

5-1-2017

Cross-Border Insolvencies: To “Universalize” or to Arbitrate?

Young Hye (Martina) Chun

Follow this and additional works at: <https://digitalcommons.pepperdine.edu/drlj>



Part of the [Bankruptcy Law Commons](#), [Dispute Resolution and Arbitration Commons](#), and the [International Law Commons](#)

Recommended Citation

Young Hye (Martina) Chun, *Cross-Border Insolvencies: To “Universalize” or to Arbitrate?*, 17 Pepp. Disp. Resol. L.J. 65 (2017)

Available at: <https://digitalcommons.pepperdine.edu/drlj/vol17/iss1/3>

This Comment is brought to you for free and open access by the Caruso School of Law at Pepperdine Digital Commons. It has been accepted for inclusion in Pepperdine Dispute Resolution Law Journal by an authorized editor of Pepperdine Digital Commons. For more information, please contact bailey.berry@pepperdine.edu.

Cross-Border Insolvencies: To “Universalize” or to Arbitrate?

Young Hye (Martina) Chun

INTRODUCTION

Globalization of ideas, cultures, and communication has allowed multinational companies¹ to expand their trade and investment internationally.² For example, most Fortune 500 companies have business operations³ and assets in multiple foreign jurisdictions through subsidiaries.⁴ In 2010, the 100 largest U.S. public companies by revenue had an average of 109 foreign-nation subsidiaries.⁵ As the international expansion of corporate business increasingly strengthens transnational business relationships, the absence of a global court has raised concerns as to how an insolvent

1. “A multinational business enterprise usually operates outside its home jurisdiction through one or more separately formed subsidiaries or affiliates. Separate units are created for tax, corporate governance[,] or limitation of liability reasons [because] it is impractical for most enterprises to do business in multiple jurisdictions as a single entity.” Gropper, *The Arbitration of Cross-Border Insolvencies*, 86 AM. BANKR. L. J. 201, 203 (2012); “Structural flexibility benefits the [multinational business] by allowing for the allocation of risk and reduction of the cost of capital through the leverage effect.” Nora Wouters & Alla Raykin, *Corporate Group Cross-Border Insolvencies Between the United States & European Union: Legal & Economic Developments*, 29 EMORY BANKR. DEV. J. 387, 397 (2013).

2. Wouters & Raykin, *supra* note 1.

3. Tom Kutsch, *Top 500 US Firms Keep \$2.1 Trillion in Tax Havens, Study Finds*, ALJAZEERA AMERICA (Oct. 6, 2015, 2:45 PM), <http://america.aljazeera.com/articles/2015/10/6/top-us-companies-keep-21-trillion-in-tax-havens-abroad.html>; “Enterprise Group” refers to such multinational companies who operate with “two or more distinct legal entities linked through either an indirect or direct form of control or ownership.” U.N. Comm’n on Int’l Trade Law, *Model Law on Cross-Border Insolvency: Legislative Guide on Insolvency Law*, U.N. Sales No. E.12.V.16, at 85-86 (July 2012) (alteration in original).

4. See, e.g., Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2313-14 (2000) [*hereinafter* Westbrook, *A Global Solution*]. See also Tax Insight: Gerbo Holdings, available at <http://www.pwc.com/ca/en/services/tax/publications/tax-insights/gerbo-holdings-tcc-did-not-apply-offshore-investment-fund-rules-investment-tax-haven.html> (explaining that the increase in foreign subsidiaries is due to “incentive to leave earnings of foreign subsidiaries in the countries in which they operate if those countries have a lower corporate tax rate than that of the US”).

5. Richard Squire, *Strategic Liability in the Corporate Group*, 78 U. CHI. L. REV. 605, 619-20 (2011).

company can either liquidate or reorganize its business when it has subsidiaries and assets that are located in different foreign jurisdictions.⁶ Due to the lack of a global court, the threshold question underlying this problem has been whether to apply the laws of the company's home or the host country.⁷ Because multinational companies have subsidiaries and affiliates in various jurisdictions, the question of the applicable "choice of law" has been the focal point in addressing the issue.⁸

To address such concerns, two opposing theoretical solutions have been proposed: to "universalize" or to arbitrate.⁹ While the United Nations Commission on International Trade Law ("UNCITRAL") has attempted to compensate for the lack of a global court by introducing the notion of "universalism"¹⁰ claims into a designated jurisdiction with certain priority statuses, it has yet to serve as a solution for American companies operating internationally through foreign subsidiaries or affiliates.¹¹

On the other hand, arbitration has become a popular practice for parties in international business transactions over the past decade.¹² The popularity is evidenced by "an increase of cases at major arbitral institutions, such as the International Chamber of Commerce's International Court of Arbitration, which received 599 requests for arbitrations in 2007, an almost twenty-fold increase in the past fifty years."¹³ Businesses have been flocking to arbitration due to arbitration's ability to provide a neutral and speedy dispute resolution process, largely subject to the parties' control and consent, in a single and centralized forum.¹⁴ According to PricewaterhouseCoopers ("PwC"), 88% of corporate counsels in a survey of 82 large corporations have used arbitration at least once, with 38% of the disputes arising from commercial transactions.¹⁵

6. Conflicting decisions from the courts involved in a multinational enterprise's insolvency cannot be readily resolved because there is no international court with jurisdiction over insolvency matters. Gropper, *supra* note 1, at 204.

