁴ One way of achieving this is by the debtor shifting its COMI to a more attractive regulatory regime on the eve-of-bankruptcy. The differences in insolvency regimes mean that certain jurisdictions, such as pro-debtor regimes, will be more attractive to the debtor than others.¹⁰⁰⁵

⁹⁹⁹ United Nations Commission of International Trade Law, Working Group V (Insolvency Law) Forty-first session, New York, 30 April-4 May 2012, UN Doc. No. A/CN.9/WG.V/WP.103/Add.1, 'Interpretation and Application of Selected Concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to Centre of Main Interests (COMI), 123G, 5.

¹⁰⁰⁰ Garrido, above n130, 462.

¹⁰⁰¹ Moss & Segal, above n230.

¹⁰⁰² Ibid.

¹⁰⁰³ COMI is not defined in the Model Law, EU Regulation, Chapter 15 of the US Bankruptcy Code or Chapter 47 of the Statutes of Canada 2005.

¹⁰⁰⁴ Eidenmuller, above n147, 1.

¹⁰⁰⁵ Webb and Butler, above n243.

In respect of change in COMI, the change of registered office is unlikely to result in a genuine shift of COMI because the presumption that the COMI is the location of the head office is rebuttable on evidence.¹⁰⁰⁶ However, COMI can be shifted by the migration of assets and liabilities to another jurisdiction if the transfer of the assets and liabilities is valid as a matter of law in both the original and new jurisdictions. The study identified that the shift to a new applicable insolvency regime should be made with the consideration that the new COMI are where creditors would be best protected. Nevertheless, there have been cases in which the shifting of COMI amounts to an abuse of freedom of establishment. In the case of cross-border banks, there is also the potential for eve-of-bankruptcy reincorporation to occur as the highly liquid assets of a bank are readily movable. Eve-of-bankruptcy asset transfers and intra-debtor transfers that exploit the choice of law rules of territorialism¹⁰⁰⁷ can also shift COMI to the detriment of creditors such as in the case of *Bank of Credit and Commerce International*¹⁰⁰⁸ which moved its headquarters to Saudi Arabia before the bank filed for bankruptcy (Chapter 3). In this case, the shift of COMI was not an attempt to forum shop for bankruptcy law, but an attempt to flee personal criminal jurisdiction.¹⁰⁰⁹

In light of the main findings, there is a current lack of harmonization in respect of choice of laws rules and the priority system of creditors which then reduces the predictability of outcomes in insolvency proceedings.¹⁰¹⁰ When many States include exceptions to the application of the *lex concursus*, it undermines the harmonisation that the Model Law seeks to achieve. As indicated, the Model Law does not address the substantive law applicable to key transactions or assets, but leaves these issues to the national laws of the jurisdiction. The UNCITRAL Legislative Guide stated that:

The application of an exception to the *lex concursus* for insolvency effects may result in disparate treatment of the insolvency effects on similarly situated creditors “merely because the different applicable law governs their rights and claims”. The approach of the Legislative Guide [of the Model Law] has been stated to ‘result in an unfortunate treatment of creditors and it seems – in the light of the history of the EU Insolvency Regulation – unrealistic to expect that countries will actually restrain themselves from providing for additional exclusions.’¹⁰¹¹

The Model Law permits secondary proceedings in each jurisdiction and allows the turnovers of the to the main proceeding for distribution. This suggests that the primary court would decide distribution

¹⁰⁰⁶ *Re Stanford International Bank*, [2009] EWHC 1441 (Ch).

¹⁰⁰⁷ *Re Stanford International Bank*, [2009] EWHC 1441 (Ch) at 800.

¹⁰⁰⁸ *Bank of Credit and Commerce International SA* (No 9), Re [1994] 3All ER 784.

¹⁰⁰⁹ Pottow, above n182, 799.

¹⁰¹⁰ European Parliament Report, Recommendations to the Commission on Insolvency Proceedings in the Context of EU Company Law, (2011/2006(INI)), Motion for a European Parliament solution, 17 October 2011, AB.

