

Virtual Territoriality: Choice of Law Principles for Cross-Border Bankruptcy Cases

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The Goal of Global Rescue

- The Modified Universalist Case for Cross-border cooperation?
 - Coordinated rescue of sale produces: transactional gain.
 - In the aggregate winners outnumber: rough wash
- Rough wash falls apart in the individual case where territorial differences matter
 - *Qimonda*
 - *Treco*
 - *Nortel*
 - Asserted entitlements tip the balance in favor local creditor expectations
- “Choice of law”/localism can be used to reinforce “strategic territorialism”
- But it can also be used facilitate global rescue and further modified universalism?
 - Choice of law principles are essential to establishing an “entitlement baseline.”

How to use “choice of law” to aid “modified universalism”

- Virtual Territoriality
 - One (global) procedural case
 - Respect local entitlements and corporate form
 - Use virtual or synthetic treatment to respect the local entitlement baseline
- Two benefits:
 - Local treatment minimizes the benefits of forum shopping
 - Entitlement baseline quantifies claims of priority

Virtual Territoriality: Scope of *Lex Fori*

- *Lex Fori* should govern the *procedural* aspects of insolvency.
- *Lex Situs* (ordinary PIL)(interest analysis) should apply to *distributional* aspects.

This distinction is recognized in the Legislative Guide

- Recommendations 30 and 31:
 - 30. The law applicable to the **validity and effectiveness of rights and claims** existing at the time of the commencement of insolvency proceedings should be determined by the **private international law rules of the State in which insolvency proceedings are commenced.**
 - 31. The **insolvency law** of the State in which insolvency proceedings are commenced (lex fori concursus) should apply to all aspects of the commencement, conduct, **administration and conclusion of those insolvency proceedings** and their effects. These may include, for example: . . .

But where is the line between
“insolvency law” and “validity and
effectiveness?”

- Both EUIR and the Legislative Guide take a broad view of “procedure.”

Old (Forum Court) Approach

- Article 4 of the EU Reg
- Recommendations 30-34 of the Legislative Guide
- Forum court applies its own insolvency law.
 - Assumes ancillaries
 - Administer local assets
 - Remaining assets remitted and administered (winding up)
 - Each court uses its own law.

The problem of value allocation is broader than choice of law?

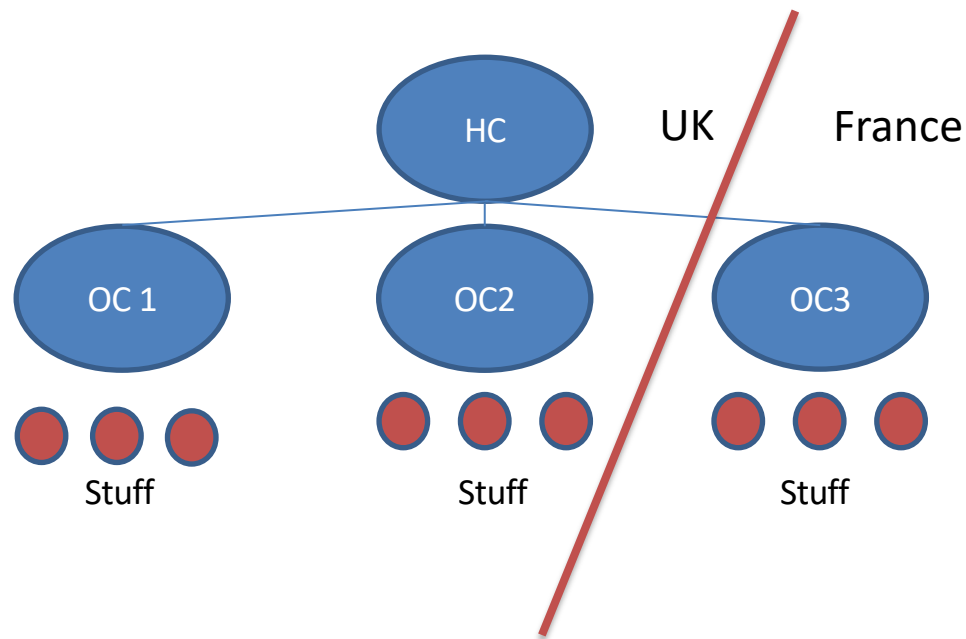
- Types of priority
 - Liens -- Assets
 - Corporate Structure
 - Territorial Jurisdiction
 - Capital Structure
 - Priority debt
 - Pari-passu Debt
 - Equity
- No single hierarchy

How does choice of law affect value allocation in rescue?