7. *Id.*

8. *Id.*

9. Westbrook, *A Global Solutions*, *supra* note 4.

10. Quotations are used to refer to universalizing throughout this paper because there cannot be a pure form of universalism approach without a global court. *See infra* Part I.

11. Westbrook, *A Global Solutions*, *supra* note 4.

12. *Id.*

13. *See* Gary B. Born, *International Commercial Arbitration* 69 (2009). In 2007, a total of 3,235 arbitration cases were filed amongst the various arbitral institutions, up 132% from 1993. *Id.*

14. *Id.* at 71.

15. PricewaterhouseCoopers, INTERNATIONAL ARBITRATION: CORPORATE ATTITUDES AND PRACTICES 2008, at 2, 5 (2008), <http://www.pwc.co.uk/services/forensic-services/insights/international-arbitration-2008.html>.

However, arbitration is not without its own drawbacks. The United States’ unpredictable and murky case law has drawn concerns over whether courts will honor arbitration clauses when the matters relate to bankruptcy matters.¹⁶ Because the Supreme Court has yet to speak specifically on honoring arbitration agreements in bankruptcy matters, there are concerns that courts in the United States may not allow consenting parties to arbitrate, rendering arbitration a suspect solution.¹⁷

This note makes a cost-benefit analysis of the U.S. Bankruptcy Code Chapter 15 and International Commercial Arbitration in the context of cross-border bankruptcy proceedings. Part I sets the stage by providing two opposing theoretical approaches to cross-border insolvencies: territorialism and universalism. Part II introduces the UNCITRAL’s Model Law on Cross-Border Insolvency, which is incorporated into the U.S. Bankruptcy Code Chapter 15.¹⁸ It presents how the Model Law has attempted to compensate for the lack of a global court by incorporating universalism.¹⁹ Part III demonstrates that while Chapter 15 sounds good in theory, it fails to address the very issue it was enacted to address. It also provides two primary reasons as to why Chapter 15 fails. Part IV assesses the clash between the Federal Arbitration Act (“FAA”) and the U.S. Bankruptcy Code. Finally, Part V both critiques International Commercial Arbitration as a remedy due to its unpredictable enforcement by courts in the United States, and also applauds its ability to provide cross-border insolvencies more uniformity and predictability due to its contractual nature.²⁰

This paper concludes that while both Chapter 15 and arbitration fail to provide a predictable, and therefore efficient, solution to both debtors and creditors in cross-border insolvencies, there is a key distinction that sets arbitration apart as the more favorable option.²¹ While the predictability issue with arbitration lies with the lower courts’ judicial hostility against arbitration, the issue with Chapter 15 stems from the code itself—both procedurally and substantively.²² In other words, while arbitration is not exactly the most predictable and reliable solution to cross-border insolvencies, the root of this very unpredictability lies with the courts’ narrow interpretation of the FAA and the inability to move forward into the

16. Born, *supra* note 13.

17. *Id.*

18. *See infra* Part I.

19. *See infra* Part I.

20. *See infra* Part V.

21. *See infra* Part V.

22. *See infra* Part V.

new era of arbitration.²³ The Supreme Court once warned that this inability “would surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international agreements.”²⁴

I. TWO THEORETICAL APPROACHES

Universalism and territorialism are opposite approaches to cross-border insolvencies.²⁵ Universalism is used to describe an insolvency system where a single court has jurisdiction over a debtor’s assets, but uses a multinational insolvency system.²⁶ A pure form of universalism is a rather idealistic theory where courts and legal systems are bound to enforce the orders of the court of the home country.²⁷ It calls for a single proceeding and a harmonized insolvency law.²⁸

On the other hand, the territorialism approach to cross border insolvency holds that “the law of any country is applicable only to the assets or persons physically subject to that law.”²⁹ Under this approach, there would be separate proceedings in each of the subsidiaries’ jurisdictions—as opposed to proceeding as one business entity.³⁰ Territorialism advocates for separate proceedings and “imposes no single law but relies on each jurisdiction to apply its own laws.”³¹ A common territorialism argument is that formal universalist law infringes upon national sovereignty.³²

While the current practice of cross-border insolvency in the Model Law is “neither of these absolutes,”³³ it strives to provide the same benefits and efficiencies of having a single court in a universalist approach. Therefore, current universalist approaches can be seen as a “modified” version of

23. PricewaterhouseCoopers, *supra* note 15.

24. Scherk v. Alberto-Culver Co., 417 U.S. 506, 517 (1974).

25. Wouters & Raykin, *supra* note 1, at 389.

26. Edward S. Adams & Jason Fincke, *Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism*, 15 COLUM. J. EUR. L. 43, 48 (2009).

27. *Id.* at 48-49.