¹⁰¹¹ Wessels, above n43, 220.

according to its choice of law rules or a protocol agreed to by the relevant courts.¹⁰¹² The primary court is allowed to subject relief to the conditions that they deem appropriate,¹⁰¹³ and may pay special attention to the adequate protection of national creditors.¹⁰¹⁴ The Model Law makes an explicit point of the protection of local creditors which is directly connected to the question of priorities.¹⁰¹⁵ However, in practice, 'it is extremely unlikely that two priority systems would be completely identical.'¹⁰¹⁶

There is also the possibility that no connection exists between the assets that are distributed by the domestic court and the creditors who would benefit from such a distribution.¹⁰¹⁷ The distribution to certain categories of creditors is inextricably linked¹⁰¹⁸ with insolvency proceedings. This was illustrated in *Lehman Brothers* when US\$8 billion of funds were transferred from London to New York during the weekend that Lehman's filed insolvency proceedings in both jurisdictions (Chapter 5). The lack of connection between the assets and the creditors was also evident in the *HIH* case (Chapter 5).¹⁰¹⁹ Furthermore, the priority conflicts in international bank insolvency are exacerbated when secondary proceedings are opened in these cases. Although 'the purpose of a secondary proceeding is to allow local creditors of a foreign debtor the opportunity to open an insolvency case in their native country',¹⁰²⁰ the opening is likely to result from the priority conflicts among creditors in an international insolvency.¹⁰²¹

The divergence between the main priority rules in the main and secondary proceedings creates further conflict.¹⁰²² Other factors relevant to international bank insolvencies concern the ambiguity in the recognition of foreign priorities in a main proceeding, the application of foreign law in granting relief to petitioners¹⁰²³ and whether the priorities in the main proceeding need to be recognized in a secondary proceeding.¹⁰²⁴ In international bank insolvencies, the opening of parallel proceedings in various jurisdictions also creates difficulties when creditors who are the beneficiaries of a domestic priority assert their rights to priority in distributions. The inflexibility of the domestic insolvency

¹⁰¹² United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 25-27.

¹⁰¹³ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 22(2).

¹⁰¹⁴ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 21(2).

¹⁰¹⁵ United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Part 2, paragraph 20(d).

¹⁰¹⁶ Garrido, above n130, 479; Frederick Tung, 'Is International Bankruptcy Possible?', 23 (2001) *Michigan Journal of International Law* 31, 45-6.

¹⁰¹⁷ *Ibid.*, 606.

¹⁰¹⁸ *Ibid.*

¹⁰¹⁹ *Ibid.*, 610.

¹⁰²⁰ Pottow, above n522, 580.

¹⁰²¹ *Ibid.*, 584.

¹⁰²² *Ibid.*, 599.

¹⁰²³ Ho, above n215, 655.

¹⁰²⁴ Westbrook, above n719, 869-870.

laws of each jurisdiction may further impede harmonization and cooperation efforts¹⁰²⁵ when regimes apply territorialism to further national sovereignty.

In consideration of the factors that are relevant to defining and determining COMI, it is important to note that the most significant difference between cross-border bank insolvency from cross-border corporate insolvency is the contagion effect and systemic consequences¹⁰²⁶ that can ensue from the failure of large, complex financial institutions (Chapter 1). These institutions are distinguished from all other institutions by their large numbers of retail bank depositors, usually hundreds of thousands, the hundreds of thousands of businesses and consumers who rely on the continued existence of these institutions for their cash management, access to their working capital including the ability to pay wages and essential suppliers and other financial services,¹⁰²⁷ and the national government's guarantee of deposits. The latter also makes them more sensitive to political interference.

It has been argued that COMI is a law of unintended consequences with unforeseen cross-border jurisdictional and legal conflicts. It may be further argued that national regulatory regimes need to address the COMI in the insolvency of cross-border banks. In cross-border bank insolvency, it is imperative for national regulatory regimes to consider and address the severe financial distress that could ensue from the choice of the debtor's COMI, specifically in the context of cross-border banks that can easily shift and manipulate COMI advantageously. National banking regulatory regimes should anticipate and deal with these potential issues and the unintended consequences of these issues. This is a possible direction for future research.

In the case of cross-border bank insolvency, one of the solutions concerning the determination of COMI would consider the common elements in the existing work of the Model Law and the future work in respect of the COMI of enterprise groups, including the revision of the EU Insolvency Regulation, which is otherwise beyond the scope of this thesis. Arguably, the present economic climate has made the implications of cross-border bank insolvencies a matter of urgency to be resolved and the instrument of an international convention a necessity for the resolution of competing priority claims.¹⁰²⁸

At present, the 1968 *Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters*¹⁰²⁹ is the instrument closest to harmonization at the EU level. It took 32

¹⁰²⁵ Westbrook, above n695, 2307.

¹⁰²⁶ Financial Crisis Inquiry Commission Report, above n16, xxi.

¹⁰²⁷ Corrigan, above n1, 3.

¹⁰²⁸ Harry Rajak, 'The Harmonisation of Insolvency Proceedings in the European Union', World Bank Global Forum on Insolvency Risk Management, Washington DC, 2003.

