# WHERE ARE ALL THE TRANSNATIONAL BANKRUPTCIES? THE PUZZLING CASE FOR UNIVERSALISM

*Robert K. Rasmussen*[*]

Universalism is on the march. For a century the goal of bringing some degree of harmonization to the world's varying insolvency regimes seemed something of a quixotic quest. Scholars repeatedly touted the welfare gains that would result if the world were to move toward a system that assigned a single forum the lead role in sorting the financial distress of insolvent debtors.[1] The near-consensus in the academy had little impact on practice, however, as countries clung stubbornly to territorialism. Each country asserted primary jurisdiction over the assets found within its borders, and would pay little heed to the work of other courts in countries where the debtors' assets were located.[2] The cries of the academic commentators went unheeded.

The tide has seemingly turned.[3] The European Union has adopted rules designed to deal with the financial distress of an enterprise with assets in various member countries.[4] It requires that the jurisdiction in which the "centre of main interests" of the enterprise is located take the lead in sorting out the affairs of the troubled firm.[5] The international organization charged with proposing model commercial laws—UNCITRAL—has drafted a law that would provide coordination in the case of a transna-

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1. *See, e.g.*, John Lowell, *Conflict of Laws as Applied to Assignments for Creditors*, 1 HARV. L. REV. 259, 264 (1888).

2. *See* Douglas G. Boshkoff, *Some Gloomy Thoughts Concerning Cross-Border Insolvencies*, 72 WASH. U. L.Q. 931 (1994).

3. *See* Ian F. Fletcher, *Maintaining the Momentum: The Continuing Quest for Global Standards and Principles to Govern Cross-Border Insolvencies*, 32 BROOK. J. INT'L L 767 (2007); John Pottow, *The Myth (and Realities) of Forum Shopping in Transnational Insolvency*, 32 BROOK. J. INT'L L 785 (2007) [hereinafter Pottow, *Myth (and Realities)*].

4. *See* Council Regulation 1346/00, Insolvency Proceedings, 2000 O.J. (L160) 1 (EC).

5. *Id.*; Case C-341/04, Eurofood IFSC Ltd., 2006 E.C.R. I-3813.

tional insolvency.[6] The United States has recently turned the proposed law into positive law by adding Chapter 15 to its bankruptcy code.[7] While there are differences between the E.U. Regulation and Chapter 15 of the U.S. Bankruptcy Code (Chapter 15), they share the same core commitments.[8] With Europe and the United States both adopting the universalist stand, its triumph now seems inevitable.

Overlooked in the discussion over whether the universalist program is better than its competitors is an assumption that rests uneasily with the realities of modern bankruptcy practice. The aim of this Article is to expose this assumption, demonstrate how it cannot be squared with the observed practices handling the financial distress of transnational enterprises, and suggest how, in light of the dynamics on the ground, the discussion on transnational insolvencies needs to evolve.

The literature on transnational insolvencies assumes that multiple insolvency proceedings will inevitably result once a transnational enterprise becomes financially distressed. It is a staple of the literature that a business with substantial assets in more than one country will be subject to bankruptcy proceedings in more than one country. Creditors seeking to get paid will attempt to seize assets in any country they are located. Thus, for those who view the prior century's commitment to territorialism with alarm, globalization raises the stakes. As more and more countries have a worldwide footprint, the number of companies whose fate will be left to competing bankruptcy systems increases. In other words, the number of insolvency proceedings an insolvent company faces is solely a function of the number of jurisdictions in which it has substantial assets. The universalist concern is that when a company faces an array of insolvency proceedings, this raises the possibility that the multiple courts will not be able to work together, and the company will be forced into liquidation.

If this assumption were accurate, one would expect that it would be easy to identify many instances where a financially distressed enterprise is subject to multiple insolvency proceedings. Companies increasingly have a global reach, and we would thus expect a surfeit of multiple proceedings. Yet the puzzle is that we see so few such cases relative to the

6. U.N. COMM'N ON INT'L TRADE LAW [UNCITRAL], UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT art. 1, U.N. Sales No. E.99.V.3 (1997).

7. 11 U.S.C. § 1501 (2006).

8. For a comparison of the two approaches, see Jay Lawrence Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles, and The EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1 (2002) [hereinafter Westbrook, *Multinational Enterprises*].

number of financially distressed debtors with multinational operations. There are undoubtedly debtors who have bankruptcy proceedings in more than one country. It is not that cases that involve multiple proceedings do not exist. Yet there seem to be many fewer cases than one would expect if one were to give full credence to the fears of those studying the field. The number of financially distressed transnational enterprises far exceeds the number of situations involving multiple insolvency proceedings.

This Article proposes an answer to this puzzle. The answer is that debtors and their senior creditors control the extent to which distressed transnational businesses are subject to more than one bankruptcy proceeding. In other words, the implicit assumption is that the number of bankruptcy proceedings to which a debtor is subject is determined by its existing deployment of assets and liabilities. In fact, however, there are ways in which debtors and their senior creditors have the ability to determine the number of countries that will be involved in resolving the companies' financial distress.

The fact that the number of forums involved in the bankruptcy of a transnational enterprise is to a large degree within the control of the debtor and its senior creditors requires that we reorient our focus on transnational insolvencies. The risk of inefficient liquidations that motivated the universalist agenda does not loom large in today's environment. Liquidations occur only when those in charge of the debtor decide that the assets should be sold. In this respect, international bankruptcy practice is converging with American bankruptcy practice.[9] In both settings, the crucial question is the extent to which debtors use the discretion they have to make value-maximizing decisions. Creditors—especially senior lenders—have had increasing input into the crucial decisions that face a financially distressed company.[10] The forces

9. I will admit to an American bias in perspective here. I have at best a passing familiarity with the bankruptcy practices in other countries. Also, the transnational insolvency cases of which I am aware have a substantial connection with the United States. The extent to which we see a general convergence among bankruptcy regimes and the extent to which the handling of the affairs of a transnational debtor depends on which countries are involved are interesting questions that are beyond the scope of this Article.