28. Wouters & Raykin, *supra* note 1.

29. Pedro Jose F. Bernardo, *Cross-Border Insolvency and the Challenges of the Global Corporation: Evaluating Globalization and Stakeholder Predictability through the UNCITRAL Model Law on Cross-Border Insolvency and the European Union Insolvency Regulation*, 56 ATENEO L.J. 798, 803 (2012).

30. *Id.*

31. Wouters & Raykin, *supra* note 1, at 390.

32. *Id.*

33. *Id.*

universalism, which provides that “local courts have a degree of freedom as to whether compliance with home-country requests is appropriate.”³⁴ “Modified universalism allows for a single main case for a multinational concern in its home country (however defined), with the insolvency of the multinational concern governed primarily by the laws of the home country.”³⁵ It recognizes secondary or ancillary cases in other countries where assets or creditors are located.³⁶ Under this approach, other jurisdictions would be expected to defer to the resolution proceedings of one main, single jurisdiction and the assets located in those non-main jurisdictions would be “consolidated as part of the main resolution proceedings.”³⁷ The apparent disadvantage from this approach is that it could generate a bankruptcy proceeding in every country in which the debtor has assets.³⁸ This disadvantage will be further discussed later on in an argument that Chapter 15, which is adopted from the Model Law, is insufficient.³⁹

II. UNCITRAL’S MODEL LAW ON CROSS-BORDER INSOLVENCY

A. History and Purpose of UNCITRAL Model Law

UNCITRAL’s Model Law on Cross-Border Insolvency has been the very attempt to replicate the ideals of universalism and “universalize” the claims arising from insolvency into one central jurisdiction its “single” proceeding—with cooperation.⁴⁰ The UNCITRAL completed drafting the Model Law on Cross-Border Insolvency in 1997.⁴¹ Currently, the Model Law has been adopted by 17 nations, including the United States.⁴²

34. Adams & Fincke, *supra* note 26, at 48-49.

35. *Id.* at 49.

36. *Id.* See Westbrook, *A Global Solution*, *supra* note 4, at 2301.

37. Bernardo, *supra* note 29, at 803.

38. Adams & Fincke, *supra* note 26, at 52-53.

39. See *infra* Part III.

40. Wouters & Raykin, *supra* note 1, at 390-91.

41. UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment, U.N. Sales No. E.99.V3 (1997).

42. Legislation based on the UNCITRAL Model Law on Cross-Border Insolvency has been adopted in: Australia (2008), Canada (2009), Colombia (2006), Eritrea (1998), Greece (2010), Japan (2000), Mauritius (2009), Mexico (2000), Montenegro (2002), New Zealand (2006), Poland (2003), Republic of Korea (2006), Romania (2003), Serbia (2004), Slovenia (2007), South Africa (2000), United Kingdom (2006), and the United States of America (2005); SIR RYAN GOODE & ROYSTON MILES GOODE, *PRINCIPLES OF CORPORATE INSOLVENCY*, (4th ed., 2011) 793, note 57. Status: 1997 - UNCITRAL Model Law on Cross-Border Insolvency, UNCITRAL, the World Bank, and the

The Model Law is designed to embody a form of “ancillary” proceeding, which provides recognition of foreign insolvency proceedings and subsequently supports cooperation among the representatives of different insolvency jurisdictions.⁴³ The adopting countries to the Model Law decide their own substantive law, but must allow foreign representatives “equal, simple, and fast access to their law.”⁴⁴ Once a court recognizes a foreign main proceeding, the recognizing court “should use its discretion to fashion post-recognition relief, equivalent to what the foreign court would anticipate under its own laws.”⁴⁵ For example, a foreign representative may desire to receive protection of automatic stay within the United States.⁴⁶

B. Center of Main Interests (COMI)

A main proceeding takes place in the debtor’s “center of main interests” (hereinafter COMI) and a non-main proceeding takes place anywhere else the debtor carries out “non-transitory economic activity.”⁴⁷ Under the Model Law, the designation of “center of main interests” or COMI is crucial because the law of debtor’s COMI is presumed to provide the primary law during the proceeding.⁴⁸ In a sense, this COMI is acting as the “global court” in that there is centralized control over the proceeding.⁴⁹ This designation ensures that there is a single distribution of the assets located cross-border, rather than having distributions in each of the multiple

International Monetary Fund have also adopted “best practice” guidelines for the liquidation or reorganization of failed business enterprises. *Id.*

43. Wouters & Raykin, *supra* note 1, at 391-92.

44. *Id.* at 391. See Jenny Clift, United Commission On International Trade Law (Uncitral): *The UNCITRAL Model Law on Cross-Border Insolvency- A legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency*, 12 TUL. J. INT’L & COMP. L. 307 (2004).

45. Wouters & Raykin, *supra* note 1, at 392. See Clift, *supra* note 44, at 323. See also In re Atlas Shipping A/S, 404 B.R. 726, 738-46 (Bankr. S.D.N.Y. 2009).