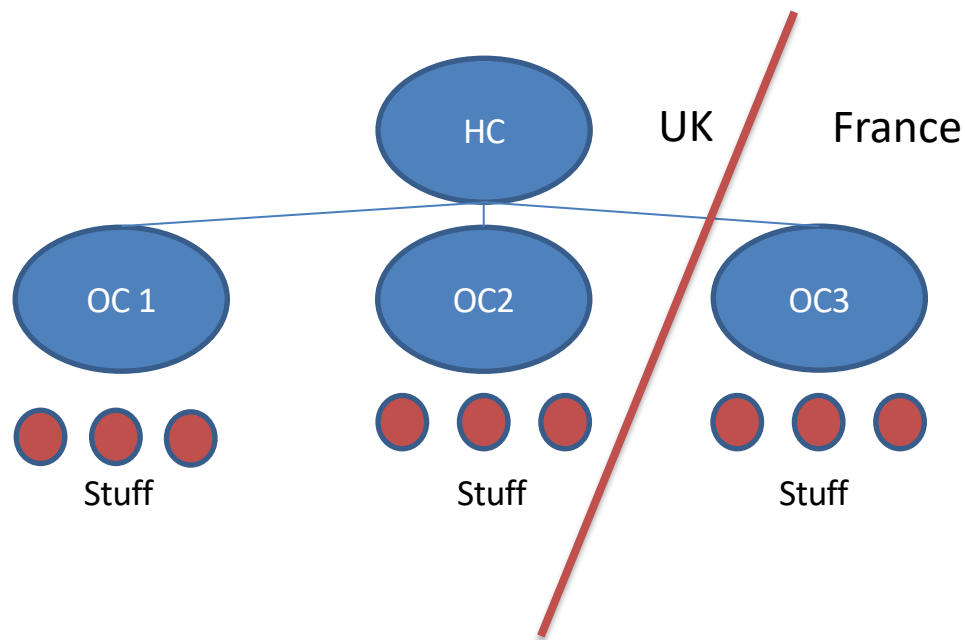
“Forum court” approach assumes a single firm where secondaries are opened:

- How can this be implemented in:
 - A cross border case?
 - No secondary or ancillary opened
 - A group case?
 - Multiple entities
 - A rescue case (recapitalization or going concern sale)?
 - No secondary
 - No sale of specific assets
 - No entity-based realization

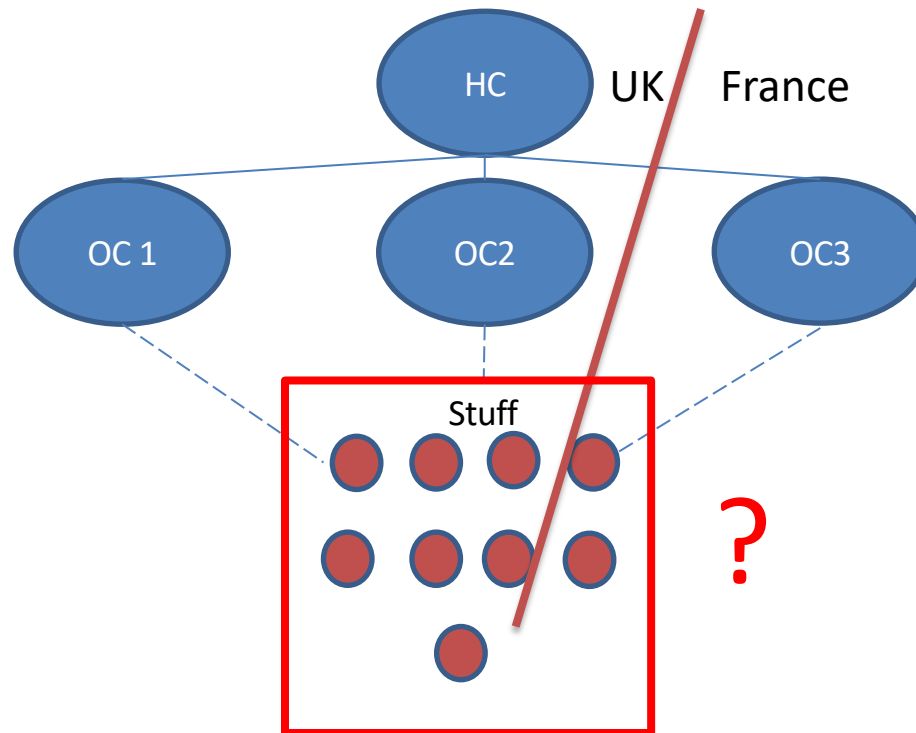
Value Allocation in Liquidation -- (Version 1)