10. The rise of creditor control in Chapter 11 and the reasons for it have been the subject of a series of Articles that I have written with Douglas Baird. *See* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209 (2006) [hereinafter Baird & Rasmussen, *Private Debt*]; Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673 (2003); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751 (2002). Others have noticed this trend as well. *See* Stephen J. Lubben, *The "New and Improved" Chapter 11*, 93 KY. L.J. 839 (2005); Jay Lawrence Westbrook, *The*

that have allowed creditors to exert greater control over the affairs of a troubled company in America do not stop at our national borders. The next generation of transnational bankruptcy scholarship should focus less on the relations between nations and more on the dynamics of control.

## I. GLOBAL COMPANIES AND TRANSACTIONAL INSOLVENCIES

Three basic paradigms dominate the transnational insolvency literature. The first, which seems to have the greater number of adherents in the academy, is universalism.[11] In its most utopian form, a universalist approach envisions a single set of insolvency rules applied by a single forum. Few expect to witness the emergence of such a system anytime soon. The more attainable universalist approach, often referred to as procedural universalism, is a system that would allow for the coordination of multiple bankruptcy proceedings. When a company with operations across the globe runs into financial distress, it will be subject to an insolvency proceeding in each country where it has substantial assets. The universalists seek a rule that identifies which country will take the lead in sorting out the debtor's affairs. By and large, universalists envision that the country that is the "home" of the debtor will be the one which is the situs of the main proceeding. The role of the other countries is to implement the decisions that have been made in the main jurisdiction. Of course, the primary decision in any bankruptcy is the fact of the company, whether it is to be rescued or liquidated.

Another paradigm, cooperative territorialism, takes a different path.[12] Like universalism, it recognizes that the territorial approach to transnational financial distress risks inefficient liquidations. Companies that are worth more if kept together will be liquidated as each nation focuses blindly on the assets within its territorial boundaries. Yet scholars em-

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*Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795 (2004); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917 (2003) [hereinafter Skeel, *Creditors' Ball*].

11. Jay Westbrook has been the most tireless proponent of universalism. Of his many contributions, two in particular set forth his overall vision. *See* Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276 (2000) [hereinafter Westbrook, *A Global Solution*]; Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457 (1991) [hereinafter Westbrook, *Theory and Pragmatism*]. Andrew Guzman has bolstered the universalist case with an economic analysis of the problem. *See* Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177 (2000).

12. Lynn LoPucki is the architect of this approach. *See* Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216 (2000); Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696 (1999).

bracing this approach believe that the self-interest of states means that they are unlikely to cede control over assets in their jurisdiction to other nations.[13] They also worry that, for some companies, is it difficult to identify which country is the home country. More recently, cooperative territorialism scholars have raised the concern that the home jurisdiction is malleable enough to allow for forum shopping, which will have a pernicious effect on transnational bankruptcy practice.[14] To avoid these ills, those in favor of cooperative territorialism counsel that each country should retain control over the assets it has, but in administering these assets, the affected countries should attempt to work together. Stated somewhat simplistically, universalism seeks cooperation through ex ante commitments whereas cooperative territorialism seeks cooperation on an ex post basis.

A third approach would give more decision-making power to the businesses themselves. Companies would, in advance, commit to having either one or multiple bankruptcy proceedings.[15] Under this approach, an enterprise that believed that its value would be maximized through a single proceeding could commit to such an action, and all states would respect this choice. Conversely, companies that thought that multiple proceedings would be better for handling their insolvency could choose that route. This approach differs from the prior two in that it allows companies rather than legislation to determine the number of bankruptcy proceedings and the location of those proceedings.

Underlying all of these approaches is an assumption about the relationship between transnational enterprises and insolvency laws. The assumption is that having assets in multiple countries inevitably leads to the commencement of multiple insolvency proceedings. When assets are spread across the world, it is inevitable that more than one country's bankruptcy law will be invoked. Creditors in each country will turn to local assets in an attempt to satisfy their claims. These efforts will eventually lead to the invocation of insolvency proceedings in each country where the debtor has substantial assets. It is the existence of these multiple proceedings that all transnational bankruptcy scholarship addresses.

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13. *See* Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT'L L. 31 (2001); Frederick Tung, *Fear of Commitment in International Bankruptcy*, 53 GEO. WASH. INT'L L. REV. 555 (2001).

14. *See, e.g.*, Lynn M. LoPucki, *Universalism Unravels*, 79 AM. BANKR. L.J. 143, 143 (2005). For a thoughtful reply, see Pottow, *Myth (and Realities)*, *supra* note 3.

15. I have argued for this approach in prior work. *See* Robert K. Rasmussen, *Resolving Transnational Insolvencies Through Private Ordering*, 98 MICH. L. REV. 2252 (2000); Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT'L L. 1 (1997).

As Jay Westbrook has noted, "a global market requires a global bankruptcy law."[16] This conflict among bankruptcy laws is the territorialist reality that fuels the agenda of reform advocates.

The focus in this literature tends to be on countries and creditors. Because of what John Pottow has aptly labeled "pride," countries have a tendency to assert a substantial interest in the assets within their territorial boundaries rather than defer to decisions made elsewhere.[17] Creditors create the problem because their narrow self-interest leads them to file chase assets wherever those assets can be found. It is rapacious creditors starting insolvency proceedings in all jurisdictions where the debtor has substantial assets that form the backdrop for all discussions of transnational insolvencies.

## II. THE SCARCITY OF MULTIPLE PROCEEDINGS

The traditional account of transnational insolvencies suggests that there would be many businesses that are subject to multiple insolvency proceedings. Once a company has significant assets in more than one country, the actions of creditors will inevitably trigger multiple insolvency proceedings. Indeed, according to this story, we would expect to see an insolvency proceeding in every jurisdiction where the debtor had sufficient assets to make it worth a creditor's effort to invoke local debt collection mechanisms.