46. 11 U.S.C. § 1517 (2012). Immediately upon the recognition of a foreign main proceeding, the automatic stay and selected other provisions of the Bankruptcy Code take effect within the United States; 11 U.S.C. § 1520 (2012). The foreign representative is also authorized to operate the debtor’s business in the ordinary course. *Id.*

47. UNCITRAL Model Law, *supra* note 42, at Part One, art. 2(f), Part Two, PP 30-31.

48. Jay Lawrence Westbrook, *Locating the Eye of the Financial Storm*, 32 BROOK. J. INT’L L. 1019 (2007) [*hereinafter* Westbrook, *Locating the Eye of the Financial Storm*].

49. *Id.* Westbrook, *A Global Solution*, *supra* note 4, at 2279. For further discussion of universalism as a governing principle in cross-border insolvency law, see *infra* text accompanying notes 80-83. *Id.*

jurisdictions.⁵⁰ In theory, this kind of centralized control would not only help in liquidating cases, but also in the reorganization cases where the goal is to have the worldwide assets intact.

C. Chapter 15 of the U.S. Bankruptcy Code

Before the U.S. codified the Model Law into Chapter 15 of the U.S. Bankruptcy Code in 2005, the first step toward facilitating procedural coordination was initially introduced into the U.S. bankruptcy laws in 1978 when the Congress adopted § 304 for an “ancillary” proceeding in the Bankruptcy Code.⁵¹ Under this section, not different from the Chapter 15, “a foreign estate administrator could seek an order from the U.S. bankruptcy court that would recognize and give support to the foreign case.”⁵² “Section 304 was based on the proposition that there was a principal insolvency proceeding in the foreign jurisdiction and that the U.S. proceedings would be [‘]ancillary[’] and provide assistance to the foreign representative . . . [by] allocating authority between the foreign and American courts.”⁵³

Under Chapter 15 of the U.S. Bankruptcy Court, a foreign court or representative recognized by a U.S. court can reap the benefits of other U.S. Code provisions.⁵⁴ Such cooperation with foreign courts is reflected in the Model Law and Chapter 15’s objectives:

[1]) cooperation . . . [between] the courts and other competent authorities of [this State and foreign States involved in cases of cross-border insolvency]; [2]) greater legal certainty for trade and investment; [3]) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested entities, including the debtor; [4]) . . . protection and maximization of the value of the debtor’s assets; [5]) . . . facilitation of the rescue of financially troubled businesses, [thereby protecting investment and preserving employment.]⁵⁵

Before such cooperation with foreign representatives may occur however, the foreign representatives must first seek the recognition of their

50. See Westbrook, *Locating the Eye of the Financial Storm*, *supra* note 48. Westbrook, *A Global Solution*, *supra* note 4.

51. 11 U.S.C. § 304 (2012) (repealed 2005). See Adams & Fincke, *supra* note 26, at 72-73.

52. Gropper, *supra* note 1, at 205. See 11 U.S.C. § 304 (2012) (repealed 2005).

53. Gropper, *supra* note 1, at 205. See 11 U.S.C. § 304 (2012) (repealed 2005).

54. Wouters & Raykin, *supra* note 1, at 393. 11 U.S.C. § 1520 (2012). A representative may also ask for relief outside of the code. *United States v. J.A. Jones Const. Grp., LLC*, 333 B.R. 637, 638 (E.D.N.Y. 2005) (allowing the foreign representative in Cayman Islands to get the turnover of debtor records on certain conditions).

55. *Id.* at 392-93 (quoting *In Re Basis Yield Alpha*, 381 B.R. 37, 44 (2008)); 11 U.S.C. § 1501 (2012).

proceedings by the U.S. courts.⁵⁶ A foreign representative can begin by filing an application and then the court determines whether the nature of the proceeding is either a “foreign main proceeding” or “foreign non-proceeding.”⁵⁷ The Article 17(2) of the UNCITRAL Model Law provides that a foreign main proceeding exists if “it is taking place in the State where the debtor has the center of its main interests” and that a foreign non-main proceeding exists if the debtor has an establishment,⁵⁸ meaning, “any place of operation where the debtor carries out a non-transitory economic activity with human means and goods or services.”⁵⁹

This distinction is important because if the court determines that the proceeding is a “foreign main proceeding,” the U.S. court must extend its protection through a mandatory stay.⁶⁰ A stay protects the debtor’s assets, rights, obligations or liabilities from creditors who may try to collect or sue the debtor by halting all such actions in the courts.⁶¹ Such protection of the stay is not given to debtors determined to be in a foreign non-proceeding unless the court grants such stay upon their own discretion.⁶²

II. GOOD IN THEORY, BUT FUTILE IN PRACTICE

Adopting the Model Law on Cross-Border Insolvency into Chapter 15 of the U.S. Bankruptcy Code, the United States attempted to compensate for the lack of a global court by designating the insolvent businesses’ COMI with certain priority status over the other jurisdictions.⁶³ However, as it will be discussed under sub-part B, this solution has demonstrated itself to be unfeasible for those companies who operate in foreign countries not through their own companies, but through affiliates and subsidiaries.⁶⁴

56. Bernardo, *supra* note 29, at 810.

57. *Id.* See 11 U.S.C. § 1520 (2012).

58. Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, pmbl., U.N. Doc. A/RES/52/158 (Jan. 30, 1998) [*hereinafter* UNCITRAL Model Law], art. 2(b).

59. *Id.* at art. 2(f).

60. Bernardo, *supra* note 29, at 810-11.

61. UNCITRAL Model Law, *supra* note 59, art. 19-22.

62. *Id.* at art. 22(3).

63. Gropper, *supra* note 1, at 209; 11 USCS § 1501 (2012). Before Chapter 15 was codified into the Bankruptcy Code, the United States introduced its first step toward facilitating coordinating cross-border insolvency in 1978. *Id.* Known as “ancillary proceeding” as it was codified in Section 304, a foreign estate administrator could seek an order from the U.S. Bankruptcy court that would reorganize and give support to the foreign case. *Id.*

64. *Id.* at 208-09.

A. *Jurisdiction Issue: The Guessing Game*

The first main issue with Chapter 15 is that it has failed to provide a clear mechanism through which to determine a debtor’s COMI, which as explained before, would determine whether the debtor’s proceeding is a main or non-main proceeding, making the stay mandatory.⁶⁵ While the Model Law has only defined “main” proceeding to be one where the debtor has center of its main interest⁶⁶ without providing what “center of main interests,” Chapter 15 only states that there is a discretion on the courts to assess whether the foreign representative has met the burden of proof.⁶⁷ Because questions arise as to which court would control over a company’s assets when a major multinational company files for bankruptcy, the code is inherent difficulty in determining whether the debtor’s COMI is costly to both the debtor and the creditors.⁶⁸ This inherent difficulty in determining multi-national debtor’s COMI means that corporate creditors would not know which jurisdiction’s law will govern collection until after their debtors file for bankruptcy and courts rule on venue.⁶⁹

The Court’s ruling in *In re SPhinx*⁷⁰ has in some way clarified the COMI determination by providing various factors, which could be relevant in its determination;⁷¹ however, it also emphasizes and warns how the discretionary nature of Chapter 15 is contrary to the Model Law’s goals and therefore not the remedy that the UNCITRAL intended to provide.⁷² The goal of UNCITRAL Model Law was to be the best alternative to a “global court” by making it “mandatory” for the adopting countries to allow foreign representatives “equal, simple, and fast access” to their law by adhering to the uniformity in law that sits at the heart of the Universalism approach.⁷³

65. *Id.* at 207-08.

66. *Id.* at 206.

67. Bernardo, *supra* note 29, at 808, 816. This discretionary power is essentially one of the two main reasons why Chapter 15 fails to serve as a predictable and efficient remedy to cross-border insolvency. *Id.*

68. *Id.* at 813.

69. *Id.* at 805.

70. *In re SPhinx, LTD.*, 351 B.R. 103, 117 (Bankr. S.D.N.Y. 2006) *aff’d*, 371 B.R. 10 (S.D.N.Y. 2007).

71. Bernardo, *supra* note 29, at 817-18; *In re SPhinx*, 351 B.R. at 117.

72. Bernardo, *supra* note 29, at 818; *In re SPhinx*, 351 B.R. at 117.

73. Wouters & Raykin, *supra* note 1, at 391; Clift, *supra* note 44; Bernard, *supra* note 29, at 819.

In this case, SPhinX was an insolvent corporation in the middle of a Chapter 11 bankruptcy proceeding in the United States.⁷⁴ It did not conduct any business in the Cayman Islands and its assets were managed by a Delaware corporation in New York City.⁷⁵ In addition, none of its directors resided in the Cayman Islands and no board meetings occurred there.⁷⁶ The issue arose when creditors filed a suit against SPhinX for receiving preferential payments by one of SPhinX's clients.⁷⁷

Most likely with the intention of circumventing this lawsuit, SPhinX thereafter filed for bankruptcy in the Cayman Islands and then filed a Chapter 15 in U.S. to attain the protection of the stay.⁷⁸ As delineated above, a foreign debtor may only get the protection of the stay if the matter is determined by the court to be a foreign "main" proceeding.⁷⁹ Thus the issue before the court was whether the proceedings in the Cayman Islands should be considered a main proceeding.⁸⁰ The first part of the ruling helped clarify what factors are relevant in determining the COMI: location of the debtor's headquarters, location of those who actually manage the debtor (such as the headquarters of a holding company), the location of the debtor's primary assets, the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case are all relevant factors.⁸¹

The second part of the ruling, however, unfortunately shed light on the Chapter 15's defect in providing the kind of predictability and uniformity Chapter 15 and the Model Law were established to provide.⁸² First, the court held that in determining a debtor's COMI, the debtor and the creditors, absent improper purpose, can "best determine how to maximize the efficiency of a liquidation or reorganization."⁸³ This reasoning, coupled with the fact that there were no party-in-interest who objected to the proceedings, led the court to find the debtor's COMI as the Cayman Islands.⁸⁴ Despite the fact that SPhinX did not meet any of the factors, the very same court provided that it had absolutely no form of any business, and

74. In re SPhinX, 351 B.R. at 107.

75. *Id.* at 107.

