A NEW APPROACH TO TRANSNATIONAL INSOLVENCIES

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Business failure has gone international.[1] The financial distress of a firm is no longer confined to territorial borders. When a multinational firm fails, the effects are felt in a number of countries. Such a firm has employees, creditors, customers, stockholders, and interested communities scattered across various jurisdictions. These constituencies all suffer losses when a multinational enterprise cannot meet its obligations. Employees may lose their jobs, creditors may not recover funds that they are owed, customers may have to turn elsewhere for goods, stockholders may lose their investment, and communities may lose an important contributor to the quality of life.

The advent of international business failure has led to an increasing debate over which country's laws should mete out its consequences.[2] A multinational corporation has significant contacts with a variety of jurisdictions. Each of these jurisdictions has its own bankruptcy law. These laws are often designed to serve different purposes. For example, it is common wisdom that the U.S. bankruptcy law in large measure seeks to promote corporate reorganization,[3] whereas the laws of some

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1. While I am unaware of any systematic attempts to document the incidence of transnational bankruptcies, the increasing attention that practicing attorneys are devoting to this problem, and the general trend towards a global economy suggest that the such bankruptcies are on the rise. *See, e.g.*, DEVELOPING YOUR INTERNATIONAL INSOLVENCY PRACTICE (Michelle Laque Johnson ed., 1995).

2. The cases which have generated the most attention to date are the insolvencies of Maxwell Communications, Bank of Credit & Commerce International (BCCI), and Olympia & York. *See In re* Maxwell Communications Corp., 170 B.R. 800 (Bankr. S.D.N.Y. 1994); Hal S. Scott, *Supervision of International Banking Post-BCCI*, 8 GA. ST. L. REV. 487 (1992); *In re* Olympia & York Developments Ltd. [1993] 12 O.R.3d 500 (Ont. Gen. Div.).

3. *See* Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1043–44 (1992); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Reorganization*, 72 TEX. L. REV. 51, 78–79 (1992); Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437, 467–68 (1992); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336 (1994).

countries are often more solicitous of the interests of creditors.[4] Similarly, certain creditors may receive preferred treatment under the laws of one country [5] while receiving less generous treatment at the hands of another sovereign. Even where different regimes agree on a certain policy, such as discouraging preferential payments on the eve of bankruptcy, they may differ in the ways in which they implement such policy, thus providing the same creditor with different treatment depending on which law governs the resolution of its claim.[6]

Historically, countries have paid little attention to these conflicts.[7] When a multinational firm became insolvent, each jurisdiction would "grab" the assets within its borders and administer those assets with little regard to any foreign proceeding involving the insolvent firm.[8] This "territorial approach" to bankruptcy law has been criticized for a number of years.[9] These criticisms have led to modest reforms. For example, the U.S. Bankruptcy Code represents a tentative congressional step toward cooperation in dealing with the financial distress of a multinational firm.

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4. For a comparison of U.S. and European bankruptcy laws, see Michelle J. White, *The Costs of Corporate Bankruptcy: A U.S.-European Comparison, in* CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES 467 (Jagdeep S. Bhandari & Lawrence E. Weiss eds., 1996); Daniel J. Arbess et al., *New Bankruptcy Laws: A Comparison of the Bankruptcy Laws of the Czech Republic, Poland, and Russia*, 1 PARKER SCH. J.E. EUROP. L. 128 (1994). For a comparison of United States and Canada's insolvency laws, see Lynn M. LoPucki & George G. Triantis, *A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies*, 35 HARV J. INT'L L. 267 (1994).

5. The U.S. Bankruptcy Code, for example, accords priority to tax claims and, in certain cases, the claims of U.S. fishermen. *See* 11 U.S.C. § 507(a)(8) (1994) (tax claims); 11 U.S.C. § 507(a)(5)(B) (1994) (U.S. fishermen).

6. For example, the U.S. Bankruptcy Code allows the recovery of many payments made by the debtor within ninety days of the filing of the bankruptcy petition. 11 U.S.C. § 547 (1994). English law, in contrast, has a four month reachback period. *See* Insolvency Act, 1986, § 240(1)(b) (Eng.). Moreover, whereas English law requires that the debtor intended to prefer the creditor for the transfer to be deemed a preference, (*see id.* § 239(5)), U.S. law does not consider the debtor's intent as legally relevant. *See* 11 U.S.C. § 547(b) (1994).

7. *See* Jay Lawrence Westbrook & Donald T. Trautman, *Conflicts of Laws Issues in International Insolvencies, in* CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW 655–56 (Jacob S. Ziegel ed., 1994).

8. *See* Charles D. Booth, *Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of the United States Courts*, 66 AM. BANKR. L.J. 135, 135–47 (1992); Kurt H. Nadelman, *Rehabilitating International Bankruptcy: Lessons Taught by Herstatt and Company*, 52 N.Y.U. L. REV. 1 (1977); Donald T. Trautman et al., *Four Models for International Bankruptcy*, 41 AM. J. COMP. L. 573, 574–75 (1993); Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 460 (1991).

9. *See* Douglas G. Boshkoff, *Some Gloomy Thoughts Concerning Cross-Border Insolvencies*, 72 WASH. U. L.Q. 931 (1994); John Lowell, *Conflict of Laws as Applied to Assignments for Creditors*, 1 HARV. L. REV. 259, 264 (1888); Jay Lawrence Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT'L L. 499 (1991); Westbrook, *supra* note 8.

Section 304 of the Bankruptcy Code allows, but does not require, a U.S. bankruptcy court to assist a foreign insolvency proceeding.[10] This provision applies to a multinational firm that has its "home" in another country, assets in the United States, and has filed for bankruptcy in the other country. The representative of the debtor's estate in the foreign bankruptcy case can attempt to enlist a U.S. bankruptcy court as an ancillary to the foreign proceeding.[11] When a U.S. bankruptcy court decides to act in this capacity, its primary functions are to stop debt collection efforts in the United States, gather the debtor's assets located in the United States, and turn them over to the foreign representative for distribution according to the terms of the foreign bankruptcy proceeding. To date, U.S. bankruptcy courts applying Section 304 have reached disparate results as to whether or not they will act as an ancillary to the foreign bankruptcy proceeding.[12]

Other countries have also sought to increase international cooperation in the bankruptcy area. The Council of Europe drafted a treaty designed to mediate conflicts which arise when a firm has contacts with more than one European country.[13] This treaty was ready for signature in 1990[14] and has been signed by eight countries,[15] but has yet to enter into force.[16] The Scandinavian countries have been leaders in this regard, having established a treaty to handle intra-Scandinavian bankruptcies in 1933.[17] Despite these efforts to foster greater cooperation in transnational bankruptcies, in practice, noncooperation remains the norm.[18]

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10. *See* 11 U.S.C. § 304 (1994).

11. *See id.* § 304(b).

12. *Compare In re* Culmer, 25 B.R. 621 (Bankr. S.D.N.Y. 1982) (allowing ancillary proceeding), *with In re* Papeleras Reunidas, S.A., 92 B.R. 584 (Bankr. E.D.N.Y. 1988) (holding that statutory considerations required dismissal of ancillary proceeding). *See also* Booth, *supra* note 8. For a history of U.S. law prior to the adoption of Section 304, see Charles D. Booth, *A History of the Transnational Aspects of United States Bankruptcy Law Prior to the Bankruptcy Reform Act of 1978*, 9 B.U. INT'L L.J. 1 (1991).

13. *See* European Convention on Certain International Aspects of Bankruptcy, Nov. 5, 1990, Europ. T.S. No. 136.

14. *Id.*

15. *See* Chart of Signatures and Ratifications, European Convention on Certain Aspects of Bankruptcy, Council of Europe: European Treaties, No. 136 (March 3, 1997).

16. For the Convention to enter into force, three countries must ratify it (*see* Article 34); to date, only one (Cyprus) has done so. *See* Chart of Signatures and Ratifications, *supra* note 15.

17. *See Sverges overenskommelser med frammande makter* 1934: 8. The Convention was amended in 1977 and 1982 (*Sverges overenskommelser med frammande makter* 1978: 10 and 1982: 85).

18. The United States is not a party to any bilateral or multilateral bankruptcy treaty. One recent attempt to increase international cooperation in this area is the model law drafted by the United Nations Commission on International Trade Law (UNCITRAL) and INSOL International. *See* Daniel M. Glosband, *UNCITRAL Adopts Model Cross-Border Insolvency*

Most academic writing in this area has deplored the extant state of affairs and called for greater cooperation when faced with a transnational bankruptcy.[19] The ultimate goal for many is a universal bankruptcy law which would apply to all firms.[20] Having a single law would obviate the problems caused by attempting to apply multiple sets of laws to a single firm. A notable failing of the existing literature, however, is that it does not suggest what the content of this law should be. A bad law which applies to everyone has little normative appeal. This article remedies this deficiency in the existing literature. Beginning with the assumption that the overall goal of bankruptcy law, at least in the corporate setting, should be efficiency,[21] this article develops the contours of an efficient multinational insolvency law.

Private international law is built on the concept of voluntary agreement between the affected parties. Indeed, contracting parties are often allowed more freedom in the international realm than the domestic.[22] This principle of private contractual choice should be extended to the selection of insolvency rules.[23] The owners of firms, not governments, are better positioned to select the insolvency rule which best maximizes

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Law, BANKR. CT. DECISIONS: WEEKLY NEWS & COMMENT, June 24, 1997, at A3. It is unclear how successful this attempt at cooperation in transnational insolvencies will be.

19. *See, e.g.*, Westbrook, *supra* note 8; Boshkoff, *supra* note 9; Lucian Arye Bebchuk & Andrew T. Guzmán, *An Economic Analysis of Transnational Bankruptcies*, Discussion Paper No. 180 (Harvard Law School, Feb. 1996).

20. *See, e.g.*, Thomas M. Gaa, *Harmonization of International Bankruptcy Law and Practice: Is it Necessary? Is it Possible?*, 27 INT'L LAW. 881, 906–09 (1993); John D. Honsberger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W. RES. L. REV. 631, 633–34 (1980); Westbrook, *supra* note 9, at 514–15.

21. Many bankruptcy academics embrace the efficiency norm. *See, e.g.*, Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311 (1993); Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987); James W. Bowers, *The Fantastic Wisconsylvania Zero-Bureaucratic-Cost School of Bankruptcy Theory: A Comment*, 91 MICH. L. REV. 1773 (1993); Bradley & Rosenzweig, *supra* note 3, at 1056 n.44; THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986). Others, however, have argued that efficiency must be tempered by concerns of distributive justice. *See* KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM (1997); Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717 (1991); Warren, *Bankruptcy Policymaking in an Imperfect World*, *supra* note 3. I have argued elsewhere that embracing redistribution as a societal goal does not imply that bankruptcy law should be the mechanism of such redistribution. *See* Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, U. ILL. L. REV. 1 (1994).

