

Comment

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The release of the *Globe White Page Americas Restructuring and Insolvency Guide 2008/2009* comes at an important crossroads in the development of insolvency laws in the Western Hemisphere. Since the publication of the last volume in 2004/2005, no fewer than six major countries, including the three largest economies in the Americas, have substantially overhauled their insolvency laws (Argentina, Brazil, Canada, Chile, Colombia and the United States). In addition, a number of countries have made changes to their secured transactions regimes or to other laws that significantly impact on insolvency and creditor rights (Guatemala, Honduras, Mexico and Peru).

In short, the landscape in which practitioners, academics and policymakers are operating has been substantially altered over the past few years. On the surface, the timing of these reforms, along with many of their substantive elements (eg, a move towards facilitating the use of security over a variety of assets and making restructuring of troubled companies easier), suggest some level of harmony; however, a deeper examination reveals vastly divergent views on the role and function of national legislation. The key international normative instruments for the development of insolvency laws – the World Bank's Principles for Effective Insolvency and Creditor Rights Systems and the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency – have existed for a number of years to provide guidance to policymakers developing national laws. However, it is clear that each individual country has had to tackle similar issues in vastly different ways so as to accommodate domestic legal, cultural, institutional and sometimes political concerns.

While it is a truism to say that domestic laws need to serve domestic needs, the increasingly transnational nature of insolvencies means that the differences between national insolvency systems will continue to be exposed, with practical and economic consequences, at a growing rate. Both the World Bank and UNCITRAL have recommended that courts dealing with insolvency cases find ways to coordinate with courts presiding over the same matter in a different jurisdiction. However, even this relatively modest goal has been fraught with difficulty. Mexico has adopted the UNCITRAL Model Law on Cross-Border Insolvency, while Brazil, Latin America's largest economy, has chosen not to (although it may do so in the future). The United States replaced the old Section 304 (recognition of foreign orders) in the US Bankruptcy Code with Chapter 15, which is essentially based on the Model Law, yet the United States' largest trading partner, Canada, in part motivated by a concern that cross-border insolvency cases would increasingly be driven from the United States, has made significant changes to the version of the Model Law being adopted in the new Canadian legislation.

Nowhere is the ambivalence to full cross-border cooperation more evident than in the treatment of the concept of the centre of main interests (COMI), which is central to the model law and to the similarly worded EU Regulation on Cross-Border Insolvency. What was originally intended to be a bulwark against forum shopping among EU member states has begun to

have the opposite effect, with a number of conflicting decisions emerging from the courts of EU member states. These include:

- a Dutch court ordering that the presumption that the COMI is in the jurisdiction of the registered head office of the debtor can be rebutted only if there are virtually no activities in that jurisdiction; and
- an English court holding that the location of the head office is just another factor of many to be considered equally.

Courts have begun to see the COMI issue as critical because it results in a determination of the national law that will drive the bulk of the insolvency proceeding.

It is tempting to categorise these differences in the approach to recognition of foreign courts as simply procedural, but even if they are, they have their origins in the basic territorial concern that foreign insolvency laws do not share the same values as one's own. This is a valid concern and major substantive differences are not difficult to find. The United States remains one of the few jurisdictions in the world where a judge can terminate a collective bargaining agreement if such termination is deemed to be in the best interests of stakeholders. In Canada, such a power existed at common law yet, in a surprise to many practitioners, the Canadian Parliament has explicitly rolled back this power in new legislation. Differences such as this, or in the priority ranking schemes of countries (ie, who gets paid first), reflect not only political compromises but, more generally, fundamental philosophical differences on how the risk of business failure should be apportioned. It is important to recognise these differences not merely as obstacles to doing business in a particular country, but as expressions of basic values, both cultural and business, that transcend legislation. For those engaged in law reform and working with policymakers on the ground, it is vital to understand that the law is, and indeed should be, an expression of these fundamental values.

An examination of recent law reforms in the Americas suggests an interesting paradox: while the values that inform specific policy choices in crafting a law vary markedly from country to country, there is a surprising harmony in the policy questions that countries have chosen not to address. Specifically, all the countries in the Americas that have engaged in insolvency reform in the last few years, from the most developed to the least developed, have either consciously or

unconsciously chosen not to tackle the very real and common challenges that appear just over the horizon in the area of insolvency and restructuring. These challenges include the following.

Explosive growth in the use of credit derivatives:

The uses of collateralised debt obligations and the potential systemic effects that they may have as part of the larger sub-prime crisis that is emerging are well known. The widespread use of credit default swaps could pose an equal or greater problem. Today, investors accumulate positions in a company by targeting layers of debt or multiple layers of debt. Where their economic interests lie is less predictable, particularly if they also hold credit default swaps. A creditor's financial interests may be best served by forcing a default if it is on the right side of a credit default position. This problem is compounded by creditors not having to disclose derivative positions, making it much harder to discern their true intentions. A recent study published by professors Hu and Black of the University of Texas concludes that the decoupling of contractual and bankruptcy rights from economic ownership poses important challenges, both for individual creditors and debtors and for the financial system as a whole (Henry TC Hu and Bernard Black, *Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications*, European Corporate Governance Institute, Law Working Paper No xx/2007, January 2008). In work-out negotiations, whether in or out of bankruptcy, creditors cannot be confident that they understand other creditors' motives and bankruptcy judges face similar issues. However, most if not all legal systems continue to operate on the assumption that creditors have an incentive to exercise their contractual and insolvency rights well in order to reduce the costs of financial distress. From a policy perspective, it becomes critical to understand better when and how the decoupling of economic interest and legal rights occurs and what, if anything, policymakers need to do to address this.

Treatment of corporate groups: Around the world, the dominant form of business organisation for medium to large enterprises is an interconnected web of two or more legal entities in a group. The entities can be organised in a variety of ways in order to maximise tax advantages or address cross-border issues. Despite this, most national insolvency systems are drafted from the perspective of a single, standalone corporate debtor and fail to address the unique issues that arise

when a corporate group is involved in insolvency proceedings. UNCITRAL has recently begun to examine this issue to develop recommendations on how national laws should address the problem of when to consolidate insolvent estates from a procedural standpoint and when to consolidate them substantively. In the meantime, the government of Australia has tabled legislation that seeks to address the issue of corporate groups directly in the context of bankruptcies and liquidations, and has set down clear tests for when estates should be consolidated. Although this is an issue which the courts in some countries have addressed, it is a matter which, sooner rather than later, will require clear legislative direction. Argentina addressed this issue in 1995 and its experience may provide useful guidance to those

tackling this matter in the future.

What is unique, and particularly valuable, about a book such as this is that it provides direct, unfiltered access to leading experts in each jurisdiction, who are able to navigate the reader through the distinct and unique practices of each country's legal culture. The chapters in this book clearly and concisely describe what areas national laws have dealt with, what areas they have not dealt with and what unique policy prescriptions they have arrived at to address common issues. As reforms continue to progress – undoubtedly tackling new and emerging issues– we can continue to expect *Globe White Page* and its contributors to keep us up to date on the latest developments in the Americas, and indeed around the world.