76. *Id.* at 108.

77. *Id.* at 109.

78. *Id.* at 109.

79. *Id.* at 117.

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

the court was inclined to find that the Cayman Islands was the debtor’s COMI.⁸⁵ Ultimately, because the court found that this particular proceeding is too obviously intended to delay and circumvent the lawsuit against SPhinX, the court used its discretionary powers to find that the proceeding is a non-main foreign proceeding.⁸⁶

It is hard to believe the court first provided very reasonable criteria by which to determine a debtor’s COMI only to not use it later and rule that COMI exists merely because 1) debtor can best determine how to maximize its efficiency and 2) no party-in-interest objected. In the end, the court used its discretionary powers to their full effect by holding that despite finding the debtor’s COMI to be in the Cayman Islands, the matter nevertheless remains a non-main proceeding.⁸⁷ This ruling directly contradicts the Model Law’s expressly stated definition of a non-main proceeding, which is “any place of operation where the debtor carries out a non-transitory economic activity with human means and goods or services.”⁸⁸

This case perfectly captures Chapter 15’s problematic nature when it comes to determining a debtor’s COMI, which in turn determines whether a debtor may receive the protection of the stay.⁸⁹ The court’s approach in this case is a byproduct of Chapter 15’s failure to provide a concrete mechanism as to preventing the court from straying too far from not only the Model Law’s goals but also, as this case shows, the very provisions of the Model Law.⁹⁰

The decision about whether a case is a non-main or main foreign proceeding is too important an issue for Chapter 15 to fail on: the very premise on which the Model Law rests is to provide a feasible form of a “global court” where a jurisdiction with the COMI functions as the centralized control system that consolidates the non-main foreign proceedings.⁹¹ However, since there is a lack of clear methodology in determining COMI, courts are given too much flexibility and discretion in ignoring the provisions of the Model Law, thereby compromising the Model Law’s effectiveness.⁹² Without the adopting countries all having a uniform

85. *Id.*

86. *Id.*

87. Bernardo, *supra* note 29, at 812-13.

88. UNCITRAL Model Law, *supra* note 43, art. 2(f).

89. Bernardo, *supra* note 29, at 813.

90. *Id.* at 813.

91. See Gropper, *supra* note 1, at 203-04.

92. See Bernardo, *supra* note 29, at 813.

and therefore predictable mechanisms to determine COMI, the Model Law is nothing but a failed attempt built on novel aspirations.

B. What about Subsidiaries?

The second issue with the Model Law is its failure to address the resolution of multinational corporate groups.⁹³ The Model Law and Chapter 15 require the treatment of each legal entity separately for the purpose of determining the location of its COMI. As explained above, the COMI determines the proper location of its main case. The Model Law's absence of remedy for multinational business that operate as a single entity is a huge deficiency because the Model Law is an attempt to compensate for the lack of a global court-in the face of globalization. Because a "legal framework that allows for the reorganization or liquidation of an entire economic unit will be more efficient than one that deals with its corporate parts separately,"⁹⁴ Chapter 15 is rather arbitrary for cross-border insolvencies with multinational businesses. For example, the majority of Chapter 15 cases in the U.S. have involved corporate groups that are composed of different legal entities such as subsidiaries.

First, there is no provisions in the Model Law that effectively deals with enterprises comprised of multiple entities or business groups. The standard on which both Chapter 15 and the Model Law rely on is designed for the "benefit of a single legal unit that seeks limited relief in another jurisdiction."⁹⁵

The implication of this limitation is best explained with a hypothetical. Assume there is an insolvent corporation incorporated in Delaware, with its entire headquarters in the United States, but has a wholly owned subsidiary in Mexico. Even if the insolvent parent corporation can prove that it fully owns and controls the insolvent subsidiary in Mexico, Chapter 15 does not allow the parent corporation to effectively control its subsidiary because it

93. Adams & Fincke, *supra* note 26, at 83 (2009) ("The Model Law . . . currently require the treatment of each legal entity separately for the purpose of determining the location of its COMI . . . such a structure . . . creates vast economic inefficiencies . . . [because] virtually all multinational corporate empires are corporate groups"). See also Wouters & Raykin, *supra* note 1, at 396 (stating that Chapter 15 does not "define a corporate group or stipulate an insolvency process for a corporate group's multiple jurisdictions").