22. *Compare* The Bremen v. Zapata Off-Shore Co, 407 U.S. 1 (1972) (allowing broad enforcement of choice of forum and choice of law clauses in international contracts) *with* Stewart v. Ricoh, 487 U.S. 22 (1988) (holding that party selection not determinative).

23. I have made a similar argument in the domestic context. *See* Rasmussen, *supra* note 3. Others have also embraced this general concept. *See* Adler, *supra* note 21; Alan Schwartz, *Contracting About Bankruptcy*, 13 J.L. ECON. & ORG. 127 (1997); Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J.L. & ECON. 595 (1993).

firm value. To increase the gains from private choice, firms should have a menu of insolvency rules from which they can choose. This choice would first be made at incorporation, and could be amended, subject to certain restrictions, as the structure of the firm changes. Placing the choice of insolvency rules in the private domain would eliminate the perceived problems with current law and would increase social welfare.

Despite the normative desirability of a menu-based system, such radical reform is unlikely in the near future. Existing law, however, offers a second-best solution. Private international law generally recognizes the validity of forum-selection clauses and choice of law clauses in private contracts.[24] This principle of contractual choice should be extended to insolvency matters. If a firm were to place a provision in its corporate charter stating that it would file for bankruptcy only in a certain jurisdiction, which would then handle the bankruptcy proceeding according to its own law, all creditors of the firm should be bound by this choice of forum provision. If courts were to accept such an argument, this would introduce a measure of private choice into the selection of insolvency rules. Although this solution is inferior to the menu approach because it provides fewer options for a firm, it is superior to the current confusion in the transnational insolvency area because it allows a firm to select the best law from those countries which have an interest in its operations.

Part I of this article sets forth the general problems associated with transnational bankruptcies. Part II then shows that, from an efficiency standpoint, the optimal solution would be to allow firms to select, at the time of incorporation, which set of bankruptcy rules will govern in the event of financial distress. Part III examines the transnational bankruptcy problem under the assumption that each nation will continue to dictate the content of its bankruptcy laws. The accepted wisdom is that under this assumption, the best solution to transnational insolvencies is for all countries to adopt a rule whereby the home jurisdiction of the firm controls the entire bankruptcy proceeding.[25] Part III shows that this solution erroneously assumes that a single proceeding is optimal for all firms. Instead, it is more efficient to allow firms to select which country's or countries' laws will apply if the firm encounters financial distress. Although this proposal is not as normatively appealing as that

24. *See The Bremen*, 407 U.S. 1; Scherk v. Alberto-Culver Co., 417 U.S. 506, 506–516 (1974).

25. *See* Westbrook, *supra* note 8, at 461 (stating that there is "nearly unanimous agreement across the world that the financial difficulties of a multinational should be resolved in one central forum").

set fort in Part II, it represents an improvement over both the current state of affairs and the most commonly suggested alternative.

I. THE TRANSNATIONAL BANKRUPTCY PROBLEM

The transnational bankruptcy problem stems from the fact that each country has its own set of insolvency rules. These differing rules lead to potential forum shopping incentives on the part of both creditors and debtors. These incentives often ensure that more than one country is asked to resolve the financial distress of a single, multinational enterprise. This part first details the incentives that lead to the initiation of multiple bankruptcy proceedings, and then examines the problems that such proceedings cause.

A. *The Incentives to Initiate Multiple Insolvency Proceedings*

Consider first the situation faced by creditors of a multinational firm that runs into financial difficulty by means of the following hypothetical situation. Assume a company with its main office and a majority of its assets in France, which is therefore considered the "home" jurisdiction,[26] but with substantial assets in the United States.[27] The firm, which has a number of U.S. creditors, begins an insolvency proceeding in France.[28] Each U.S. creditor has two options: (1) it can go to France, press its claim in the French tribunal, and be satisfied with the payout which it receives; or (2) it could attempt to have its dispute resolved in this country.

A U.S. creditor could proceed in the United States in one of two ways. First, it could proceed under state law and attempt to levy on the assets located in this country. Any such attempt, however, could be met by a bankruptcy petition filed under Section 304 by a foreign representative of the debtor.[29] A foreign representative is the person empowered

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26. There are any number of rules by which one could identify a "home" jurisdiction. One could look to where the majority of the assets are located, where the home office of the company is located, or where most of the transactions take place. In most situations, it should be easy to determine the "home" jurisdiction of a firm. For some concerns with identifying the "home" of a domestic corporation, see Lynn M. LoPucki, *Why the Debtor's State of Incorporation Should Be the Proper Place for Article 9 Filing: A Systems Analysis*, 79 MINN. L. REV. 577, 592–93, 633–35 (1995).

27. To keep the analysis relatively simple, I want to assume that the corporation has substantial contacts with only France and the United States. Of course, one could easily extend the analysis to a situation where the firm has significant contacts with a variety of jurisdictions.

28. *See generally* Law No. 85-98 of January 25, 1985, J.O., January 26, 1985, p. 1097.

29. *See* 11 U.S.C. § 304 (1994).

by the foreign proceeding to represent the interests of the debtor.[30] A Section 304 petition does not begin a full-blown bankruptcy proceeding. Rather, it begins a "case ancillary" to the foreign proceeding.[31] A case ancillary gives the bankruptcy court the power, but not the obligation, to stay all actions against the debtor in the United States.[32] In essence, the bankruptcy judge must decide which forum, the U.S. court or the French court, should process the claims of the U.S. creditor. If the bankruptcy court so decides, it can remit all of the U.S. creditors to the French proceeding.

Alternatively, the U.S. creditor could join with two other creditors and commence an involuntary bankruptcy proceeding under Section 303 of the U. S. Bankruptcy Code.[33] In such a situation, the foreign representative can move to have the case either dismissed or suspended under Section 305.[34] The requirements for dismissal or suspension under Section 305 in this instance are the same as those under Section 304 for deciding whether to grant a foreign representative relief in an ancillary proceeding.[35] In both situations, the bankruptcy court must decide whether, and to what extent, it will assist the foreign bankruptcy proceeding or conduct its own full-fledged bankruptcy proceeding.

Any action by the U.S. creditor to litigate its claim in this country presumably would be based on its expectation that it will receive more money from the debtor in the U.S. forum. If the French court promised the creditor a greater net return on its claim, there is little reason to believe that the U.S. creditor would seek to press its claim in the United States. The expectation for a higher domestic return may be based on a number of reasons. First, it may be more convenient for the U.S. creditor to litigate here rather than travelling to France. Travelling is expensive, as is the employment of local counsel. Moreover, to the extent that any of the employees of the U.S. creditor would have to participate in the foreign proceeding, this participation diverts their attention from other matters. While such diversion may occur regardless of where the litigation takes place, it is sensible to assume that the distraction will be greater if the employee has to travel to a foreign jurisdiction. Thus, even if the U.S. and French courts offer the U.S. creditor the same payout at the end of the proceeding, the costs involved

30. *See id.* § 101(24).
31. *Id.* § 304(a).
32. *See id.* § 304(b).
33. *See id.* § 303.
34. *See id.* § 305(b).
35. *See id.* §§ 304(b), 305 (a)(2). The one difference between these two sections is that orders under Section 304 are appealable (*see* 28 U.S.C. § 158(d) (1994)), but those under Section 305 are not (*see* 11 U.S.C. § 305(c) (1994)).

with the foreign system may prejudice the U.S. creditor towards seeking its remedy in the United States.[36]

A second reason for a U.S. creditor to proceed in this country is that there may be more assets per claim in the United States than in the enterprise as a whole. For example, assume that regardless of which country's law applies to the creditor's claim, the creditor has a general unsecured claim of undisputed value which will take a pro rata share of the assets which remain after all priority claims have been paid.[37] Given the insolvent firm's worldwide distribution of assets and claims, it may be that the U.S. creditor will receive only five cents for each dollar it is owed in the French proceeding. By proceeding in the United States, in contrast, the creditor can expect either to be paid in full, if no U.S. bankruptcy petition is ever filed, or, even if a bankruptcy proceeding is started here, to receive fifty cents on the dollar. Such a disparity might result whenever there are more assets per dollar of claim in this country than in the foreign jurisdiction, and whenever the creditor reasonably expects that the U.S. proceeding will be limited to U.S. creditors chasing assets located in the United States. In this situation, it is the firm's distribution of assets and claims rather than the content of any nation's bankruptcy law which drives the U.S. creditor towards this country's bankruptcy system.

A final reason for the U.S. creditor to eschew the French proceeding is the substantive difference in the respective bankruptcy systems.[38] It may be that its claim is entitled to priority under U.S. bankruptcy law but treated only as a general unsecured claim in France. For example, the creditor may have obtained a judicial lien in this country which, assuming that it was obtained more than ninety days before the filing of bankruptcy and thus not subject to attack as a preference,[39] would enable the creditor to receive payment in full. The French proceeding, however, might not recognize the validity of the judgment lien, and thus would

36. Indeed, Section 304 recognizes the inconvenience to U.S. creditors of processing their claims in the foreign proceeding as a factor for a bankruptcy court to consider in deciding whether or not to defer to that proceeding. *See* 11 U.S.C. § 304(c)(2) (1994).

37. *See id.* § 726(a)(2), (b).

38. Areas of possible difference include different priority status and different avoidance rules. Differences in priority status may result from the fact that one law gives special treatment to certain creditors. For example, the U.S. Bankruptcy Code gives preferential treatment to wage claims, benefit claims, claims by grain farmers against grain elevators, claims by U.S. fisherman against fish storage operators, consumer claims, claims for alimony and child support, tax claims, and claims based on a commitment to a federal depository institution's regulatory agency to maintain the capital of an insured depository institution. *See id.* § 507(a). With regard to the problems created by differences in avoidance laws, see Westbrook, *supra* note 9.

39. *See* 11 U.S.C. § 547 (1994).

remit the creditor to unsecured status. This discussion, of course, assumes that the French court would not apply U.S. law to the claim, and that the U.S. court would not apply French law.[40]

In short, a U.S. creditor will seek to avoid a foreign proceeding when it believes that a proceeding in this country promises it a greater return. Yet, even if the U.S. creditor believes that a single proceeding in France would net it a higher return, it still may pursue its claim in this country in addition to pressing a claim in France. Although the U.S. creditor cannot hope for a double recovery on its claim,[41] it may file a second claim because of the following problem: if the creditor proceeds only in France, other creditors will not be prevented from proceeding in the United States, and as a result, it is not ensured that the assets located in the United States will be distributed according to French law. Indeed, as more U.S. creditors participate in the French proceeding exclusively, the remaining U.S. creditors have an increasing incentive to proceed under U.S. law, assuming that there is no clear commitment in U.S. law to cooperate with the French proceeding. This situation arises because the value of the U.S. assets are unaffected by the U.S. creditors joining the French proceeding. As more and more U.S. creditors join the French proceeding exclusively, there are fewer claims chasing the U.S. assets. These remaining U.S. claims thus receive a larger payout than initially expected. At some point, it will become rational for some U.S. creditor to proceed in the United States. When this happens, all U.S. creditors, including those who have filed in France, will have an incentive to file claims in the U.S. forum. In fact, given that the first U.S. creditor making its decision as to where to process its claim can anticipate precisely this sequence, it may as well pursue its claim in both jurisdictions initially even if it believes that it would be better off under a single French proceeding.