The empirical reality, however, appears to be quite different. Unfortunately, I do not know of any thorough empirical study that provides solid

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16. Westbrook, *A Global Solution*, *supra* note 11, at 2287; *see also* Guzman, *supra* note 11, at 2177 ("The growth of international business, therefore, has brought with it a growth in the number of international business failures." (footnote omitted)); Westbrook, *Multinational Enterprises*, *supra* note 8, at 1 ("The steady expansion of international trade has become perhaps less significant than its consequence, the growth of multinational enterprise, which in turn has lead inevitably to the increased incidence of multinational financial failure."); Jay Lawrence Westbrook & Jacob S. Zeigel, *The American Law Institute NAFTA Insolvency Project*, 23 BROOK. J. INT'L L. 7, 8 (1997) ("The paradigm case for the Project is the bankruptcy of a company with headquarters in one of the NAFTA countries and with suppliers, lenders, operations, assets, employees, and stockholders in all three."); Barry L. Zaretsky, *Bankruptcy in the Global Village: Introduction*, 23 BROOK. J. INT'L L. 1, 1 (1997) ("As cross-border economic activity has increased dramatically, so have questions about reconciling the various systems for dealing with business failure."); Westbrook, *Theory and Pragmatism*, *supra* note 11, at 457 (stating that "the emergence of worldwide defaults" is one consequence of "[t]he surging growth of transnational enterprise").

17. *See* John A. E. Pottow, *Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to "Local Interests,"* 104 MICH. L. REV. 1899, 1901 (2006) [hereinafter Pottow, *Greed and Pride*].

data on the percentage of companies with transnational operations that become subject to bankruptcy proceedings in more than one country. The evidence that is available, however, suggests that multiple-proceeding cases are much less frequent than they would be if the standard account of transnational insolvency were accurate. In the last ten years, 1,448 public companies filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code (Chapter 11).[18] One would guess that a large number of these companies—probably a substantial majority—had assets in other countries. Yet few of these cases involved multiple proceedings. Indeed, it is relatively easy to identify large transnational companies that addressed their problems in a single bankruptcy forum. Below are a few notable examples.

### *A. United Airlines*

One would think that if there was ever a worldwide company, it would be United Airlines ("United"). United was (and still is) one of the world's largest airlines. As of 2003, it had over 1,600 daily departures to over 110 destinations across 23 countries.[19] The company is part of a global network which operates flights in every corner of the world. The revenues that United generates reflect its international character. In 2003, sixty-four percent of United's revenues came from North America, fifteen percent from the Pacific, thirteen percent from Europe, and three percent from Latin America.[20] Its planes and employees circled the world on a constant basis. In every country it operates it needs landing slots, maintenance, fuel, ticket agents, and the like. Few would question that United has "profound effects on the dozens of nations around the globe" in which it operates.[21]

When United encountered financial distress in 2002, however, this did not trigger the host of ills that the universalists fear. Creditors in the various countries where United was operating at the time did not rush to grab assets to satisfy their debts. United did not face a host of conflicting and competing bankruptcy proceedings. Rather, United landed in a single bankruptcy court in the United States.[22] United was a transnational debtor, but the bankruptcy case was domestic.

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18. *See* THE 2006 BANKRUPTCY YEARBOOK & ALMANAC 31 (Kerry A. Mastroianni ed., 2006).

19. UAL Corp., UAL Corporation and Subsidiary Companies Report on Form 10-K for the Year Ended December 31, 2003, at 3 (2004), *available at* http://media.corporate-ir.net/media_files/NYS/UAL/reports/UAL10K2003.pdf.

20. *Id.* at 7.

21. Pottow, *Greed and Pride*, *supra* note 17, at 1900.

22. *In re* UAL Corp., No. 02-B-48191 (Bankr. N.D. Ill. 2006).

*B. Sea Containers*

*Sea Containers* provides another example of a case which would seem to present the conditions that universalists fear would lead to multiple proceedings. Sea Containers has $1.67 billion in assets and 8,000 employees worldwide. Its operations consist primarily of two discrete businesses: a railroad based in the United Kingdom and a joint venture with General Electric Co. (GE) to lease sea containers.[23] This latter operation is one of the four largest of its type in the world.[24] Sea Containers, as a complement to this latter business, manufactures and repairs containers in Charleston, South Carolina; Yorkshire, England; and Santos, Brazil.[25] The company has offices in London, Genoa, New York City, Rio de Janeiro, Singapore, and Sydney.[26]

While Sea Containers had substantial assets, it also had substantial debts. It owes more than $1.5 billion. Thus, if one credits the asset values it reports, Sea Container is marginally solvent. However, the company could not service its debt. In particular, it could not meet a $110 million payment on publicly issued notes that were maturing in late 2006. To resolve its problems, Sea Containers filed a Chapter 11 bankruptcy petition in Delaware.[27] To date, this remains the only insolvency proceeding involving the company.

*C. Exide*

Exide is the world's largest manufacturer and distributor of batteries. Its Web site boasts that it manufactures and distributes batteries in eighty-nine countries.[28] In fiscal year 2001, it had worldwide sales of $2.4 billion.[29] If one were to look at Exide in fiscal 2001, it would be difficult to imagine a more transnational operation. Fifty-two percent of the company's sales were in Europe, forty-five percent in North Amer-

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23. *See* Sea Containers Ltd., Company Profile, http://www.seacontainers.com (last visited May 18, 2007).

24. *See id.*

25. Sea Containers Ltd., Containers: Factories, http://www.seacontainers.com/fr_containers.asp (last visited May 18, 2007).

26. Sea Containers Ltd., Home Page, http://www.seacontainers.com (last visited May 18, 2007).

27. *In re* Sea Containers Ltd., No. 06-11156 (Bankr. D. Del. filed Oct. 15, 2006).