94. Adams & Fincke, *supra* note 26.

95. Gropper, *supra* note 1, at 209.

does not provide a mechanism through which both proceedings can be held in the United States.⁹⁶

This limitation was reflected in the 2012 Fifth Circuit decision in *In re Vitro S.A.B. de C.V. United*.⁹⁷ In this case, the Fifth Circuit highlighted a foreign company’s limitations in using Chapter 15 to seek a form of relief for its subsidiaries.⁹⁸ In *Vitro*, the insolvent parent company was the largest glass manufacturer in Mexico from 2003 to early 2007.⁹⁹ After borrowing more than 1 billion dollars through unsecured notes guaranteed by Vitro’s subsidiaries in the United States, Vitro filed for voluntary reorganization under Mexico’s bankruptcy law.¹⁰⁰

In Mexico, Vitro’s reorganization plan provided that it would cancel Vitro’s existing debt, and most importantly, that all non-debtor guarantees of the debt would be extinguished.¹⁰¹ Thus, when creditors filed involuntary bankruptcy petitions against Vitro’s subsidiaries in the United States, Vitro commenced a Chapter 15 proceeding, under which a “foreign representative” can achieve recognition of a foreign insolvency proceeding.¹⁰²

In refusing to enforce Vitro’s reorganization plan from Mexico, the Fifth Circuit noted that all of the specific forms of relief listed in section 1521 apply to property of a debtor and the debtor only.¹⁰³ Therefore, the court ruled that the form of relief Vitro was seeking was not applicable because the creditors were not filing suits against Vitro, but rather its subsidiaries.¹⁰⁴

The Fifth Circuit’s decision reflects the Chapter 15’s failure to ease the pain of resolving a cross-border insolvency when a debtor has subsidiaries and affiliates in different jurisdictions.¹⁰⁵ In order for the UNCITRAL’s vision of “universalizing” to succeed in cases of cross-border bankruptcy reorganization, the company’s subsidiaries and affiliates must also be taken into account.¹⁰⁶

96. *In re Vitro S.A.B. de C.V. United*, No. 11-33335-HDH-15, 2012 Bankr. LEXIS 2841 (Bankr. N.D. Tex. June 21, 2012).

97. *In re Vitro*, *supra* note 96, at 1.

98. *Id.* at 5.

99. *Id.* at 2.

100. *Id.* at 2-3.

101. *Id.* at 2.

102. *Id.*

103. *In re Vitro, S.A.B. de C.V. v. ACP Master, Ltd*, 473 B.R. 117, 122,133 (Bankr. N.D. Tex.), *aff’d sub nom. In re Vitro S.A.B. de CV*, 701 F.3d 1031 (5th Cir. 2012).

104. *Id.* at 1-2.

105. *Id.* at 3.

106. Bernardo, *supra* note 29, at 802.

Failing to take subsidiaries into account means that each separate corporation, whether it is a wholly owned subsidiary or not, will have to file for a bankruptcy proceeding in each jurisdiction.¹⁰⁷ This piecemeal process “result[s] in undermining the very purpose of a cross-border insolvency regime—the maximization of firm value, the protection of creditors, and the salvaging of the firm as a going concern.”¹⁰⁸ This undermining is due to the fact that separate proceedings lead to the appointment of multiple estate administrators, which in turn creates significant additional costs, and given the difficulty of coordinating the administrators’ separate responsibilities, the possibility of a reorganization is likely to be precluded.¹⁰⁹ This difficulty was also demonstrated in the largest cross-border insolvency in history—when the Lehman Brothers, Inc. filed for bankruptcy with eighteen subsidiaries, and seventy-five bankruptcy proceedings brought in over forty countries.¹¹⁰

IV. THE FAA VS. U.S. BANKRUPTCY CODE

A. *Understanding the Bankruptcy Code*

In order to understand why there is a circuit split as to whether a multinational insolvency dispute is arbitrable, one must first look at the congressional demand within the U.S. Bankruptcy Law:

Bankruptcy law is designed to serve two primary purposes. First, bankruptcy gives an overburdened debtor a “fresh start.” By relieving debtors of unmanageable obligations, bankruptcy allows debtors to resume or continue productive activity in society. Second, bankruptcy serves the interests of creditors by providing them with an equitable distribution of the debtor’s nonexempt assets. Bankruptcy creates a process in which

107. *Id.* at 825.

108. *Id.* at 822.

109. *See* Adams & Fincke, *supra* note 26, at 59. The *Nortel* case provides a good example. *In re Nortel Networks, Inc.*, 669 F.3d 128 (3d Cir. 2011). In *Nortel*, on the premise that Canada was the COMI of the Nortel parent and the U.K. was the COMI of the European subsidiaries, the Delaware bankruptcy court recognized the Canadian and the U.K. proceedings respectively as foreign main proceedings under Chapter 15 of the Bankruptcy Code. These proceedings were uniquely successful in providing for a cross-border sale of assets, as the three groups were able to dispose of much of their worldwide property on a going-concern basis, including the sale of a substantial patent portfolio in a public auction.