Thus, when a multinational firm having substantial assets in the United States encounters financial distress, it is all but inevitable that some interested party, whether a creditor, the debtor, or a foreign representative, will seek the protections of the U.S. Bankruptcy Code. In each case, once the matter comes before the bankruptcy court, the judge must

40. On the general confusion surrounding the question of which preference law to apply, see Westbrook, *supra* note 9, at 525 (identifying five possible choice of law rules in avoidance actions).

41. Under U.S. bankruptcy law, a creditor in a U.S. proceeding who has already recovered on its claim in the foreign proceeding will not recover until the other creditors with the same priority have received the same value as the first creditor. *See* 11 U.S.C. § 508(a) (1994). The European Convention on Certain International Aspects of Bankruptcy has a similar provision. *See* Europ. T.S. No. 136, art. 5.

decide whether to send the U.S. creditor off to France, or whether to entertain the claim itself.

The converse situation occurs where a multinational corporation has its home in the United States. Here, the firm files for bankruptcy protection in the United States and a foreign creditor seeks to evade the application of U.S. bankruptcy law to its disputes with the debtor. The foreign creditor may thus seek to have its country resolve its claim against the debtor and seek satisfaction of such claim out of the debtor's assets located abroad. Alternatively, the foreign creditor may either seek to have the U.S. bankruptcy court defer to a judgment which the creditor obtained in a foreign jurisdiction, or at least apply the law of the foreign jurisdiction to its dispute with the debtor. The motivation for the foreign creditor in this situation is the same as that of the U.S. creditor in the preceding example. In short, the creditor will take the course of action which offers the highest payout. As with the U.S. creditor, even if the foreign creditor is quite content with its treatment under the law of the firm's home country (the United States), it will be forced to press its claim in both the domestic and foreign tribunals.

From the perspective of the U.S. bankruptcy court, however, the situations are quite different. Whereas the U.S. bankruptcy court had control over whether to defer to the foreign proceeding in the case of the U.S. creditor seeking to avoid a foreign bankruptcy proceeding, it has little direct control where the foreign creditor is fleeing the reach of the U.S. Bankruptcy Code. If a foreign jurisdiction is willing to entertain the creditor's claim and has control over sufficient assets of the debtor to satisfy that claim, and the foreign creditor is content to press its claim only in the foreign proceeding, then there is little that the U.S. bankruptcy court can do to protect the U.S. interests at stake. This is true despite the declaration of the U.S. Bankruptcy Code that it applies to all of the debtor's assets worldwide.[42] The U.S. court simply has no means by which it can force a recalcitrant jurisdiction to cooperate with it.

To this point, we have only been considering the incentives of creditors as to where they press their claims. Debtors have an incentive to forum shop as well. Managers of the debtor usually control the decision when to initiate an insolvency proceeding. Different insolvency regimes treat managers differently. For example, the default rule in reorganization under Chapter 11 of the U.S. Bankruptcy Code is that the

42. *See* 11 U.S.C. § 541(a)(1) (1994). The United States is not alone in claiming more power than it has. *See* Insolvency Act, 1986, § 436 (Eng.) (asserting that the Act applies to property "wherever situated").

managers remain in control of the debtor's day-to-day operations.[43] Other countries, such as England, oust managers much more readily.[44] Depending on whether they want to stay on or leave, the managers have an incentive to shop for the laws which promise the best outcome for them.

The forum shopping problem is probably less acute for debtors than it is for creditors. For a creditor to pursue its claim in any given country, all it needs is for there to be assets located in that country. It does not matter to the creditor whether or not the country in question can be considered the "home" of the debtor. The managers of the debtor are more constrained. Simply having assets in a country with promanager laws will not assist managers who do not reside in that country. It is difficult to imagine a U.S. court claiming that it has the authority to reorganize the affairs of, say, a Japanese debtor simply because the Japanese firm has assets in the United States. It is even harder to imagine a Japanese court acceding to such an exercise of jurisdiction. For there to be a problem of debtor forum shopping, it must be the case that there are at least two jurisdictions which can plausibly assert that they should be allowed to administer the affairs of the insolvent firm.[45]

To be sure, it is possible in theory that the treatment of managers in bankruptcy may affect managers' decision of where to locate the firm in the first instance. One might conjecture that managers would like to establish the firm in a jurisdiction which is manager-friendly. There are, however, a number of problems with this suggestion. The first is that

43. *See* 11 U.S.C. § 1107 (1994). On the favorable treatment of existing managers, see James J. White, *Harvey's Silence*, 69 AM. BANKR. L.J. 467, 471–72 (1995); Lynn M. LoPucki, *Chapter 11: An Agenda for Basic Reform*, 69 AM. BANKR. L.J. 573, 576–77 (1995) ("The United States is probably the only developed nation that leaves the debtor in unsupervised possession of the estate during a reorganization"); Rasmussen, *supra* note 3, at 72. While a high percentage of managers are eventually replaced during a Chapter 11 reorganization, *see id.* at 72, n.79 (citing studies), this is better treatment than they would receive either in other countries' bankruptcy systems or if the firm remained outside of bankruptcy.

44. *See* Insolvency Act, 1986, § 14 (Eng.) (all management power passes to an outside administrator). For some recent concerns over this practice, see Nick Segal, *An Overview of Recent Developments and Future Prospects in the United Kingdom*, *in* CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW 10–12 (Jacob S. Ziegel ed., 1994). Canada also displaces its managers more readily than does the United States. *See* LoPucki & Triantis, *supra* note 4, at 302–05. The same is true of Australia. *See* Ron Harmer, *An Overview of Recent Developments and Future Prospects in Australia (With Some Reference to New Zealand and Asia)*, *in* CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW 39, 48 (Jacob S. Ziegel ed., 1994).

45. This was the case in the Maxwell bankruptcy where the head offices of the firm were in England, and the majority of the assets were in the United States. *See infra* pp. 29–30 (discussing the Maxwell bankruptcy).

most multinational firms are domestic firms which have grown in size. It is simply not the case that the firm had any opportunity to shop for a favorable jurisdiction before it was incorporated.[46]

Another reason why promanager bankruptcy laws will not provide an incentive for a firm to locate in that jurisdiction is that, to the extent that such laws are inefficient, they impose a price on the firm. Voluntary creditors can adjust the price of their loans. To the extent that a promanager law reduces the chances of the creditor being repaid, the creditor can raise its interest rate. If the cost of the promanager law exceeds its benefits, the owners of the firm will not have an incentive to seek out such a law.[47]

Thus, debtor forum shopping does not appear to be a serious problem. Nevertheless, given a multinational firm's worldwide dispersion of assets and creditors, it is quite likely that in any insolvency of a multinational entity, there will be more than one bankruptcy proceeding.

B. *The Problems Created by Multiple Insolvency Proceedings*

Once two bankruptcy proceedings involving the same firm have begun, each bankruptcy court faces a number of decisions. In most situations, it will be clear which country is the home of the debtor. There is little to suggest that in such a situation, the bankruptcy court in the home jurisdiction would allow the other bankruptcy forum to resolve the debtor's affairs. The real question is the extent to which the other bankruptcy forum will cooperate with the home jurisdiction. To ascertain the options available to the non-home bankruptcy forum, it is necessary to delineate the points on which there may be conflict.

A central feature of any bankruptcy proceeding is delimiting the debtor's assets.[48] These assets include both those owned by the debtor at the time it files for bankruptcy, as well as those which the debtor can recover from others through the bankruptcy process. Most bankruptcy

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46. This of course differs from the domestic situation in this country, where firms are free to incorporate wherever they wish, regardless of where their assets are located. In this regard, it is interesting to note that while the present Bankruptcy Code allows a firm to file for bankruptcy in the location where it is incorporated (*see* 28 U.S.C. § 1408 (1994)), the Bankruptcy Commission, which was established by Congress to evaluate extant law, has proposed eliminating this provision. For a criticism of this proposal, see Robert K. Rasmussen & Randal S. Thomas, *Improving Corporate Bankruptcy Law Through Venue Reform* (November 1997) (unpublished manuscript, on file with author).

47. Lynn LoPucki has argued that some voluntary creditors do not price the risks associated with their loans. *See* Lynn M. LoPucki, *The Unsecured Creditor's Bargains*, 80 VA. L. REV. 1887, 1949–63 (1994). For a response, see Rasmussen, *supra* note 21, at 25.

48. *See* Thomas H. Jackson, *Translating Assets and Liabilities to the Bankruptcy Forum*, 14 J. LEGAL STUD. 73 (1985).

systems allow debtors to set aside certain prebankruptcy transfers.[49] Preference law allows the debtor to void transactions that prefer a creditor at the expense of other creditors.[50] In virtually every bankruptcy proceeding, unsecured creditors do not get paid in full. Almost all bankruptcy systems look askance at transactions immediately prior to the filing for bankruptcy which allow an unsecured creditor to receive payment in full.[51] Different countries, however, have different methods of policing preferential transfers. For example, there is no agreement in how long prior to bankruptcy a transfer must be before it is subject to a preference attack. The U.S. Bankruptcy Code only scrutinizes transfers that occur within ninety days of the filing for bankruptcy, unless the creditor was an insider.[52] England has a four month reachback period,[53] and other countries have differing periods.[54] Preference law also varies across jurisdictions as to whether the debtor's intent to prefer the creditor is necessary to set aside the transaction. The U.S. Bankruptcy Code does not require such a showing;[55] other countries do.[56] It is thus not surprising that it is often the case that one country's bankruptcy regime would treat a payment as preferential whereas another country's would not.

Preference law is not the exclusive avenue for bringing assets back into the firm. Fraudulent conveyance law also avoids certain prebankruptcy transfers. A fraudulent conveyance occurs when the debtor transfers property with the intent to defraud creditors or when the debtor, while insolvent, transfers property for less than a reasonably equivalent value.[57] Once again various jurisdictions implement the general goal of fraudulent conveyance law in different ways, leading to the situation where one jurisdiction would set aside a transaction, where another would not.