¹⁰²⁹ *Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters* (27 September 1968).

years for this convention to be part of EU regulations. Since the global financial crisis in 2008, and the subsequent sovereign debt crisis in Europe, a mere decade is far too long this time for resolution of the legal issues mentioned in this study to occur. The world economy is still recovering from the most recent crisis, albeit with continuing instability. The contagion effects from international bank insolvencies (Chapter 1) that were a significant detrimental and unpredictable factor are still prevalent in parts of the globe today. As indicated in the introduction, a major objective of this study is to provide the theoretical framework on which solutions can be based that will resolve the conflicts between jurisdictions including that of COMI and competing priority claims.

This thesis has argued that the implications of cross-border bank insolvencies need to be addressed at the international level. Case law has clearly shown that neither domestic regimes nor domestic insolvency laws have been adequate in addressing these issues. With hindsight, the magnitude of the most recent international bank insolvencies, which were a significant factor in triggering the global financial crisis, is now understood to be too complex, too perplex, and too large to be resolved within domestic regimes. If these implications, conflicts between jurisdictions and the gaps identified in this study are ignored, then the same problems will persist and continue. It is argued that there is far too much at stake to wait for another global financial crisis to address these cross-border problems. If this occurs, then arguably these problems will become even more deeply embedded in future international bank insolvencies, producing greater economic inequity within domestic regimes, and the ramifications of which would instigate greater financial and economic suffering globally.

The ramifications of international bank insolvencies, as evidenced in 2008, are reflect the reality of the times. International insolvency regimes such as the EU Insolvency Regulation and the Model Law must consider this fact in their revision and reform. This can be achieved by implementing greater harmonization in insolvency and, first and foremost, by addressing the cross-border problems with foresight and the benefit of the lessons learned from hindsight.

7.3 The Contribution to Knowledge

This study will contribute to the reconciliation of conflicting differences between legal doctrinal and policy fields, and national legal systems in respect of international bank insolvencies, and assist the greater predictability and certainty of determining COMI. It will further develop knowledge of insolvency law frameworks by evaluating the impact of the UNCITRAL Model Law and the EU Insolvency Regulation, and of the utility of a movement towards uniform national laws and procedures. It is important to identify the impact to resolve some of the issues in the academic debate regarding universalism and territorialism concerning COMI and the cross-border aspects of international bank insolvency. This is highly relevant to understanding legal frameworks and their

effectiveness in various jurisdictions, and the quest for consistency and fairness of outcomes. This contributes to academic knowledge by presenting internationally-themed solutions between opposing theoretical viewpoints in the harmonization of laws. Hence, it adds to the knowledge of international bank insolvency law, international insolvency law, and private international law, and their methodology.

This study will also contribute by presenting recommendations with the potential to assist international insolvency law revision and reform, policy development, and harmonization of laws and legal principles by assisting in the reconciliation of conflicting laws and ensuring predictability and consistency of outcomes in these fields and in respect of the determination of COMI and the distributional outcomes from the priority ranking of creditors in conflicting legal systems. It is generally agreed that national regulation of corporate groups in cross-border insolvencies should be aligned and consistent in as many jurisdictions as possible.¹⁰³⁰

This thesis will make a practical contribution by addressing these concerns and showing how greater harmonization of laws can be achieved in international insolvency regimes through the legal instrument of an international convention. An effective and reliable international insolvency regime also needs to consider the commercial and economic reasons for constituting corporate groups such as international banks. This, in turn, requires further clarification of how corporate groups are seen in law: are they a series of separate legal entities or a single economic enterprise? This entity-enterprise dichotomy is compounded by the inefficiency of current international insolvency processes which need further reform. It is intended that this thesis will contribute to further reform by addressing why coordination and cooperation is imperative in cross-border bank insolvency cases and why the lack of this hampers efficiency. The global financial crisis has led to an increasing number of international bank insolvencies so that the resolution of these issues requires further attention. The findings of this study will be relevant to ensuring greater equity, fairness and justice to creditors and others with interests in companies in a group, greater certainty in international insolvency law and in the regulation of international banks, and better regulatory practices and policy. These practical contributions may extend to the further harmonization of common and civil law,¹⁰³¹ and lead to greater predictability which may further improve the efficiency of firms across both systems.

¹⁰³⁰ Irit Mevorach, *Insolvency in Multinational Enterprise Groups* (2009), 49.

¹⁰³¹ Mevorach, above n4, 427-448.

7.4 Implications of the Research

The major implications of this research address significant cross-border aspects of international bank insolvencies concerning COMI and the distributional outcomes ensuing from this that have not been previously examined in detail.