28. Exide Technologies, About Exide Technologies, http://www.exide.com/about_exide.html (last visited May 20, 2007).

29. Exide Corp., Form 10-K (Annual Report), at 2 (June 29, 2001), *available at* http://files.shareholder.com/downloads/XIDE/126418007x0xS1045969-01-500609/813781/filing.pdf.

ica, and three percent in the Asia Pacific region.[30] Exide at that time employed approximately 20,000 people. While 8,400 of them were in North America, more were employed in Europe.[31] The company owned real estate in the United States, Australia, England, France, Germany, Italy, New Zealand, Poland, Portugal, and Spain.[32] Its largest single facility was a five million square-foot manufacturing plant in Italy.[33]

After the turn of the century, Exide found itself heavily indebted. The debt had been incurred as part of its expansion into the Asia Pacific region.[34] Despite its global reach, Exide resolved its financial distress in a single insolvency proceeding, which, as with *Sea Containers*, was a Chapter 11 case filed in Delaware.[35]

What allowed these three companies to avoid the ills posited by the universalists? In each case there was a debtor with substantial assets in numerous countries. Creditors of each company could be found in various jurisdictions as well. Yet in all cases there was only a single insolvency proceeding. There were no competing courts or cooperating courts; there was only a single court where the affairs of each debtor were hammered out.

Part of the explanation lies in corporate structure. Each of these companies, as is the case with the vast majority of large, publicly held companies, was not housed within a single legal entity. Rather, each was a corporate group. For example, when United Airlines filed for bankruptcy in Chicago, there were in fact twenty-eight separate bankruptcy petitions filed.[36] One was by the parent company and twenty-seven were by its subsidiaries. The cases were procedurally consolidated into a single proceeding.[37]

The twenty-eight companies owed the bulk of United's debt and owned the majority of the enterprise's assets. To be sure, United had two foreign subsidiaries: Four Star Insurance Company and Kion de Mexico. United decided not to put either of its two foreign subsidiaries into insolvency proceedings. They continued to run their operations in the ordi-

30. *Id.*

31. *Id.* at 14.

32. *Id.* at 16.

33. Exide Technologies, Form 10-K (Annual Report), at 17 (Aug. 19, 2002) [hereinafter Exide Corp., Annual Report 2002], *available at* http://files.shareholder.com/downloads/XIDE/126418007x0xS950109-02-4366/813781/filing.pdf.

34. *See id.* at 2.

35. *Id.*

36. *In re* UAL Corp., Nos. 02-48191–02-48218 (Bankr. N.D. Ill. filed Dec. 9, 2002).

37. *In re* UAL Corp., No. 02-B-48191 (Bankr. N.D. Ill. Dec. 11, 2002) (order directing joint administration of cases), *available at* http://www.pd-ual.com/Downloads/UAL%20Joint%20Administration%20Order.pdf.

nary course of business, and they remain subsidiaries of the new, reorganized United.

Yet corporate structure is only part of the story. Corporate structure allows the debtor to pick and choose which entities file for bankruptcy. Yet the debtor also needs a mechanism to ensure that the entities that it does not put into bankruptcy are not forced into bankruptcy by unpaid creditors. What we observe here is creative financing designed to ensure that the foreign operations remain outside of insolvency proceedings. Consider in this regard the Exide bankruptcy. Exide and four of its domestic subsidiaries filed for bankruptcy in Delaware.[38] Exide's foreign lenders, who were owed money by Exide's foreign subsidiaries, agreed to a standstill, and the bankruptcy case proceeded in this country. To be sure, the foreign subsidiaries may have needed access to capital. Yet this was accommodated within the American Debtor-in-Possession (DIP) financing package. The DIP loan included a $65 million sub-facility that Exide could draw upon to lend to its foreign subsidiaries. So long as the lenders of the foreign subsidiaries adhered to the standstill and the trade creditors were paid in the ordinary course of business, Exide could address its financial distress in a single forum. In the end, after two years in bankruptcy, Exide emerged from Chapter 11 as a Dutch company.

In addition to corporate structure and financing, the goals which those in control of the companies sought to achieve played a large role. To illustrate this point, consider Sea Containers. The company in the 1980s and 1990s had diversified it operations. It began as a marine container leasing company in 1965, and it eventually sought to expand beyond its core business. Perhaps most notably, it bought the Hotel Cipriani in Venice and the Venice Simplon-Orient Express tourist train.[39] Early this decade, however, the company decided that it needed to focus on its core business. It sold many of its discrete businesses, leaving the company with its railway and sea container operations as its primary lines of business. Indeed, in 2006 it even sought a buyer for the railroad.

Despite the sale of its assets, Sea Containers could not service its debt. The company, however, had already decided on what business strategy to pursue; it wanted to shed all of its extraneous business and focus on its container operations. All it needed to do was to adjust its debts so that its obligations would be in line with its revenues. Accordingly, Sea Containers began discussions with an ad-hoc committee of noteholders. The

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38. Exide Technologies, Annual Report 2002, *supra* note 33, at 2.

39. News Release, Orient Express Hotels Trains & Cruises, Company Profile (July 2006), at 2, *available at* http://www.oeh.com/binaries/Company%20Profile%2017.10.06_tcm4-76330.pdf.

company had issued four series of notes, one of these was to mature in October 2006. The company had hoped to reach agreement on a consensual restructuring of the public debt without the need for an insolvency proceeding, but it could not find common ground with its noteholders before the principal payment became due.

To forestall default on the public notes, Sea Containers had an American subsidiary file a petition for bankruptcy under Chapter 11. Immediately thereafter, the parent company, which is chartered in Bermuda, and another subsidiary, this one chartered in the United Kingdom, also filed for bankruptcy under Chapter 11.[40] As all of the notes had been issued by the parent company, the filing prevented the holders of the notes from taking any collection action.[41] Neither the parent nor the two subsidiaries contained any of the operating assets of the company. Both the railroad and the sea container business continued to operate and pay their debts in the ordinary course.