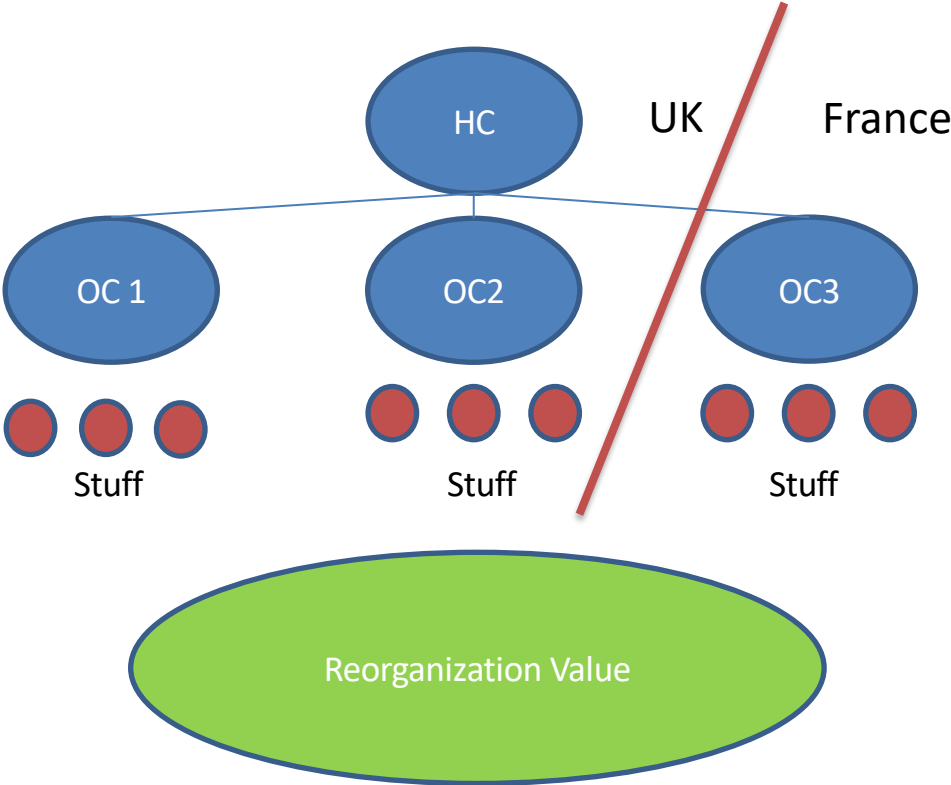
Value allocation in Liquidation -- (Version 1)



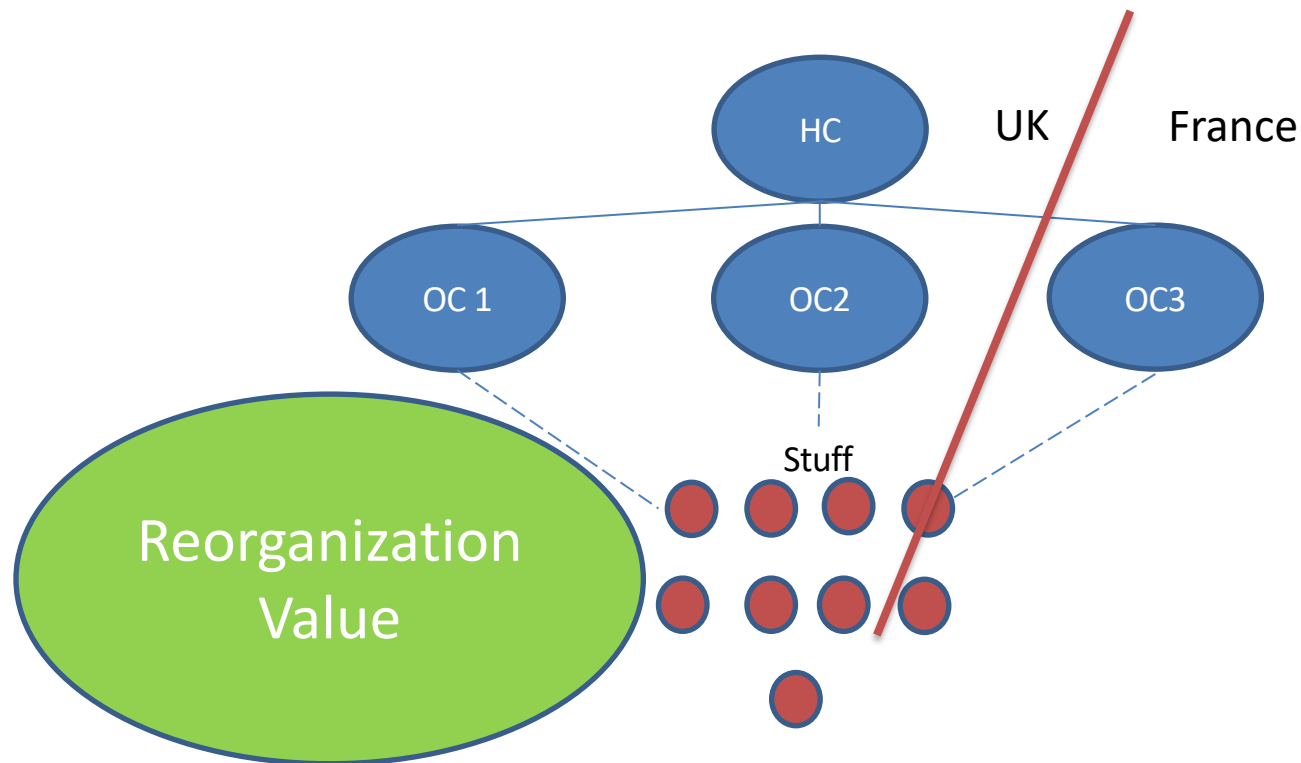
Value allocation in Liquidation -- (Version 2)