A second crucial aspect of any bankruptcy law is determining the relative priority of claimants to the debtor's assets. Countries have a

49. *See* Westbrook, *supra* note 9, at 504 (noting that "[m]ost countries seem to have rules that permit the avoidance of transactions that take place after the inception of a debtor's financial crisis").

50. For a general discussion of preference law, see DAVID G. EPSTEIN et al., BANKRUPTCY § 6 (1993).

51. *See* Westbrook, *supra* note 9, at 504–05.

52. *See* 11 U.S.C. § 547(b)(4)(A) (1994). The reachback period for insiders is one year. *See id.* § 547(b)(4)(B).

53. *See* Insolvency Act, 1986, § 240(1)(b) (Eng.).

54. Indeed, some countries have no fixed reachback period; rather, the judge determines which prebankruptcy transactions are subject to attack. *See, e.g.*, John A. Barrett, Jr., *Mexican Insolvency Law*, 7 PACE INT'L L. REV. 431, 449 (1995).

55. *See* 11 U.S.C. § 547(b) (1994).

56. Canada, for example, requires a showing of the debtor's intent to prefer the creditor. *See* Bankruptcy Act, R.S.C., ch. B-3, § 95(2) (Can.).

57. *See* 11 U.S.C. § 548 (1994).

wide array of interests that they prefer. The United States, for example, allows secured creditors first priority to the debtor's assets, up to the value of their collateral.[58] Other countries are not so protective.[59] The United States also gives a limited priority to the claims of workers for unpaid wages.[60] Other countries vary on this issue.[61] Finally, the United States elevates the claims of U.S. fishermen in bankruptcy proceedings involving fish processors, grain producers in bankruptcy proceedings involving grain storage operators, and consumers over other unsecured creditors.[62] Such claimants do not receive such favored treatment abroad.

A third component of the bankruptcy process is running the affairs of the debtor during the bankruptcy proceeding. Issues which must be addressed in this regard include who should be in control of the day-to-day decision-making process while the firm is in bankruptcy, what should be done with executory contracts, and how should lawyers working for the debtor be compensated.[63] Again, countries take different approaches to these issues. For example, U.S. law, absent a court order to the contrary, leaves the current managers in charge of the debtor's affairs while the debtor attempts to reorganize;[64] if the debtor is liquidating, a trustee is appointed to handle the liquidation.[65] Canada, while generally allowing the debtor's management to remain in place, makes it easier to displace these managers.[66] English law, at the other extreme, allows for the appointment of an administrator who has the power to displace the current management if he so chooses.[67]

A final aspect of a bankruptcy proceeding is deciding what to do with the firm's assets. The fundamental decision is whether the company is liquidated or reorganized. Again, countries differ in their policy

58. *See id.* § 725 (1994). For a recent economic-based attack on this policy, see Lucian Ayre Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996).

59. For example, Mexican insolvency law gives workers a priority over secured creditors for wages earned one year prior to the filing for bankruptcy. *See* "Ley de Quiebras y de Suspension de Pagos," D.O., 1993 art. 261 et seq. Other countries are more protective of secured creditors in that they make it easier than the United States does for the secured party to recover its collateral. *See, e.g.*, R.C.C. Cuming, *Canadian Bankruptcy Law: A Secured Creditor's Heaven, in* CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW 379 (Jacob S. Ziegel ed., 1994).

60. *See* 11 U.S.C. § 507(a)(3) (1994).

61. *See supra* note 59.

62. *See* 11 U.S.C. § 507 (1994).

63. *See, e.g., id.* § 1107 (power of debtor in possession to run affairs); *id.* § 365 (executory contracts); *id.* §§ 327, 503, 507 (allowing employment of attorneys, treating their wages as administrative expenses, and giving such expenses priority in payment).

64. *See id.* § 1107.

65. *See id.* §§ 701–02.

66. *See* LoPucki & Triantis, *supra* note 4, at 302–05.

67. *See* Insolvency Act, 1986, § 14(2) (Eng.).

preference. The United States is generally perceived as having a bias toward reorganization.[68] It is willing to incur the cost of attempting to reorganize an inefficient firm in order to ensure that all efficient firms are reorganized. In other words, the United States encourages reorganization attempts, even though many attempts will fail; other countries are less solicitous of reorganization and are more likely to liquidate firms that file for bankruptcy.[69]

Given this wide divergence in the substance of various bankruptcy regimes, different results will occur depending on which country's insolvency law will be applied. Thus, when a multinational firm encounters financial distress and multiple insolvency proceedings have begun, each court involved faces a basic choice: does it apply its own law to the assets within its jurisdiction or does it cooperate to some extent with the other bankruptcy proceeding. If the court chooses the latter course, then it has to decide the extent of its cooperation. The most complete form of cooperation is to simply defer to the other proceeding. Consider again the case where bankruptcy proceedings against the same firm have been filed in both France, where the majority of the firm's assets and managers are located, and the United States. The U.S. court could enter a stay preventing creditors from levying on the firm's assets located in the United States, and send all of the creditors to the French proceeding.[70] All of the substantive decisions would be made in France. French law would decide whether or not a transaction could be set aside as either a preference or a fraudulent conveyance; French law would decide the respective priorities of the various claimants; French law would decide how to administer the estate, and French law would decide what happens to the firm's assets. The role of the U.S. court would be to simply ensure that the orders of the French court, to the extent that they involve U.S. assets, are implemented.

There are, however, other, lesser levels of cooperation. Indeed, one could imagine differing levels of cooperation in each aspect of a bankruptcy proceeding. Returning again to our French-U.S. case, consider the question of whether or not a prebankruptcy transaction should be set

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68. *See* sources cited *supra* note 3 and accompanying text.

69. *See* Julian R. Franks & Walter N. Torous, *Lessons From a Comparison of U.S. and U.K. Insolvency Codes*, 8 OXFORD REV. OF ECON. POL'Y 70 (1993); Michelle J. White, *The Costs of Corporate Bankruptcy: A U.S.-European Comparison*, *in* CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES 467 (Jagdeep S. Bhandari & Lawrence E. Weiss eds., 1996).

70. *See In re* Axona Int'l Credit & Commerce Ltd., 88 B.R. 597, 618 (Bankr. S.D.N.Y. 1988), *aff'd*, 115 B.R. 442 (S.D.N.Y 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991) (transferring assets to home country proceeding in Hong Kong).

aside as a preference.[71] The U.S. court could attempt to engage in a choice of law analysis to determine which country's law should apply to the transaction at issue, it could apply the law of the jurisdiction in which the assets are located at the time bankruptcy petition is filed, it could hold that the transaction should be avoidable if the law of either France or the United States would set it aside, or it could hold that the transaction would be avoidable only if the law of both the United States and France would set it aside.[72] If the U.S. court, using one of these decision rules, decides that the transaction should be set aside, it then "cooperates" with the French court by sending the recovered assets to France for distribution according to French priority rules.

One can easily imagine other amalgams of applying U.S. and French law which would still be deemed cooperation. For example, if there is no attempt in either France or the United States to reorganize the company, the U.S. court could supervise the liquidation of the U.S. assets, and remit the proceeds to the French proceeding. In short, cooperation can entail any number of possible actions. On each issue of substantive bankruptcy law, the U.S. court is faced with the question of applying its own law or deferring to French law. While it is easy to identify total cooperation—send the entire proceeding to France—and total noncooperation—pretend that France does not exist, there is a broad range of actions that a court can take which can easily be labeled either cooperation or noncooperation.

The easiest way to address these myriad problems is to ignore them. Indeed, this has been the approach that most countries have followed.[73] Generally, the courts of each country administer the insolvent firm's assets located within its borders according to its own laws without any regard to the firm's assets located elsewhere. This approach to transnational bankruptcies has come to be known as the "territorial approach," or, more derisively, as the "grab rule."[74]

The opposite of the territorial approach is the "universal approach," of which there are a number of versions. In its most pristine form, the universal approach endorses a single bankruptcy law which would apply to all firms regardless of location.[75] It is thus accurate to call this approach "substantive universalism." Whereas the territorial approach ignores the problem caused by multiple jurisdictions, the substantive

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71. For a detailed analysis of this problem, see Westbrook, *supra* note 9.

72. *See id.* at 525.

73. *See* Westbrook, *supra* note 8, at 460; Nadelmann, *supra* note 8; Barbara K. Under, *United States Recognition of Foreign Bankruptcies*, 19 INT'L LAW. 1153, 1154–55 (1985).

74. *See* sources cited *supra* note 8.

75. *See* Gaa, *supra* note 20, at 906–09; Honsberger, *supra* note 20, at 633–34; Westbrook, *supra* note 9, at 514–15.

universal approach eliminates the problem by eliminating the multiple proceedings with their differing sets of insolvency rules.

A variation of this approach, also referred to as "universal" in the academic literature and most often endorsed by commentators, is for all countries to adopt the rule that every transnational bankruptcy be handled in the "home" jurisdiction of the multinational firm, with the courts of other countries acting as ancillaries to assist the primary court.[76] Unlike the more pristine form of universalism which has a single set of insolvency rules for all multinational firms, this form of universalism requires the home country to apply its domestic insolvency law to the multinational debtor.[77] Thus, one can call this approach "procedural universalism."

A more tempered version of the procedural universal approach—called "modified universalism"[78]—advocates a system with more limited cooperation. It retains the general goal of procedural universalism of a single proceeding, usually in the firm's home country, by giving bankruptcy courts the power to defer to foreign proceedings. However, it departs from pure procedural universalism in that it provides local bankruptcy courts with the discretion not to cooperate with the home jurisdiction if it deems that jurisdiction's laws unfair to local creditors.[79] Under this approach, the bankruptcy judge, when faced with a transnational insolvency, decides on a case-by-case basis whether to cooperate with the foreign proceeding. The U.S. Bankruptcy Code, in Section 304, currently adopts this approach.[80]

By and large, academics have embraced the universal approach; in particular, they endorse procedural universalism.[81] The argument on which they rely, however, applies to all types of universalism. That argument is that universalism increases social welfare.[82] One source of this increase is that universalism provides creditors with a clear set of rules, which allows them to price their loans more accurately. If creditors do not know which set of insolvency rules apply, they will raise their interest rates to compensate for this uncertainty.[83] This increase in interest rates without a corresponding benefit is a net social loss.

76. *See* Westbrook, *supra* note 9, at 515.

77. *See id.* at 517–18.

78. This is Westbrook's term. *See id.* at 517.

79. *See id.*

80. *See* 11 U.S.C. § 304 (1994).

81. *See* Bebchuk & Guzmán, *supra* note 19; Westbrook, *supra* note 8; Todd Kraft & Allison Aranson, *Transnational Bankruptcies: Section 304 and Beyond*, COLUM. BUS. L. REV. 329 (1993).