Not only can we readily find cases in which the debtor can structure its bankruptcy proceedings such that it does not encounter multiple forums, but we can also find situations in which *debtors* themselves invoke the multiple forums as part of their strategy for addressing the problems that they face. One example of this is the Enron bankruptcy. Enron filed a bankruptcy proceeding in the United States, but it also filed insolvency proceedings in England, Canada, Japan, and Thailand. The assets owned by Enron were indeed liquidated, but this was not the inefficient liquidation that is the stuff of universalists' nightmares. With Enron, the causal arrow ran in the other direction. It was not that the multiple proceedings led to Enron's liquidation. Rather, it was the decision to liquidate Enron's assets that led to the multiple proceedings. Enron had engaged in aggressive expansion overseas. These assets, by and large, were dedicated assets such as power plants, dams and water facilities. There was little reason to believe that these assets should be kept together in a sin-

40. The use of a subsidiary to establish venue in a chosen court is a common practice in American bankruptcy litigation. Perhaps the most notable use of this maneuver was when Eastern Airlines established venue in the Southern District of New York by placing the subsidiary that ran Eastern's hospitality suites for its frequent fliers into bankruptcy there, even though this subsidiary was solvent. Six minutes later, the parent company filed in the same district, basing venue on the fact that an affiliate already had a case pending in that court. Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1365 (2000).

41. *See* 11 U.S.C. § 362 (2006).

gle enterprise. Rather, they needed to be sold to the highest bidder.[42] Here, local insolvency proceedings provided a convenient vehicle to dispose of these businesses. Sales conducted by the local bankruptcy courts assured the buyers that they would get clean title to the purchased assets.

The ongoing Calpine bankruptcy is yet another example of the debtor deciding to open multiple proceedings. Calpine is a large energy producer with assets in the United States, Canada, and Mexico.[43] Calpine had grown aggressively through acquisitions which it financed with debt. When Calpine sought bankruptcy protection, its attorneys made a decision to file cases in both the United States and Canada, but not in other jurisdictions where it owned assets. Moreover, only some of Calpine's subsidiaries in these countries filed for bankruptcy. The reason for this decision was that the attorneys concluded that the two-case strategy offered more flexibility than if Calpine had proceeded in the United States alone, and that only certain of the subsidiaries needed to address their problems as part of an insolvency proceeding.

The care that goes into deciding how many proceedings are opened and for what purpose highlights a distinction between transnational insolvencies and domestic insolvencies that is too often overlooked. Two decades ago, Thomas Jackson justified American bankruptcy law as solving a collective action problem.[44] Left to their own devices, creditors would pursue their state law collection remedies. This dogged pursuit of their narrow interests would lead to an inefficient piecemeal liquidation of the business.

The analogy does not translate perfectly to the international setting. As mentioned above, transnational businesses, by and large, are structured as corporate groups. The assets of the business within one country tend to be owned by a domestic corporation in that country, with the stock of that company owned by a foreign parent. When a creditor seeks to realize on its assets, it sues the domestic corporation. Each country, however, has a system designed to deal with the financial distress of its domestic entities. By and large, these systems prevent a destructive piecemeal liquidation of the domestic entity. Thus, national insolvency laws simply do not suffer from the lack of coordination evinced by the state law debt collection system.

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42. On the lack of going concern in Enron and the controlled sale of all of its assets, see Douglas G. Baird & Robert K. Rasmussen, *The Four (or Five) Easy Lessons of Enron*, 55 VAND. L. REV. 1787 (2002).

43. *In re* Calpine Corp., 2007 WL 685595, at *2–3 (Bankr. S.D.N.Y. Mar. 5, 2007) (order regarding replacement post-petition financing, objection to claims, and value of secured claims).

44. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986).

This does not imply that Chapter 15, the UNCITRAL Model Law, or the E.U. Insolvency Regulation is necessarily a poor or misguided idea. Each may provide a useful default rule, especially in those cases where a transnational company becomes financially distressed very quickly, and those in control do not have a chance to decide on the best course of action prior to filing for bankruptcy. Yet when debtors are not in a "free fall" situation, the coordination mandated by these laws may not matter all that much. In many instances transnational defaults can be handled in a single case. In other situations, debtors can use corporate structure to decide precisely how many proceedings will be opened and in which countries. Corporate structure and creative financing allow bankruptcy lawyers several degrees of freedom when planning a case.

To be sure, there is not infinite flexibility in this regard. One could imagine a world in which capital structure decisions are designed to ensure that the threat of inefficient multiple proceedings are eliminated at the lending stage. For example, assume that the debtor and its lenders decide that American law provides the framework under which they would want to work out any future financial distress. Assume also that, prior to the execution of the loan, the debtor had no relationship at all with the United States. It would be relatively easy to form an American company, have the loan made to that company, and have other members of the corporate group guarantee the obligations. The new American company would then distribute the borrowed funds to the operation companies on an as-needed basis. All new borrowing activity would be undertaken by the American company. This action would place all of the debt in the American subsidiary. If financial distress were to arise, the American subsidiary could file for bankruptcy under American law.

Such a "bankruptcy-centric" view of capital structure, however, runs aground on reality. There are numerous forces that affect a company's capital structure to a vastly greater degree than does the possibility of a future bankruptcy proceeding. Tax law, for example, imposes severe limits on freedom in this regard. Imagine a typical case in which the parent company is an American holding company, its main operating subsidiary is also an American company, and it also has two foreign subsidiaries. The simple structure of a loan to the American parent with guarantees by all of the subsidiaries is not a realistic probability. This is due to the effect of section 959 of the U.S. Tax Code—the so-called "deemed dividend" provision.[45] The net effect of this provision is that if the foreign subsidiaries were to guarantee the loan to the American parent, this would subject all of the income of the foreign subsidiary to United States

45. 26 U.S.C. § 959 (2006).

income tax. The same result would occur if the American parent were to pledge more than two-thirds of the stock of the foreign subsidiary to back up the loan. The economic effect of subjecting the foreign subsidiaries' income to United States tax exceeds any benefit gained in having an optimal structure in place to deal with any future financial distress.[46]

While tax law thus limits the freedom of lenders to structure their transactions, there are still ways that lenders can limit the possibility of conflicting bankruptcy proceedings at the lending stage. For example, if the foreign subsidiaries are not contributing much to the overall asset package, the lender may be content to have the foreign subsidiaries enter into negative covenants limiting the amount of debt that the foreign subsidiaries can incur. Such a limitation would have two effects. The first is to preserve value for the lender, in that the lender has a direct claim against the parent and also can get a lien on up to two-thirds of the foreign subsidiaries' stock. This would provide the lender with a first position on the equity of the foreign subsidiary. Second, by limiting the amount of debt in a foreign subsidiary, the lender limits the risk that that subsidiary would be insolvent and the risk of being thrown into a foreign insolvency proceeding over the parent's objection.