Corporate Groups-Rescue (Version 2)



Corporate Groups – (Version 2)



Priority v. Pari Passu: Three Principles for Virtual/Synthetic Treatment

- Entitlement baseline
- Realizable value
- Residual estate

Entitlement Baseline:

- Claims to priority must be *traceable* to value that could be *realized* from:
 - Assets
 - Entity
 - JurisdictionWithout the “group solution.”
- The *realizable value* establishes the *entitlement baseline*
- The *“synthetic entitlement”*

Context: Bases for Distributional Priority

- Liens -- Assets
- Corporate Structure
- Territorial Jurisdiction

- Capital Structure
 - Debt
 - Equity

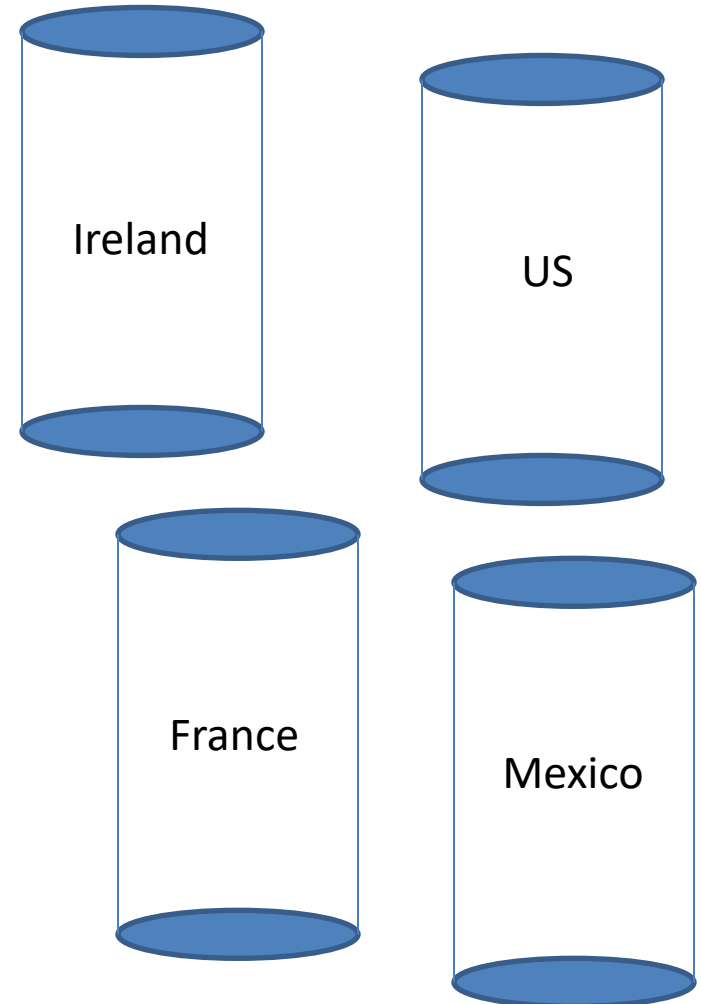
Best interests/Realizable Priority

How much could be realized in a territorial proceeding?
The “synthetic entitlement”