82. *See* Westbrook, *supra* note 8, at 464–66.

83. *See id.* at 466.

Proponents of universalism posit other savings as well. One is in the area of administrative costs. Under a universal regime, there need only be one main proceeding instead of several. This decrease in the number of forums, it is argued, will reduce the overall cost of the bankruptcy proceeding.[84] There will be fewer attorneys needed, and issues resolved in one forum will not need to be relitigated in another. Even if one propounds a universal regime which entails the use of ancillary courts in countries other than the debtor's home jurisdiction, there will still be administrative savings. While parties may have to hire counsel to represent them in both the main and ancillary proceedings, the amount of litigation handled by the ancillary proceedings will be less than it currently is under the territorial system.

Furthermore, the proponents of universalism argue that it increases the value of the debtor's assets, regardless of whether the firm is reorganized or liquidated.[85] A successful reorganization depends on keeping assets spread across various countries in the firm.[86] This is more likely to occur under a single set of insolvency rules than if each country applies its own insolvency rules to the assets within its borders.[87] Conversely, if the firm is going to be liquidated, a single proceeding will allow the seller to package the assets in a way that maximizes their value.[88]

Lucian Bebchuk and Andrew Guzmán have recently put forth a new argument in favor of the universal approach.[89] Bebchuk and Guzmán examine the effect that the territorial approach has on investment decisions prior to the onset of financial distress. Their basic claim is that the territorial rule can skew investment choice. They posit a situation where a firm has existing debt and assets in a single country. The firm is then faced with the choice of making a new investment in either this first country or a new country. In their model, the new country's bankruptcy law would give priority to this new debt, whereas the existing country's bankruptcy law would not. In this situation, the firm may make the investment in the new country even though such investment is inefficient. The driving force behind this result is that the firm, by issuing

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84. *See* Daniel M. Glosband & Christopher T. Katucki, *Claims and Priorities in Ancillary Proceedings Under Section 304*, 17 BROOK. J. INT'L L. 477, 481 (1991) ("Territoriality not only sacrifices international cooperation but also necessitates the cost and inefficiency of a full bankruptcy proceeding in each country that houses assets.").

85. *See* Westbrook, *supra* note 8, at 460.

86. Regarding the general need to keep assets together for a successful reorganization, see JACKSON, *supra* note 21, at 7–19.

87. *Cf.* Westbrook, *supra* note 8, at 481 ("[territoriality] encourages a race to the courthouse of countries housing assets. . ."); Warren, *The Untenable Case for Repeal of Chapter 11*, *supra* note 3, at 350–52 (race to courthouse destroys a firm's value).

88. *See* Westbrook, *supra* note 8, at 465–66.

89. *See* Bebchuk & Guzmán, *supra* note 19.

new debt with a higher priority than the existing debt, is able to place some of the downside risk of the project on the existing debtholders.[90] Central to their analysis is the assumption that the new country and the old country differ on the priority level accorded to the new debt. Based on this scenario, they conclude that the territorial approach to international insolvency creates the possibility of inefficient investment as compared to the universal approach.

II. THE OPTIMAL SOLUTION TO THE TRANSNATIONAL BANKRUPTCY PROBLEM

Perhaps the most striking feature of the arguments in favor of universalism is their almost complete disregard for the substance of the bankruptcy law which is to be applied. Those who argue for a single set of rules to cover multinational bankruptcy, the substantive universalist approach, make no effort to even adumbrate the content of such a universal regime.[91] Such a deficit undermines the force of their arguments. One can readily admit that there may be gains to be had by having a single proceeding or a set of clear rules designating one, among possible forums, as the principal forum, but still conclude that the costs associated with that regime outweigh the benefits of avoiding current practice. To be a bit extreme, one can imagine a controlling rule which resolves all contested disputes by trial-by-battle. The costs of judicial administration are low, but the error costs of the proceeding itself are quite high. One cannot thus endorse the concept of having a single set of bankruptcy rules for an insolvent company without saying something about the content of those rules.

The same problem bedevils those who argue for a single forum which applies its domestic bankruptcy law to the multinational firm, they simply take existing domestic law as a given. There is no attempt to ascertain the efficacy of this law.[92] This renders their arguments incomplete. The gains foreseen are attributable to having a bankruptcy proceeding in a single forum pursuant to a single set of insolvency rules.[93] Yet, if that forum has an inefficient law, the gains may be lost. To

90. This problem with issuing priority debt has been well discussed in the domestic context. *See* George G. Triantis, *Secured Debt Under Conditions of Imperfect Information*, 21 J. LEGAL STUD. 225, 236 (1992).

91. *See* sources cited *supra* note 20.

92. The proponents of modified universalism, however, do acknowledge a need to look at the substance of forum law. They contend that a U.S. bankruptcy court should defer to a foreign proceeding only when the foreign law is similar to U.S. law. *See* Westbrook, *supra* note 8. They make no effort, however, to define what constitutes "close enough."

93. *See id.* at 461–71.

complete the case for universalism, one must examine the substance of the law to be applied. Universalism will remain fatally incomplete until the content of the law to be applied is specified.

There is, however, a deeper conceptual error imbedded in the argument for universalism, in both its substantive and procedural forms. Both implicitly assume that governments dictate the applicable bankruptcy rules. This assumption should be abandoned because imposing a single rule on firms will be inefficient compared with a system permitting a debtor to choose the law governing its bankruptcy.[94] The general thrust of the argument is one of comparative advantage. The possibility that a firm may encounter financial distress is known to all who voluntarily deal with the firm. Lenders decide the terms of loans based on the possibility of repayment.[95] Bankruptcy rules determine payouts when the firm encounters financial distress, and thus form part of the calculus when lenders make lending decisions. Lenders in a competitive market price their loans so as to receive, on an expected basis, the competitive rate of return.[96] This being the case, the firm ultimately pays the price for inefficient bankruptcy rules through the form of higher interest rates.

There are two institutions which are potential candidates for selecting the insolvency rules that help determine the price of loans: the market, represented by the owners of firms, and the government, represented by the legislature.[97] Here, firms have an advantage over the government because they can ascertain the price of different insolvency rules through the market. They observe the different interest rates charged by lenders for differing sets of insolvency rules, and can compare these

94. *See* Barry E. Adler, *Finance's Theoretical Divide and the Proper Role of Insolvency Rules*, 67 S. CAL. L. REV. 1107 (1994); Rasmussen, *supra* note 3, at 78–100; Schwartz, *Contracting About Bankruptcy*, *supra* note 23, at 129. Even those who argue that Chapter 11 may be efficient do not necessarily endorse the notion that firms should not be able to contract out of it. *See* Randal C. Picker, *Voluntary Petitions and the Creditors' Bargain*, 61 U. CINN. L. REV. 519, 522 n.16 (1992).

95. *See* Rasmussen, *supra* note 3, at 57–58; William H. Meckling, *Financial Markets, Default, and Bankruptcy: The Role of the State*, 41 LAW & CONTEMP. PROBS. Autumn 1977, at 13, 21, n.19; Frank H. Easterbrook, *Is Corporate Bankruptcy Efficient*, 27 J. FIN. ECON. 411, 414 (1990).

96. *See* Rasmussen, *supra* note 3, at 57–58, n.15; Meckling, *supra* note 95, at 21.

97. A possible institution for generating bankruptcy rules is a private body such as a trade organization or a group charged with formulating such laws. In the domestic setting, the most prominent of these is the National Conference of Commissioners on Uniform State Laws. In the international bankruptcy context, INSOL International played a large role in the drafting of the proposed model law on transnational insolvencies. *See supra* note 18. On the problems that can arise in such private bodies, see Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743 (1993); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995). These private bodies can either produce proposed legislation for governments to enact or standard forms for private parties to adopt.

differing costs to the benefits of competing insolvency rules. Firms can then select the set of rules which provides the highest net return.[98]

The government, in contrast, has no particular insight to either the cost of any given set of rules that it may choose to enact nor to the benefits that those rules bring.[99] Legislatures have no process to ascertain the market's pricing of the rules it enacts, nor can it determine the value of its rules to those affected by them. Legislatures are thus in a worse position than are firms to engage in the cost-benefit analysis critical to assessing the efficiency of a given set of insolvency rules. Firms may not inevitably make the optimal selection in every instance; on balance, however, they should perform better than the legislature.[100]

A second reason also favors the market over the government in deciding which insolvency rules should apply. Legislatures, by their nature, pass rules which cover a broad class of entities. They operate on a categorical basis; they simply cannot make individualized determinations. The market, on the other hand, can offer a variety of alternatives which allows a party to select the most suitable one for its needs. Thus, if firms differ as to which set of insolvency rules prove optimal, a market solution will more likely produce optimal diversity than a legislatively mandated one.[101] In short, the simple argument for a general regime of freedom of contractual choice applies to the bankruptcy context as well as it does to other commercial and corporate contexts.[102]

There are, of course, limits to this sweeping argument. Some creditors of a firm do not choose to transact with the firm. Rather, the firm through its actions makes these persons creditors. The most obvious example of this is a firm's tort creditors.[103] If firms were allowed to

98. This discussion assumes that efficiency is the appropriate criterion for assessing bankruptcy law. For a defense of this position, see Rasmussen, *supra* note 21.

99. The shortcomings discussed in this paragraph are also evident in the private lawmaking bodies mentioned in note 97.

100. On the necessity of identifying the better institution, rather than comparing a single institution to a perfect world, see NEIL K. KOMESAR, IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMICS, AND PUBLIC POLICY (1994); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 15–42 (1985).

101. Markets do not always provide optimal diversity. *See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713 (1997).

102. For the general argument as to why contractual freedom should be the norm in the corporate context, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 1-39 (1991); Symposium, *Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989).

103. The other significant category of involuntary claimant is the government, which is generally owed taxes by a failing firm. *See* Douglas G. Baird, *The Reorganization of Closely Held Firms and the "Opt Out" Problem*, 72 WASH U. L.Q. 913, 915 (1994); LoPucki, *supra* note 47, at 1897.

dictate the treatment of these creditors in bankruptcy, one would expect that these creditors would not fare well. For this reason, advocates of contractual freedom in the bankruptcy context also argue that government should determine the priority status of involuntary creditors.[104] As to the level of that priority, most prioritize tort claimants over all voluntary creditors.[105]

Despite this agreement on basic principles, those advocating an economic approach to bankruptcy disagree as to the best way to implement those principles. The general debate is whether the government should supply a set of nonexclusive legal regimes, from which the firm can choose at the time of its formation, or whether government should exit the insolvency context entirely and leave the matter to private contract.[106] Both proposals replace a bankruptcy system mandated by the government with one chosen by those whose money is at stake. They differ crucially not so much on whether either constrains private choice—under each the only constraint is the treatment of involuntary creditors—but on whether the government can reduce the transaction costs associated with determining the possible alternative rules.