Of course, a potential future bankruptcy proceeding is far from the only, or even most important, factor when a debtor plans its capital structure. It may have economic reasons to put debt into the foreign subsidiary. Debt is a tax shield, and the value of that shield may be more to the foreign subsidiary than it is to the parent. Also, there may be substantial value in the assets of the foreign subsidiary that the debtor would like to borrow against, but an American lender would hesitate to lend because it cannot lock up the assets.

Yet another factor driving capital structure is convenience. Businesses often need access to banking services on a constant basis. Operating companies issue commercial letters of credit, send wire transfers, and deposit funds on a daily basis. It is often cheaper to buy these services from a local bank that finances the company's working capital needs. Forcing all of these relationships to a foreign bank in order to control the location of any future bankruptcy proceeding would make little sense.

When there are reasons for having a subsidiary incur debt, one pattern that we see is to have each local subsidiary establish its own line of credit with a local bank. This local borrowing creates a tax shield for the foreign subsidiary. Additionally, it allows the enterprise to borrow against

46. Of course, as is seen in *Sea Containers*, one can place the parent company in Bermuda. So long as there is one member of the corporate group in the United States, Chapter 11 will be an option.

the foreign assets. It also creates a relationship with a local bank that can provide needed services. While incurring debt at the subsidiary level creates the risk of multiple insolvency proceedings because the enterprise now has multiple creditors chasing assets in various jurisdictions, planning on the eve of bankruptcy can alleviate the threat. One potential tactic is to get a standstill agreement as in *Exide*. Under such an understanding, the lenders agree not to enforce their loans against the foreign assets.[47] Indeed, standstill agreements are a common practice. For example, John Armour and Simon Deakin have documented how the so-called "London Approach" to corporate restructuring rests on standstill agreements.[48] In its traditional form, the London Approach was the U.K. method for resolving the financial distress of large corporations. By and large, the debt of these corporations was held by London Banks. When the borrowers encountered financial distress, the lenders would agree to a standstill. Under a standstill, all of the banks agree not to collect on outstanding loans. They would then restructure the business outside of formal insolvency proceedings. To the extent that the American parent can assuage the fears of the foreign lenders, these lenders can execute a standstill and proceed under Chapter 11.

Even when the foreign lenders get nervous and call their lines of credit, adroit action on the part of the debtor's professionals can prevent a foreign proceeding. For example, it is possible to get takeout financing in the DIP loan. In such a loan, the debtor borrows a sufficient amount to both fund its needs for the reorganization effort and to pay off the foreign lender. Such action ensures that the foreign lender cannot open up a new insolvency proceeding and create the threat of multiple proceedings.

Current bankruptcy practice thus does not leave one overly concerned with the thought that failure to adopt a purely universalist regime has led to great inefficiencies of the type that motivates the universalist project. This does not mean that there is no cause for concern. Debtors have some degree of control over where their affairs will be handled. The question which the transnational insolvency literature has to address is whether this discretion will be used in a socially satisfactory manner.

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47. In *Sea Containers*, the private lenders had a security interest in basically all of the assets of the company. Although the company was in default under both of its two main credit facilities, neither lending group sought to place the debtor in insolvency. The aim of the United States Chapter 11 case is simply to restructure the public debt, which is junior to the secured debt.

48. *See* John Armour & Simon Deakin, *Norms in Private Insolvency: The "London Approach" to the Resolution of Financial Distress*, 1 J. CORP. L. STUD. 21 (2001).

## III. CREDITOR CONTROL AND TRANSNATIONAL INSOLVENCIES

Transnational insolvency practice has developed the ability to avoid some of the more dire expectations of scholars. To be sure, there are undoubtedly cases in which the unexpected happens and the debtor finds itself thrust into bankruptcy proceedings with little opportunity for advance planning. The risk of uncoordinated proceedings may have been reduced, but not eliminated. So called "free falls" will still occur. Yet such cases may well become a residual category. For an increasing number of financially distressed companies, which country or countries handles the reorganization effort will be the result of conscious planning on the part of the debtor and its senior creditors. This development opens up new areas of scholarly inquiry. Much of the academic attention in the transnational insolvency literature has been focused on which actions countries should take to mitigate the problems caused by local creditors triggering competing proceedings around the globe. The more pressing issue today is to understand the implications of modern transnational reorganization practice.

For example, one overlooked policy question that needs to be addressed is the extent to which debtors should retain the freedom they have in restructuring their affairs. As recounted above, debtors today often choose which country is going to be the venue of the main reorganization effort and the extent to which the courts of other countries will be involved. The welfare effects of this practice have yet to be considered by either scholars or policymakers. To do this, one first has to assess the factors that drive a debtor's decisions as it slides into bankruptcy. The bankruptcy practice of today looks fundamentally different from the practice of two decades ago. At that time, it was common to view Chapter 11 as a haven for the very managers that were responsible for leading the company into financial distress. Many European practitioners viewed such a system with disbelief. Today, however, Chapter 11 has been transformed. Managers often are replaced even before the case is filed. Moreover, the new CEOs tend to be cut from a different cloth: they often are professionals who specialize in turnaround work, do not plan to remain with the company for a long time, and their prospects for future employment depend on how well they maximize the returns to the company's investors, primarily its private debt holders.[49]