Firstly, in lieu of short-term solutions to the conflicts between jurisdictions arising from COMI and the priority ranking of creditor schemes, the long-term solution of harmonization of laws and legal principles, needs to be addressed. The implementation of short-term solutions will prolong the conflicts in international bank insolvencies, and only a long-term solution can adequately address these conflicts. Where appropriate, the harmonization of laws and legal principles would contribute to ensuring the much needed certainty and stability by enabling creditors and other parties to better predict the governing law.¹⁰³² The uncertainty and instability has been and continues to be problematic when international insolvency regimes are confronted with international bank insolvency cases.

A realistic goal is the agreement of principles to determine which jurisdiction's laws govern circumstances, together with mutual recognition of the domestic insolvency regimes and laws.¹⁰³³ It has been stated that 'an insolvency regime may require the application of many fundamental private law principles; and a convention on bankruptcy, to be meaningful, may need the participating states to concede that such disputes in their country may be resolved by quite different principles from those which apply in domestic disputes.'¹⁰³⁴ As a multinational bank operates as an integrated global unit,¹⁰³⁵ there also needs to be consideration of operating principles in legal regimes that guide a determination or the way to proceed during insolvency.

Secondly, this research discovered that in international bank insolvency, the legal instrument of an international convention is needed to enforce potential solutions and encourage further harmonization in international insolvency regimes. The significance of international treaties has long been recognised.¹⁰³⁶ From a theoretical point of view, it may be argued that a legal instrument that is capable of enforcing legal principles is at least the only solution. In traditional private international law, harmonization may not be achievable in consideration of the politics of national autonomy.¹⁰³⁷ Many arguments have been put forward concerning the impact of insolvency in its economic

¹⁰³² Richard Garnett, 'International Arbitration Law: Progress Towards Harmonisation', (2002) 3 *Melbourne Journal of International Law* 400.

¹⁰³³ Rajak, above n1033, 7.

¹⁰³⁴ *Ibid*, 5.

¹⁰³⁵ Hupkes, above n468, 14.

¹⁰³⁶ *Ibid*, 5.

¹⁰³⁷ Garnett, above n1021, 410.

ramifications on society and the consequence of addressing the negative externalities, through the harmonization of rules.¹⁰³⁸ In cases of international bank insolvencies, the enforceability of laws and legal principles is paramount to obtaining fairness and efficiency of outcomes. The concept of an international convention is a mechanism by which national sovereignty and international policies have the potential to reach international agreement. The major jurisdictions of international banks would, arguably, be most relevant to an international convention addressing international bank insolvencies.

Thirdly, the implications for the EU legal framework, in consideration of the impending revision and reform of the EU Insolvency Regulation, concern the omission of subsidiaries of international banks, and the context in which their insolvency operates. Since the onset of the financial crisis and in consideration of the current sovereign crises in Europe, the limited scope of the European Union Directive on the Reorganisation and Winding Up of Credit Institutions¹⁰³⁹ to deal with the subsidiaries of a cross-border banking group needs to be given immediate attention. Furthermore, the current approach of the Insolvency Regulation creates significant impediments to the implementation of an effective COMI in one applicable jurisdiction to all other jurisdictions. When dealing with the insolvency of an international bank that crosses various divergent jurisdictions, this exacerbates the complexity and perplexity of conflicts.

The plurality of jurisdictions creates several issues in particular in terms of the coordination between multiple jurisdictions and the inadequate protection of creditors.¹⁰⁴⁰ The ‘profound impact’ on the treatment of participants in international insolvencies and the effect on jurisdictions¹⁰⁴¹ are significant incentives to find solutions. The implementation of the Insolvency Regulation focuses on the concept of COMI as a ground for opening main insolvency proceedings and its Article 3(1). Article 3(1) of the Directive concerns international regulatory authority and the principle of unity. Notwithstanding this, a significant problem with Article 3(1) is that the concept of COMI can work only with the universality principle whereby one court is competent to open a single set of insolvency proceedings, leading to a worldwide insolvency proceeding. The Insolvency Regulation implies that a specific COMI can be determined for each individual firm. However, the practical experience with this in international bank insolvency cases deems this impractical, inefficient, and costly.

¹⁰³⁸ Paul Omar, ‘Four Models of Rescue: Convergence or Divergence in European Insolvency Laws? Part 2’, (2007) 18 (5) *International Company and Commercial Law Review* 171, 177.

¹⁰³⁹ *European Parliament and Council Directive 2001/24/EC on the Reorganisation and Winding-up of Credit institutions* (entered into force on 5 May 2001).