On balance, it is preferable to have a menu of options available for firms at the formation stage rather than a single default rule of simply enforcing private contracts. To understand why, the costs associated with a single default rule must be evaluated. Under traditional economic analysis of corporate law, the virtue of default rules is that firms can decide whether the default rule maximizes firm value, and if it does not, choose a better rule at a relatively low cost.[107] To the extent firm owners have an incentive to select rules that maximize firm value, this action will maximize social welfare.[108]

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104. *See* Adler, *supra* note 21, at 339–40; Rasmussen, *supra* note 3, at 67; Schwartz, *Contracting About Bankruptcy*, *supra* note 23, at 142 n.28.

105. *See* Adler, *supra* note 21, at 340; David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565 (1991); LoPucki, *supra* note 47, at 1907–16; Rasmussen, *supra* note 21, at 31–35.

106. *Compare* Rasmussen, *supra* note 3; Robert K. Rasmussen, *The Ex Ante Effects of Bankruptcy Reform on Investment Incentives*, 72 WASH. U. L.Q. 1159 (1994); Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85 (1995); and Schwartz, *Contracting About Bankruptcy, supra* note 23, at 144; *with* Adler, *supra* note 21; Adler, *supra* note 94; Bradley & Rosenzweig, *supra* note 3.

107. The classic statement of this rule is found in EASTERBROOK & FISCHEL, *supra* note 102, at 1–39.

108. For the best articulation of this position, see *id.* at 1–39. Given the ease with which corporations can opt out of the default rule, Bernie Black has asserted that the role of corporate law is minimal. *See* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U.L. REV. 542 (1990).

Recent work, borrowing from the economic literature on network externalities, questions this simple proposition.[109] A network externality in the product area exists where the value of the product depends on the number of persons using the product.[110] For example, part of the value of having an IBM-compatible personal computer is that many other people own them, thus creating a market for software and hardware. Michael Klausner has shown that when the value of a default rule to a firm turns on how many other firms have adopted it, the choice made by a single firm whether to adopt or depart from that rule may not be socially optimal.[111] At times, all firms may adopt the default rule, even if social welfare would be improved by having a diversity of rules. At other times, all firms may choose not to follow the default rule, and select their own customized rule, even if there is a single rule which, if adopted by all firms, would increase social welfare. In such situations, efficiency can be improved by having a menu of options from which firms can select the best bankruptcy rule, rather than having a single default rule.[112]

While a detailed analysis of the network externalities problem in the bankruptcy context is beyond the scope of this article, such externalities do exist, thus lending support for the menu approach. A single set of insolvency rules would not be optimal for every firm. Yet, if there was a single default rule, it may be that network effects would lead to a "lock-in" effect where all firms adopted this single rule. The sources of these network externalities include legal service externalities and marketing externalities.[113]

Legal service externalities exist where lawyers are familiar with the default rule, and this familiarity creates an incentive for clients to adhere

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109. *See* Klausner, *supra* note 101, at 758–59; Kahan & Klausner, *supra* note 101.

110. Work in this area includes Joseph Farrell & Garth Saloner, *Installed Base and Compatibility: Innovation, Product Preannouncements, and Predation*, 76 AM. ECON. REV. 940 (1986); Joseph Farrell & Garth Saloner, *Standardization, Compatibility, and Innovation*, 16 RAND. J. ECON. 70 (1985); Michael Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424 (1985); Michael Katz & Carl Shapiro, *Systems Competition and Network Effects*, 8 J. ECON. PERSP., Spring 1994, at 93.

111. *See* Klausner, *supra* note 101.

112. *See id.* at 839–41. I have elsewhere argued that having a menu increases efficiency as opposed to leaving the matter to private contract. *See* Rasmussen, *supra* note 3, at 62–68. Ian Ayres has also suggested that legislatures provide menus for corporate contracts. *See* Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391, 1416 (1992).

113. The types of network externalities identified by Klausner are interpretive network externalities, common practice network externalities, legal services network externalities, marketing network externalities, and learning effects. *See* Klausner, *supra* note 101, at 774–89. Only the last two types of network externalities exist in the contract for bankruptcy context. Klausner himself notes that network externalities may inform the current bankruptcy debate. *Id.* at 766, n. 25.

to that rule.[114] Once lawyers are familiar with particular contractual terms, it costs the client more in legal fees to have a new contract with new language and new terms drafted. In the bankruptcy context, there are a number of potentially complicated issues whose resolution both requires elaborate drafting and permits many alternative terms, as the current morass of international bankruptcy law illustrates. Given a default rule of enforcing private contracts, there will be a cost advantage for the firm at the front end in choosing the existing terms rather than attempting to customize a set of bankruptcy rules for the firm. This savings in costs could lead a firm to adopt the default rule even though a different rule would maximize firm value.

A similar externality exists in the marketing area. Firms need investors, both at the stage when they first form, and when they first go public. These investors must evaluate the product that they are buying. To the extent there is a well-used default rule, the investors will be familiar with the costs and benefits of the rule.[115] If a firm decides to adopt a customized set of bankruptcy rules, however, investors will have to spend resources to ascertain the costs and benefits of the unfamiliar customized rules. The same holds true for all subsequent creditors, who will also price the cost of having to learn any unfamiliar term.[116] Once again, there are cost savings for firms adopting the existing default rule instead of attempting to craft a rule which better suits the needs of the firm.

These costs can be ameliorated by having a menu of options from which firms can select. By having a number of publicly disseminated insolvency rules, lawyers will gain expertise with each set of rules.[117] Thus, as amongst the rules, there will be little or no legal service externalities. Lawyers will be conversant with the various choices available to firms, and thus should charge roughly the same amount for each of the available choices. Only if the firm decides to craft a set of insolvency rules that departs from the choices on the menu will there be legal service externalities. Thus, to the extent that a well-crafted set of options can cover the needs of a large majority of firms, the problems associated with legal services externalities would be greatly reduced.

Adopting a menu of insolvency options would also decrease marketing externalities. Those deciding to invest money in the firm, either by taking an equity stake or by extending credit, would be familiar with

114. *See id.* at 782–84.

115. *See id.* at 785–86.

116. *See* Rasmussen, *supra* note 3, at 65–67.

117. Of course, there is an optimal number of rules. At some point, the gain attributable to adding another rule to the menu is outweighed by the cost of having to learn the details of that rule. *See id.* at 100.

the various options on the menu. To be sure, these investors will charge differing rates depending on how they are treated under the differing options. Yet, because they are already familiar with these options, there will be no charge for the added cost of learning an entirely new set of insolvency rules. By shifting from a single default rule to a menu of options, the marketing externalities would be reduced significantly.

Once it is decided that a menu of options would be superior to a single default rule, one still must face the question whether the market can provide such a menu by creating standard forms or whether the government should layout the menu options. Despite the general effectiveness of market solutions to bankruptcy problems,[118] in this area, the government can probably do a better job. The network externalities that exist under a single default rule would prevent the market from forming the standard forms necessary to create a well-functioning menu regime. Even if one law firm decided to invest resources to create a set of standard forms, it is unlikely that a firm would choose one of these forms rather than the default rule. The default rule has an installed base of interpretation; other lawyers know how courts have interpreted the rule. Such a base of interpretation does not exist with respect to the privately generated forms. Also, those who invest money in the firm know the contours of the default rule; they would have to spend additional resources to determine the contours of the insolvency rules drafted by the law firm. It is these very problems which doom the default rule approach.[119] Only if the law firm were able to draft a set of insolvency rules whose efficiency gains exceeded these network externalities would a firm have an incentive to deviate from the default rule. The government's comparative advantage in publicizing its menu leads to the conclusion that the government, rather than the market, should craft the menu of bankruptcy options.

This argument gains force when one moves from the domestic context to the international one. Countries differ in their legal traditions and in their languages. When a firm departs from the default rule to craft its own insolvency regime, there is greater potential for misunderstanding the import of this regime when a foreign court may be called upon to interpret its provisions. Similarly, foreign investors may face a higher cost in learning the tailor-made rules than would domestic investors.

118. *See generally* Rasmussen, *supra* note 3; Rasmussen & Skeel, *supra* note 106, at 91–96.

119 Kahan and Klausner's recent study of contracting in the bond market supports the conclusion that law firms are not well situated to provide alternatives to the governing default rule. See Kahan & Klausner, *supra* note 101, at 753–56.

Thus, the network externalities discussed above increase when one moves from the national to the international arena.[120]

A menu approach to international insolvency law thus promises significant efficiency gains over any system which either imposes a single regime or sets one such regime as a default rule. For this reason, it is preferable both to the current situation, in which each country applies its own set of mandatory insolvency laws to the assets of the debtor found within its borders, and to proposed systems of substantive universality. The task of crafting the options which should appear on the menu remains. The article's goal is not to specify the contours of the optimal menu,[121] but to change the direction of the debate over international bankruptcy law from the question of which mandatory rule should apply to the insolvent multinational firms to the question of which set of insolvency rules should be offered to multinational firms. Firm choice should replace government mandate.

III. SECOND-BEST SOLUTIONS

Adopting the menu-based solution to the problem of transnational bankruptcies would require a fundamental shift in the way countries approach this problem. Most other proposed reforms urge more incremental changes in extant law. The preference of most, if not all, academic commentators would be a meta-rule that the "home" country of the multinational firm provide the single forum, and controlling law, for handling all transnational bankruptcies.[122] This part shows that such a meta-rule is not obviously preferable to the current system. This part then proposes a new approach to transnational insolvencies which is not a radical departure from current law. This approach would allow firms to select which country's laws would govern in the case of financial distress. While I do not claim that the latter procedure is ideal, it represents an improvement to the current state of affairs, while remaining within the confines of existing legal doctrine.

120. Implementation of this menu approach would best be done through a treaty among nations specifying the choices on the menu. While one could certainly imagine individual countries setting up their own menus which both detail specific options and validate any other choice made by the parties, this would more than likely lead to a large number of differing options as each country added more to the list. While current efforts to draft international insolvency treaties have been less than successful, one would imagine that it is easier to reach agreement on what acceptable options would be rather than agree on a single, universal procedure. Indeed, the recently drafted model law by UNCITL and INSOL avoids attempting to specify a single insolvency regime. *See supra* note 18.

121. For a proposed menu for domestic firms, see Rasmussen, *supra* note 3, at 100–21.

122. *See* Westbrook, *supra* note 9, at 517–18.