Even in cases in which old managers stay in place, they are not immune from the actions of creditors. The lenders providing the financing for the bankruptcy case can exert enormous influence on whether the

49. *See* Baird & Rasmussen, *Private Debt*, *supra* note 10, at 1235.

debtor is restructured or its assets sold to the highest bidder.[50] Sophisticated lenders are going to keep managers on a short leash. Jamie Sprayregen, perhaps the most prominent attorney representing debtors in Chapter 11 cases before he joined Goldman Sachs last year, has opined that "the central purpose of the restructuring market . . . is to serve as the means by which the economy recycles assets and maximizes value, thereby maximizing creditor recoveries."[51]

There is a vibrant and deepening literature that explores the control that creditors can exert in the domestic context.[52] One can find tentative support for the new practices as well as opposition to them. This literature to date has focused primarily on the American market. While a plausible working assumption may be that the trends one finds in America extend to transnational insolvencies worldwide, this is merely an assumption. More work exploring the dynamics of transnational insolvencies needs to be done.

A difficulty in attempting to evaluate practice in this area, both domestically and internationally, is that bankruptcy practice is by no means static.[53] Two examples illustrate the point. The first is the rise of second liens. A second lien is created when the lender takes a security interest in the assets of the debtor, even though all of these assets have been pledged to a prior lending group. Second liens have begun to replace traditional mezzanine financing for a substantial number of companies.[54] A loan accompanied by a second lien has the same priority of payment as the first loan. In this crucial respect, it is not a traditional subordination

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50. These lenders may come onto the scene when bankruptcy is filed through a debtor-in-possession financing package. This financing may be done in large part by those who hold substantial portions of the company's existing secured debt. Alternatively, the financing may come through the use of cash collateral. In such a situation, the debtor will be solicitous of the concerns of its existing secured lending syndicate.

51. James H.M. Sprayregen et al., *Chapter 11: Not Perfect, But Better than the Alternatives*, 14 J. BANKR. L. & PRAC. 6, art. 1 (2005).

52. *See* Lubben, *The "New and Improved" Chapter 11*, *supra* note 10; George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J., 19 (2004); Westbrook, *The Control of Wealth in Bankruptcy*, *supra* note 10; Baird & Rasmussen, *Private Debt*, *supra* note 10; Baird & Rasmussen, *Chapter 11 at Twilight*, *supra* note 10; Harvey R. Miller & Shai Y. Waisman, *The Creditor in Posession: Creditor Control of Chapter 11 Reorganization Cases*, 21 BANKR. STRATEGIST 1 (2003); Skeel, *Creditors' Ball*, *supra* note 10; Baird & Rasmussen, *The End of Bankruptcy*, *supra* note 10; Barry Adler et al., *Bankruptcy Initiation in the New Era of Chapter 11* (working paper).

53. Douglas Baird and I explore these ongoing changes in Douglas G. Baird & Robert K. Rasmussen, *Common Pools, Common Disasters, and the Anticommons: Hedge Funds in Modern Reorganization Law*, (working paper) [hereinafter Baird & Rasmussen, *Hedge Funds in Bankruptcy Law*].

54. On second liens, see Baird & Rasmussen, *Private Debt*, *supra* note 10, at 1247.

agreement under which the subordinated party does not receive a payout until the superior party is paid in full. The rights of payment of both first-lien holders and second-lien holders enjoy the same priority. However, second liens have a second position as to collateral backing the loans. Those holding a second lien cannot seize their collateral and realize on it ahead of the first-lien holder.

The crucial document in a second-loan transaction is the inter-creditor agreement, which specifies the relationship between the first lender and the second. Bankruptcy is one of the issues over which the parties negotiate at the time that the second-lien financing is being put in place. One typical provision allows the second-lien holder the option to buy out the position of the senior lender. One possibility given the dynamic of the market is that we may see lenders owning both the first and second liens.[55]

The effects of second-lien financing on domestic reorganization practice have yet to be fully felt. Second-lien financing arose at a time of quiescent bankruptcy activity. The combination of low interest rates and abundant liquidity has meant that relatively few companies have filed for Chapter 11 relief in the past two years. Indeed, 2006 saw the least number of large, publicly held companies filing for bankruptcy since 1984.[56] One thing appears clear: given the way that the amount that the second-lien lenders lend to the debtor is determined, it is unlikely that that there will be any value left for unsecured creditors when the company files. Second-lien lenders tend to value the company on an enterprise basis, and lend close to such value. When the value of the business declines, the money owed to the first- and second- lien holders will exceed the value of the company. Thus, we can expect to see bankruptcies in which the only groups in the money are the first- and second-lien holders.

While silent lines are often no longer completely "silent," it is usually the case that the inter-creditor agreement provides that the second-lien holder automatically consents to a cash collateral order to which the first-lien holder has consented. This provision provides a great deal of discretion to the first-lien holder in crafting the bankruptcy financing package. Moreover, the second-lien market differs between Europe and the United States. In the United States, the assumption is that Chapter 11 will be

55. Steven S. Kerr & Joanna Rovito, *Second-Lien Evolution Creates Higher Recovery Prospects—At First-Lien Lenders' Expense*, *in* STANDARD & POORS, A GUIDE TO THE LOAN MARKET 46, 48 (2005), *available at* http://www2.standardandpoors.com/spf/pdf/fixedincome/loan_market_2005_pg46-54.pdf.

56. *See* News Release, Admin. Office of the U.S. Courts, Bankruptcy Filings Decline in FY 2006 (Dec. 5, 2006), *available at* http://www.uscourts.gov/Press_Releases/bankruptcyfilings120506.html.

used. The inter-creditor agreement dictates the extent to which the senior lien holder gets to "drive the bus." Oftentimes, the second-lien holder will agree not to contest certain aspects of the proceeding. In Europe, which has a greater tradition of out-of-court restructurings than exists in the United States, the inter-creditor agreement devotes efforts towards standstill agreements. These agreements have the effect of buying time for the company to restructure its operations. The rise of second liens and the continued development of inter-creditor agreements provide a new mechanism to ward off the evils chronicled by those espousing the universalist position.