¹⁰⁴⁰ Dobah Care, ‘Le Systeme Canadien et le Systeme Europeen’, LLM Thesis, Universite de Montreal, June 2007.

¹⁰⁴¹ Paul J. Omar, ‘The Landscape of International Insolvency Law’, (2002) 11 *INSOL International Insolvency Review* 173, 198.

Fourthly, the Model Law is essentially nationalistic in that it gives to domestic regimes the flexibility to consider the extent to which provisions are adopted.¹⁰⁴² In the case of international banks, the cross-border issues are multi-jurisdictional and therefore, the attempts to resolve these within domestic regimes are not adequate. The solutions can be construed only at an international level. The Model Law is not specifically tailored to address the insolvency proceedings of financial institutions. When jurisdictions that have adopted the Model Law encounter international bank insolvencies, these are subject to general insolvency law. The problems that arise from this dichotomy, as examined in this study, illustrate the potential conflicts and the inadequacy of general insolvency law to deal with the complexities of international banks in insolvency. This is a critical gap that needs immediate attention. When the complexities of resolving cross-border bank insolvencies increase, the difficulties of determining the COMI are exacerbated. The ambiguity in national regimes over the determination of COMI has created conflicts between jurisdictions. As international banks are variously regulated in their respective jurisdictions, the binding nature of hard law is needed to effectively address their insolvency.

At present, neither the EU legal framework nor the Model Law specifically addresses the cross-border insolvency of international banks. As yet, there are still no international rules addressing the cross-border aspects of international bank insolvencies. This gap needs to be addressed in these frameworks beginning with international bank insolvency cases. The conflicts between jurisdictions in cross-border insolvency and the development of corporate groups in these frameworks would provide a strong foundation for the inclusion of international banks. Since the collapse of *Lehman Brothers*, global markets have remained unpredictable and unsteady. A more effective resolution of COMI may be a possible solution in assisting the international financial system to handle other bank insolvencies of similar magnitude and, in doing so, mitigate the effects of the next global financial crisis. These legal frameworks need to address the cross-border insolvency of banks by extending their scope and according their insolvency the attention that it deserves.

7.5 Future Research

History has shown that most sovereign crises are intertwined with banking crises to the extent that the two are interconnected.¹⁰⁴³ As there is a high correlation between the incidence of sovereign insolvency and bank insolvency, further research with the common objective of achieving predictability, that is imperative to resolving the conflicts between jurisdictions, is recommended to explore the connection between these two occurrences. The linkage between the two was illustrated

¹⁰⁴² Bank of International Settlements, above n2, A39.

¹⁰⁴³ Gert Wehinger, 'The Financial Industry in the New Regulatory Landscape', (2011) 2 *OECD Journal: Financial Market Trends*, 225, 231.

in the Icelandic banking crises that were discussed in Chapter 3 and as ‘throughout the ages, sovereign default has been the single biggest cause of banking collapse.’¹⁰⁴⁴

The doctrine of international comity expresses ‘the true foundation and extent of the obligation of the laws of one nation within the territories of another’.¹⁰⁴⁵ The underlying premise of external deference¹⁰⁴⁶ is concerned with international political and economic interests that impede the equality of distribution among creditors. In this respect, conflicts law is needed to mitigate ‘inadvertent importation of foreign policies and exportation of domestic policies’¹⁰⁴⁷ that may inadvertently create new conflicts. Future research would consider the impact of conflicts law in international policy-making in the context of international bank insolvencies, to address the gaps that have been identified in the international insolvency legal frameworks and extend this thesis topic further.

Finally, this study discussed the desirable concept of an international convention on cross-border bank insolvency. This study concludes with the possible solution of an international convention pertaining to the cross-border aspects of international bank insolvency that will have the capacity, adaptability, ability, and most importantly, the enforceability to address the abovementioned conflicts between jurisdictions. The instrument of an international convention could also address the conflicts between jurisdictions arising from COMI. Further research is recommended to explore the feasibility, applicability, and practicality of such a legal instrument with adequate provisions, since this is beyond the scope of this thesis.

¹⁰⁴⁴ Andrew G. Haldane, ‘Banking on the State’, (2009) 139 *Bank for International Settlements Review* 1.

¹⁰⁴⁵ Joseph Story, *Commentaries on the Conflict of Laws* (Boston: Little Brown and Company, 1852).

¹⁰⁴⁶ Christopher C. Wheeler, ‘Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation’, (2003) 39 *Journal of Stanford International Law* 253, 267.

¹⁰⁴⁷ *Ibid.*

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