A. *The "Home" Jurisdiction Approach*

Procedural universality calls for a set of rules designed to ensure that a single forum handles the financial distress of a transnational firm. This forum would apply its own bankruptcy rules, including its own choice of law rules.[123] Scholars advocating this approach to transnational insolvencies generally agree that the best rule would be for the firm's "home" country to administer all the debtor's assets.[124]

This proposal may not achieve the results attributed to it, however. Recall that the case for universalism relies on efficiency grounds: clear rules decrease lending costs and do not skew investment choices, and a single forum provides a number of administrative savings.[125] Yet for some firms, the current territorial approach may produce more efficient results than this alternative.

The driving force behind the argument for procedural universality is that it prevents a destructive race to the firm's assets. But it is not always true that the international setting provides a theater for a calamitous race to the assets. In this regard, the parallel argument long invoked to explain the need for domestic bankruptcy law, both by law and economic bankruptcy scholars[126] and by more traditional bankruptcy scholars,[127] proves to be an inapt analogy. The domestic argument proceeds from the premise that state debt collection law allows individual creditors to carve up the firm by receiving judicial liens and levying on the debtor's property to satisfy these liens. No state has a commonly used collective debt collection mechanism. It only provides individual remedies.[128] Permitting individual creditors to pursue their state-law remedies leads to a number of inefficient results, including the piecemeal sale of the assets of the firm which may be worth more if kept together; excessive monitoring by individual creditors to ensure they are not last in line once the race to the assets begins; and numerous judicial proceedings as each creditor rushes to its preferred forum.[129] These concerns do not apply in the international context, since most nations have some form of bankruptcy law which will end the destructive race to the assets in that country. For example, Section 362 of the U.S. Bankruptcy Code stays all debt collection efforts and

123. *See* Westbrook, *supra* note 8, at 461–71.

124. *See id.*

125. Bebchuk & Guzmán, *supra* note 19; Westbrook, *supra* note 8.

126. *See* JACKSON, *supra* note 21, at 7–19.

127. *See* Warren, *Bankruptcy Policymaking in an Imperfect World*, *supra* note 3, at 350–52.

128. *See* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 782–85 (1987).

129. *See* Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements and the Creditors' Bargain*, 91 YALE L.J. 857, 860–68 (1982).

forces the creditors into a collective proceeding.[130] Thus, there is no threat of a destructive race inside the borders of any country.

To be sure, the affairs of a transnational corporation extend beyond the jurisdiction of a single sovereign. Yet in many cases, having the assets in each country administered separately does not raise the specter of inefficient deployment of those assets. Consider in this regard the recent insolvency of Olympia & York, which was primarily engaged in developing commercial property in various countries.[131] It is hard to see why allowing each country to administer the property within its borders would lead to inefficient deployment, since there is no synergy amongst the differing assets. How the firm's London assets are deployed has no effect on the management of the firm's Canadian properties. Thus, even if individual creditors induced each country to administer the local assets under its own bankruptcy law, it is difficult to imagine that such a piecemeal resolution of Olympia & York's financial distress would have caused a large loss in terms of social welfare. Only an unquestioned belief in the value of international cooperation would lead to the conclusion that the lack of cooperation in *Olympia & York* is a cause for concern.[132]

Consider also the case of U.S. Lines, a major ocean carrier that filed for Chapter 11 reorganization under the U.S. Bankruptcy Code.[133] Even though no one disputed that the United States was the home jurisdiction, most courts outside the United States refused to defer to the U.S. bankruptcy court.[134] For shipping lines, firm assets usually are spread all over the world. Is it the case, however, that the assets of a shipping line are worth more than the sum of their parts? Presumably, when each country allowed its home creditors to seize the ships within its jurisdiction, these ships were not sent to the scrap yard. These ships are most likely still plowing through international waters.[135] There may have been an end to the firm U.S. Lines, but there may not have been a loss of a going-concern

130. *See* 11 U.S.C. § 362(a) (1994).

131. *In re* Olympia & York Developments Ltd. [1993] 12 O.R. 3d 500 (Ont. Gen. Div.).

132. *See* Jay Lawrence Westbrook, *Developments in Transnational Bankruptcy*, 39 ST. LOUIS U. L.J. 745, 745–46 (1995).

133. Felixstowe Deck & Railing Co. v. U.S. Lines, 2 Lloyd's Rep. 76 (1987). *See* Stefan A. Riesenfeld, *Transnational Bankruptcies in the Late Eighties: A Tale of Evolution and Atavism*, *in* COMPARATIVE AND PRIVATE INTERNATIONAL LAW: ESSAYS IN HONOR OF JOHN HENRY MERRYMAN ON HIS SEVENTIETH BIRTHDAY 409, 416 (David S. Clark ed., 1990).

134. *See* Westbrook, *supra* note 8, at 479.

135. Of course even if some ships were taken out of service, proponents of cooperation would still have to demonstrate that this course of action was inefficient. Industries often suffer from overcapacity, and liquidation of one firm is one avenue toward reducing the excess supply.

surplus. However, at least one prominent commentator has pointed to this case as an example of the ills caused by a lack of cooperation.[136]

The presence of a bankruptcy system in each country also reduces the other evils identified with the domestic race to the assets. Because there will only be a single proceeding in each country, the fear of a different proceeding for each creditor is reduced. To be sure, there still may be additional expenses than if there was only one proceeding worldwide. The debtor will need counsel in each of the proceedings. Also, some creditors may pursue the debtor in all available forums, thereby increasing costs. On the other hand, some creditors, such as a bank which takes a security interest in all of the firm's domestic assets, may only participate in a single proceeding in its home country, thus eliminating the need for counsel abroad. Thus, the existence of multiple proceedings under the current territoriality approach may reduce the costs to some firms but increase them for others.

The remaining argument in favor of universalism is that offered by Bebchuk and Guzmán. Recall that they assert that territoriality skews investment decisions in a way that universalism does not. The linchpin of their analysis is the assumption that each country's law will favor that country's creditors over foreign creditors. It is this favoritism that, in their model, allows a firm to obtain a lower interest rate by investing in a new country which will elevate the claims of its domestic creditors over the claims of the firm's existing creditors. Absent such favoritism, the territorial approach will not affect investment choice.[137] The question of recognition of foreign creditors, however, is distinct from the question of which forum or forums should handle the financial distress of a multinational firm. Few, if any, argue that foreign creditors should be treated differently from domestic creditors based solely on their nationality. Indeed, most countries today accord national treatment to foreign creditors.[138] Thus, while the argument of Bebchuk and Guzmán is analytically sound, it is an argument for national treatment of creditors (which most countries practice) rather than an argument for universalism (which most countries eschew). It is thus still the case that, on an a priori basis, one cannot maintain that universalism dominates territoriality for all firms.

To say that procedural universality will not generate more efficient results in every case, is not to say, however, that it will not generate efficient results in any case. For example, consider the case where multiple proceedings lead to the liquidation of a firm that otherwise would

136. *See* Westbrook, *supra* note 8, at 478–83.
137. See Bebchuk & Guzmán, *supra* note 19, at 12–13.
138. See Westbrook, *supra* note 131, at 755.

have and should have remained intact. In what circumstances would this be the case? First, there would have to be a firm which is worth more as a going concern than it would be if it were liquidated piecemeal. Second, the firm's operations would have to be so integrated that a single forum was necessary to revamp the firm's capital structure. The recent Maxwell bankruptcy may have been such a case.

Maxwell Communication Corporation (MCC) was an English holding company with more than 400 subsidiaries worldwide.[139] The managers of MCC filed a petition in the Southern District of New York under Chapter 11, which provides better treatment for incumbent managers than does the English Insolvency Act. The following day, the managers also obtained an order in London putting the firm into administration under the Insolvency Act. There were thus two primary proceedings involving MCC.

Given the nature of MCC, there is reason to believe that there was value in keeping the firm in its current configuration. The managers of the firm, who presumably had expertise in handling MCC's business, were located in England. The majority of the assets, however, were located in the United States. Supposing that the managers of MCC were in the best position to maximize the return on these assets, the assets "needed" these managers to achieve their highest value. To the extent that the managers' business ability was to some extent firm specific, they likewise needed the assets to maximize their value. The two insolvency proceedings, however, raised the possibility that the U.S. assets would be administered separately from the English managers and thus much of the value of the overall enterprise would be lost.

Despite the fact that neither England nor the United States has embraced procedural universality, the English and U.S. courts and attorneys were able to approximate it through their own agreements so as to avoid a piecemeal handling of MCC. The U.S. Bankruptcy Court refused to dismiss MCC's Chapter 11 petition, and instead appointed an examiner with expanded powers.[140] The High Court appointed as administrators insolvency practioners suggested by MCC's major bank creditors.[141] The examiner and the administrators then drafted an "Order and Protocol." This document, which was approved by both the Bankruptcy Court and the High Court, set forth the ground rules for the two insolvency

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139. *See* Evan D. Flaschen & Ronald J. Silverman, *The Role of the Examiner as Facilitator and Harmonizer in the Maxwell Communication Corporation International Insolvency*, *in* CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE LAW 621, 624 (Jacob S. Ziegel ed., 1994).

140. *See In re* Maxwell Communication Corp., 170 B.R. 800 (Bankr. S.D.N.Y. 1994), *aff'd*, 186 B.R. 807 (S.D.N.Y. 1995).

141. *See* Flaschen & Silverman, *supra* note 139, at 624.

procedings. This document in essence attempted to harmonize the two competing insolvency systems into a single regime. The examiner and the administrators agreed that MCC's Chapter 11 plan and the Administration in England would provide for essentially the same treatment of MCC and its subsidiaries. The parties also agreed that MCC's assets outside of the United States and England should be sold quickly.[142] In effect, the two parties negotiated a bankruptcy treaty for this case.

These facts suggest that all of the parties involved in the MCC bankruptcy believed the firm was worth more with its English and U.S. assets combined. As a result, both the examiner and the administrators spent considerable resources in harmonizing the U.S. and English proceedings. Even where significant barriers exist, cooperation designed to achieve universality does occur when there are clear gains.

Which is the more common situation, *Olympia & York* or *Maxwell*? In other words, how often is a multinational company's operations so integrated that applying different insolvency laws threatens the efficient deployment of the firm's assets? Ultimately, this is an empirical question, to which the answer is changing constantly. Although MCC is, by all accounts, a highly unusual case in that the managers were located in one country and the majority of the assets in another,[143] the trend is toward more integrated transnational operations.[144] What is clear, however, is that the threat of inefficiently tearing apart a firm is not necessarily as large as is assumed in the standard arguments against the territorial approach. The simple equation between the domestic and international contexts on which the case for procedural universalism is normally based cannot withstand scrutiny.