A second development which is altering both domestic and international bankruptcy practice is the rise of hedge funds.[57] The standard operating assumption of American bankruptcy law is that it is, by and large, a forum for parties who do not want to be there. The debtor and its creditors entered their relationships with hope for the best, but the worst materialized. The banks, the management, the public lenders, and the trade creditors had to make the best of a bad situation. Bankruptcy placed them in a collective forum where they would chart a new course of action.

Hedge funds have rendered this conception obsolete. Those creditors who want no part of bankruptcy have an exit option: they can sell out to the various hedge funds that take a stake in many cases. Some hedge funds seek to profit solely based on their informational advantage and the desire of creditors for liquidity. They will purchase the claims of trade creditors, buy up public bonds, and purchase loans on the secondary market. These funds make their profit on the basis of paying less for the claims than they will ultimately be settled for at the end of the day.

Other hedge funds, however, play the loan-to-own game. They view bankruptcy as a potential vehicle for an acquisition. They acquire claims with the expectation that they will be long-term investors in the company.[58] For example, Ed Lempert and his hedge fund, ESL, bought Kmart while the company was in Chapter 11.[59]

These financial developments do not end at the oceans' shores. Hedge funds prowl the world looking for opportunities to invest their bugling war chests. Indeed, hedge funds are a major source of second liens, both in America and in Europe. They are already playing major roles in notable bankruptcies. For example, in the ongoing Delphi bankruptcy, the

57. *See* Baird & Rasmussen, *Hedge Funds in Bankruptcy*, *supra* note 53.

58. For a description of this activity, see David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905, 1929–32 (2004).

59. While Kmart is primarily an American company, it does have foreign subsidiaries. None of these foreign subsidiaries were subject to insolvency proceedings.

current plan is to restructure the company using a $3.4 billion infusion by a consortium of hedge funds.[60] The managers of Delphi chose this package over another one offered by a competing group of hedge funds.[61]

Hedge funds have the effect of increasing the concentration of claims. With the existence of hedge funds, there are fewer dispersed investors. Indeed, to the extent one concludes that these developments increase the likelihood that a company's assets are deployed to their highest-valued use, this would suggest a different policy prescription than the one offered by the universalists. Rather than nudging countries to coordinate their laws, those involved with transnational insolvencies should push countries to facilitate the claims-trading market. The fewer the participants, the more likely it is that they will be able to reach an agreement on how best to deploy the company's assets. With fewer players in the game, it may become even easier for debtors to limit themselves to a single forum and only use a second forum when those in control decide that such action will increase value.

To the extent that one views the changing state of affairs positively, future reforms should attempt to harness the power of the creditors. We do not need coordination among bankruptcy courts; what we need is coordination among lenders. Devices such as second liens and entities such as hedge funds may serve to increase such coordination.

On this vision, efforts by lawmakers to decide ex ante which is the "correct" forum for transnational insolvencies seem misguided. Allowing those with their hands on the levers of control to select the bankruptcy forum may well increase value. A single American proceeding to reorganize Exide and multiple proceedings to sell Enron may have been the correct decision. It is difficult to imagine a set of binding rules that would have allowed both Enron and Exide to accomplish what each company needed.

On the other hand, the increasing complexity of the interests that are held by hedge funds may make it more difficult to reach consensus on what should happen to the debtor. Should this happen, the changes that we are witnessing do not enhance value but dissipate it. For example, it takes little to imagine a hedge fund threatening to launch a value-destroying second proceeding in order to force payment on its claims. Indeed, there have already been situations in the sovereign debt markets in which a hedge fund aggressively pursued its legal rights to increase its return even though such action had the effect of impairing restructuring

60. Nick Bunkley, *Parts Firms Drawing Investors*; *Operations Tilted Away from Detroit Toward World Market*, INT'L HERALD TRIBUNE, Feb. 1, 2007, at 12.

61. *Id.*

efforts. Along these lines, hedge fund activity seems to be at odds with the clubby nature of the London Approach.

Of course, the market may adjust to these threats. In the medium run, more money is made by finding solutions that maximize value rather than by strategies that simply transfer value. Still, as we go forward in thinking about transnational insolvency law, this is the type of risk that we should be worried about. We should not make it easier for a recalcitrant creditor to initiate an insolvency proceeding. Indeed, given the increasing concentration of debt claims, we could imagine fairly high triggers designed to protect against opportunistic behavior.

## IV. CONCLUSION

Ten years ago, transnational insolvency law seemed to be a growth industry. Worldwide economic growth and the lowering of transaction costs promised to create more companies whose reach exceeded national boarders. Such growth in transnational business would lead to growth in transnational insolvency. We have indeed seen the growth in business, but we have yet to see the accompanying explosion in transnational insolvency. This does not mean that transnational companies do not file for bankruptcy—they do. However, the fear of uncoordinated proceedings running up costs and liquidating viable companies has not become reality. By and large, it may be the case that the ills so apparent to academics were apparent to practitioners and their clients as well. Ultimately, markets reward those who can find value.

The challenge for the next generation of transnational insolvency scholarship is threefold. The first part is to understand current practices. The number of bankruptcy cases involving multiple proceedings is far less than the number of cases involving debtors with foreign subsidiaries. We need to better appreciate this dynamic. We lack comprehensive data on how many transnational enterprises resolve their financial distress in a single insolvency proceeding. The second part is to assess the welfare effects of this practice. American bankruptcy law has come to be characterized by creditor control. Given the fluidity of capital markets, it should come as no surprise to see this same pattern played out with transnational companies. Finally, the third part is to reevaluate our efforts. To the extent that we applaud or condemn the current trend, there is little to suggest that bankruptcy laws can halt its development. Rather, our reform efforts have to take shape against the backdrop of this practice. In doing so, we need to reorient our focus. Rather than focus on countries and the extent to which they cooperate, we need to focus on the market players who are creating modern transnational insolvency practice.