Absolute Priority

Conceptual Solutions: Silos

- Choice of Law
 - Virtual Territoriality
- Procedural
 - Synthetic Secondary
- Comity
 - Adequate Protection
- Informal
 - *Collins and Aikman*

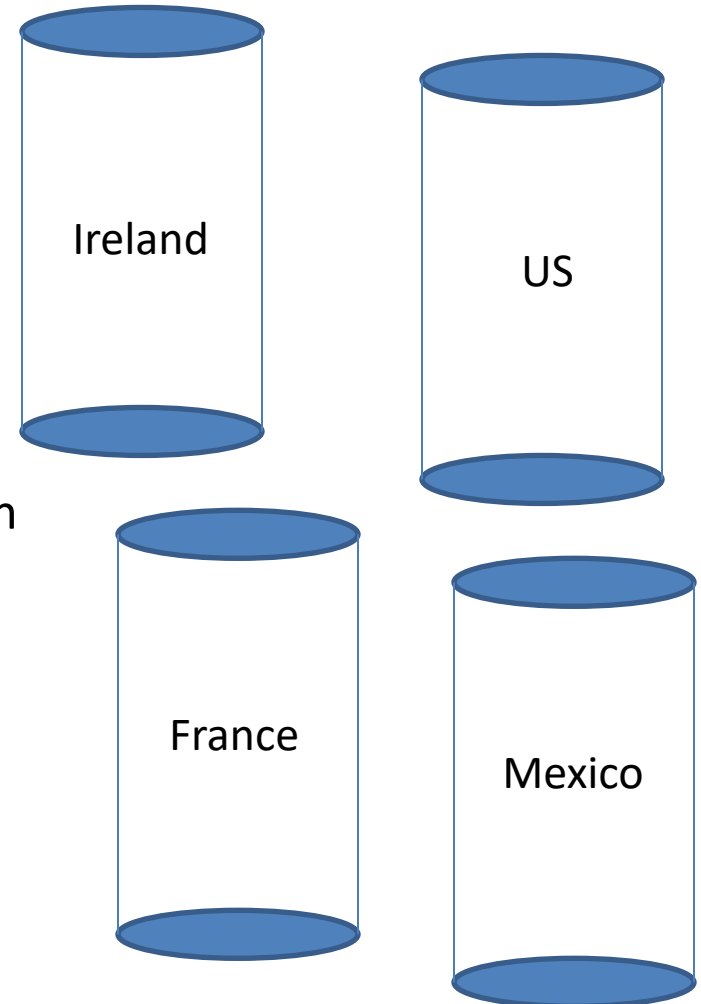


Synthetic (Local) Treatment: Single Firms and Enterprise Groups

- EU Recast
 - Coordinating proceeding
 - Undertaking
 - “As if” treatment
- MLEG
 - Planning Proceeding
 - Group Insolvency Solution
 - Provides for local recognition and local treatment (Synthetic (main and/or non-main) treatment)
- Still need an entitlement baseline – Choice of Law

Realizable Value

- Asset Based Priority
 - Depends on Value of the Assets
- Corporate Structure Based Priority
 - Limited to assets of the entity
 - Value of claims with recourse
- Territorial/Jurisdictional claim to priority
 - Distribution that would be obtained in a territorial winding up.
- Waterfall Priority – Capital Structure
 - Statutory priority (COMI)
 - Pari Passu Claims
 - No need to locate if centrally administered
 - Hotchpot if distributions decentralized



Synthetic Entitlement

- Liens -- Assets
 - Corporate Structure
 - Territorial Jurisdiction
- Capital Structure
 - Debt
 - Equity

Best interests/Realizable Priority

How much could be realized in a territorial proceeding?
The “synthetic entitlement”

Absolute Priority

The Residual Estate

- Traceable/Realizable Value
 - Synthetic entitlement
- Residual Estate
 - Untraceable and bankruptcy created value
 - *Pari Passu* distribution

Benefits of an entitlement baseline based on realizable value

- Enhance cooperation by reducing the size of outcome differences
- Fiduciary duties
 - Provides a basis for fulfilling duties.
 - Provides a process for getting comfort
- Respects national policy choices
- Respects sovereignty

Suitable for Harmonization

- Existing Instruments
 - EU Reg – Recast
 - Legislative Guide – Recommendations 3—34
 - III/ALI Choice of Law Principles
- There are differences
- Key issue: **Scope of lex fori**
 - In “main” case
 - In a “planning proceeding”
 - In a “secondary.”
- **Focus on “procedural” coordination to facilitate cooperation**