Even if the territorial approach does not lead to the routine liquidation of economically efficient companies, one might be tempted to argue that it nevertheless raises the costs of liquidation when compared with the procedural universalism approach. But the threat of excessive creditor monitoring, which Thomas Jackson points to in justifying domestic bankruptcy law,[145] does not loom large in the international context. The reason for this reduction is, again, each jurisdiction has its own set of bankruptcy laws. To the extent that the bankruptcy law of a country embraces pro rata sharing among general, unsecured creditors, the incentive to engage in duplicative monitoring of the affairs of the debtor is greatly reduced. Since each creditor is assured that the assets

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142. *See id.* at 632.

143. *See* Jay Lawrence Westbrook, *The Lessons of* Maxwell Communications, 64 FORDHAM L. REV. 2531, 2541 (1996).

144. *See* Wilson Chu, *Avoiding Surprises Through Due Diligence*, BUSINESS LAW TODAY, Jan./Feb. 1997, at 8.

145. *See* JACKSON, *supra* note 21, at 16.

in any given country will not be parceled out to the first creditor to grab the assets, it has less incentive to ensure that it is the first in line.

To be sure, there is still the obvious problem of multiple proceedings. Given the general adherence to the territorial approach, each transnational bankruptcy generates a number of insolvency proceedings, though it is unclear how much of a problem this is. For example, assume a transnational firm in financial distress that should be liquidated. There is no reason to seek to reorganize the firm; it is suffering from incurable economic distress. It may be efficient to have each country handle the liquidation of assets within its borders. As noted above, going to a foreign proceeding is expensive for creditors. If the firm's assets will be sold, why should those sales not be conducted locally?

The case for the home jurisdiction rule is thus not as compelling as its supporters suggest. For many firms, the territorial approach may actually provide a superior set of insolvency rules. Moreover, the territorial approach may be able to replicate procedural universality when it is appropriate to do so, as it did in the case of MCC. On balance, one cannot conclude that one approach dominates the other. Empirical evidence is needed to ascertain the types of multinational firms which encounter financial distress.

B. *A Procedural Rule of Firm Choice*

As an ex ante matter, one cannot identify which meta-rule—territoriality or universalism with a single proceeding in the home jurisdiction—better maximizes social welfare. These choices do not exhaust the possible alternatives. A much better approach would be to allow firms to specify in their corporate charter which country's or countries' insolvency laws will apply if the firm becomes insolvent.

This approach extends the general rule favoring party choice in contractual settings. In many contractual settings, there is more than one jurisdiction affected by the contract. Although the domestic and international conflict of law rules designating which law shall apply in particular situations are often quite complex,[146] the law has provided an easy solution to this problem: within broad limits, let the parties decide which law should apply. As a general matter, courts enforce contractual provisions selecting which forum the dispute is to be litigated in[147] and which law applies.[148] Indeed, courts will often enforce such provisions even when they are certain that such enforcement will lead to a different

146. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188 (1971).

147. *See* The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972).

148. *See* RESTATEMENT, *supra* note 146, § 187.

substantive outcome than if the court decided the matter itself according to its own law.[149] A court will decline to enforce such provisions only when following the law of the other jurisdiction would be contrary to the fundamental policy of the court's own state.[150]

The justification for the general rule of party choice is that it fulfills the expectations of the parties, and allows them to ascertain with relative certainty what their rights will be under the contract.[151] When two parties sign a contract containing a provision enforceable in the jurisdiction in which one party is located, but not in the jurisdiction where the other party finds itself, there is no ex ante reason to favor the policy judgment of one jurisdiction over the other. Given this, the sensible solution is to allow the parties to choose which jurisdiction's law shall apply.

The Supreme Court has endorsed this reasoning. In *The Bremen v. Zapata Co.*,[152] a U.S. shipper entered into a contract with a German carrier to ship one of its drilling rigs. The contract contained a forum-selection clause, which directed that disputes arising out of the shipment be litigated in London. The contract also contained an exculpatory clause protecting the carrier from claims arising out of damage to the shipped drilling rig.[153] The U.S. shipper brought suit in the United States. U.S. courts would not enforce the exculpatory clause, but English courts would.[154] The Supreme Court held that the forum-selection clause should be enforced, noting that "[t]he choice of [the English] forum was made in an arm's-length negotiation by experienced and sophisticated businessmen, and absent some compelling and countervailing reason it should be honored by the parties and enforced by the courts."[155]

The rule articulated in *The Bremen* should be extended to allow a firm to select which forum should adjudicate its bankruptcy. Moreover, although the conflicts of law principles generally distinguish choice of forum from choice of law, in the bankruptcy context it makes sense to combine these principles. Bankruptcy rules are notoriously complex. It is fanciful to expect a court to apply the bankruptcy law of a foreign country with anything approaching an acceptable degree of accuracy.[156]

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149. *See, e.g.*, *The Bremen*, 407 U.S. 1.

150. *See* RESTATEMENT, *supra* note 146, § 187(2)(b).

151. *See id.*, § 187 cmt. e; FRIEDRICH K. JUENGER, CHOICE OF LAW AND MULTISTATE JUSTICE 55–56 (1993).

152. *The Bremen*, 407 U.S. 1.

153. *Id.* at 3.

154. *Id.* at 8.

155. *Id.* at 12.

156. See, for example, Jay Westbrook's description of the English courts failure to understand American bankruptcy law in *Felixstowe Deck & Railway Co. v. U.S. Lines*, 2 Lloyd's Rep. 76 (1987) (the *U.S. Lines* case). Westbrook, *supra* note 8, at 480–82.

Thus, for pragmatic reasons, a forum should generally apply its own bankruptcy law. Moreover, even outside the bankruptcy context, courts tend to apply their own law to multinational problems.[157] A firm should not be allowed to select one country as the forum for the dispute, and then specify that it should apply another country's bankruptcy law.

Subject to this restriction, firms should be allowed to specify which country or countries should administer its affairs if it encounters financial distress. Just as in *The Bremen*, most of the firm's creditors are likely to be sophisticated business people capable of looking after their own interests. If international parties are free to adopt a forum that would enforce an exculpatory clause which a U.S. court would not, why should they not be free to choose a forum and its accompanying bankruptcy laws?

There are two obvious objections to the above argument, neither of which withstands close examination. The first is that there is a coordination problem involved in the bankruptcy context which does not exist in the standard two-party contract situation.[158] The two-party contract only binds the immediate parties; other parties are usually not affected by its provisions. In the bankruptcy context, however, the choice of a bankruptcy regime affects all the firm's creditors. For example, if a firm borrowed money from a bank and the lending agreement included a clause which stated that if the firm encountered financial distress it would file for bankruptcy in England, the enforcement of this clause would affect all the firm's creditors. These creditors, however, may have no reason to expect the bankruptcy to be held in England.

This problem can be easily overcome. Rather than having the bankruptcy selection in a single contract between the firm and one of its creditors, the clause should be in the corporate charter to be enforceable. This would notify all creditors as to where the firm's bankruptcy would be held.[159]

The second problem with allowing firms to select the bankruptcy forum is that the argument for choice does not extend to involuntary creditors. This argument parallels the objection to allowing firms complete freedom in specifying the treatment of all of their creditors. By

157. *See, e.g.*, Larry E. Ribstein, *Choosing Law By Contract*, 18 J. CORP. L. 245 (1993).

158. *See* Rasmussen, *supra* note 3, at 65–67.

159. For a detailed discussion of the benefits of using the corporate charter to specify bankruptcy rules, and appropriate limitations on charter amendments, see Rasmussen, *supra* note 3, at 16–21; Robert K. Rasmussen, *Free Contracting in Bankruptcy at Home and Abroad*, *in* THE FALL AND RISE OF FREEDOM OF CONTRACT (F.H. Buckley ed., forthcoming 1998) (on file with author). Those deciding to lend money to the firm would know to examine its charter to ascertain the situs of any future bankruptcy procedings.

their nature, involuntary creditors have not made a decision to extend credit to the firm. They thus did not have an opportunity to assess the firm's choice of bankruptcy forum, and then decide if they were willing to run the risk of having their claims adjudicated in that forum. Involuntary creditors thus risk having their claims settled in an inconvenient forum according them lower priority than would the forum which would otherwise handle their claim.

In the United States, this is not much of a burden, given that most involuntary creditors are accorded a low priority—that of an unsecured creditor.[160] If the United States provided a more efficient and fair treatment of involuntary claimants, the firm's freedom of choice would have to be restricted in order to protect that priority. Such protection could come from a rule providing that U.S. courts would only enforce a forum-selection clause as applied to the involuntary creditor, where the law of that court provides a priority at least as equal to the priority that the creditor would receive in the U.S. court and where that court provides an effective means to resolve the claim.

The Bremen allows the application of such a rule. While the Supreme Court in that case held that forum-selection clauses are presumptively valid, it also held that they can be overcome when the party seeking to avoid the bite of the clause "clearly show[s] that enforcement would be unreasonable and unjust . . . ."[161] To the extent a bankruptcy selection clause lowers the priority of an involuntary claimant, the clause, as applied to the given creditor is "unreasonable and unjust."

The rule of *The Bremen* should therefore be extended to the bankruptcy setting. Such an extension would allow firms to select from among the bankruptcy laws of the various countries in which it operates the one which it views as the most efficient. Indeed, to the extent that countries would compete amongst each other to be selected as the provider of bankruptcy laws, this proposal, if followed, may lead to a general increase in the efficiency of all country's bankruptcy laws.[162]

160. For criticisms of this treatment from both economic and noneconomic perspectives, see Rasmussen, *supra* note 21, at 31–35; LoPucki, *supra* note 47, at 1907–16; Mark J. Roe, *Commentary on "The Nature of Bankruptcy": Bankruptcy, Priority, and Economics*, 75 VA. L. REV. 219, 226–28 (1989); Leebron, *supra* note 105, at 1640–50.

161. *The Bremen*, 407 U.S. at 15.

162. The analogy here is the "race to the top" in U.S. corporate law. *See generally* Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977); ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 14–24 (1993). Indeed, one could push the analogy further and argue that rather than allowing a firm to specify in its corporate charter the country or countries in which it would file for bankruptcy, firms should be required to file for bankruptcy in the jurisdiction in which they are incorporated.

CONCLUSION

Transnational bankruptcies are becoming an ever increasing event in the global economy. To date, the legal regime has responded to the problem by either ignoring it, or through modest efforts at governmental regulation. Both responses are unsatisfactory. Ideally, if countries would forgo their insistence on mandating the content of the bankruptcy laws, each firm would, at the time of its formation, select its insolvency regime from a menu of bankruptcy options.

Such fundamental change in transnational bankruptcy, while normatively desirable, is unlikely to occur in the near future. Current norms of private international law, however, provide a vehicle for improving the extant state of affairs. Courts should enforce provisions in corporate charters which specify which country's or countries' bankruptcy law should apply when the firm encounters financial distress. Adhering to party choice would replace the current muddle of laws surrounding transnational insolvencies with a more coherent approach.