110. Leigh Kamping-Carder, *Court OKs Global Lehman Protocol*, LAW360 (June 18, 2009, 12:00 AM), <http://www.law360.com/articles/107073/court-oks-global-lehman-protocol>.

creditors as a group can receive the highest possible return, while ensuring that no creditor benefits unfairly at the expense of others.¹¹¹

Congress passed the Bankruptcy Reform Act in 1978.¹¹² The Bankruptcy Code originally granted bankruptcy courts jurisdiction over all proceedings arising under or related to the Code.¹¹³ However, Congress’ 1984 Amendments to the Bankruptcy Code granted bankruptcy courts “original and exclusive” jurisdiction over bankruptcy cases, as well as original, but not exclusive, jurisdiction over civil cases arising under or related to the Code.¹¹⁴ Essentially, this created a two-tier structure: (1) bankruptcy courts may enter judgments arising under the Code, but (2) for actions only related to the Code, “bankruptcy courts may make only proposed findings of fact and conclusions of law, to be submitted to the district court for it to enter orders or judgments, unless the parties consent otherwise.”¹¹⁵ The former are known as “core” proceedings while the latter is known as the “noncore” proceedings.¹¹⁶

“The core/non core distinction provides one . . . bright-line rule on the enforcement of arbitration agreements in bankruptcy.”¹¹⁷ “[C]ore claims are those that arise under the Bankruptcy Code or arise in a case under the Bankruptcy Code . . . They are claims that are made possible by the operation of the Bankruptcy Code.”¹¹⁸ “Noncore claims exist and could be pursued entirely outside bankruptcy law.”¹¹⁹ “The courts are in wide agreement that both district and bankruptcy courts must enforce an otherwise valid arbitration clause covering a noncore claim.”¹²⁰ “[Noncore]

111. Paul F. Kirgis, *Arbitration, Bankruptcy, and Public Policy: A Contractarian Analysis*, 17 AM. BANKR. INST. L. REV. 503, 505 (2009).

112. Bankruptcy Reform Act § 241(a).

113. *Id.*

114. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, §§ 101(a)–(b), (98 Stat.) 333, 333.

115. 28 U.S.C. § 157(b), invalidated as applied in *Stern v. Marshall*, 131 U.S. 2594 (2011).

116. 28 U.S.C. §§ 157(b)–(c).

117. Kirgis, *supra* note 111, at 517.

118. *Id.*

119. *Id.*

120. See Marianne B. Culhane & Michaela M. White, *Enforcing (or not) Arbitration Clauses in Bankruptcy*, 1362 PRAC. L. INST. CORP. L. & PRAC. HANDBOOK SERIES 39, 48 (2003) (“[T]he presumption is that if the dispute is covered by an otherwise valid arbitration agreement, the agreement should be enforced . . . Generally, bankruptcy courts are found to have no discretion to deny motions to stay pending arbitration in debtor-derivative non-core matters . . .”). *But see* U.S. Lines, Inc. v. Am. Steamship Owners Mut. Prot. and Indem. Assoc. (In re U.S. Lines), 197 F.3d 631, 793 (2d Cir. 1999) (noting conflict between arbitration law and bankruptcy law “is lessened in non-

[Vol. 17: 65, 2017]

Cross-Border Insolvencies

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

[c]ourts seem nearly unanimous that there is no discretion to deny arbitration of noncore claims if a valid arbitration clause applies.”¹²¹

B. *The FAA and the NY Convention*

The Federal Arbitration Act (FAA) was enacted in 1925 to govern arbitrations in the United States¹²² with the specific goal of eliminating any judicial interference in the enforcement of such agreements.¹²³ This new federal statute was strongly supported by the business community, which had lobbied hard for arbitration reform.¹²⁴ The FAA provides that arbitration agreements “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”¹²⁵ The enforceability of arbitration agreements in international commercial contracts was formally established when the United States agreed to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) in 1970.¹²⁶

The FAA has three primary purposes. First, it makes agreements to arbitrate enforceable, backed by the remedy of specific performance.¹²⁷ It accomplishes this objective by conferring a right to apply to a federal district court to enforce any arbitration agreement in a contract “evidencing a

core proceedings which are unlikely to present a conflict sufficient to override by implication the presumption in favor of arbitration”).

121. Kirgis, *supra* note 111, at 518.

122. See Federal Arbitration Act, Pub. L. No. 68-401, 43 Stat. 883, 883 (1925) (“An Act To make valid and enforceable written provisions or agreements for arbitration of disputes arising out of contracts, maritime transactions, or commerce among the States or Territories or with foreign nations”).

123. Kirgis, *supra*, note 111, at 511 (defining the three primary goals of the FAA as: (1) making agreements to arbitrate enforceable, (2) enforcing arbitral awards, and (3) making awards final by limiting judicial review).

124. Born, *supra* note 13, at 133. The business community viewed litigation as “expensive, slow and unreliable,” which led New York to enact an arbitration statute in 1920 recognizing the enforceability of arbitration agreements in New York courts. *Id.*

125. 9 U.S.C. § 2.

126. See Lindsay Biesterfeld, Note, *Parties to International Commercial Arbitration Agreements Beware: Bankruptcy Trumps Supreme Court Precedent Favoring Arbitration of International Disputes*, 2006 J. DISP. RESOL. 273, 279. “Congress incorporated the Convention into the United States Arbitration Act. The United States Arbitration Act requires the courts to recognize and enforce arbitration agreements between parties to an international commercial contract.” *Id.* at 279-80.

127. See 9 U.S.C. § 2.

transaction involving [interstate] commerce.”¹²⁸ Second, the FAA provides a mechanism for judicial enforcement of arbitral awards.¹²⁹ If the parties provide for judicial enforcement in their agreement, then a district court must enter the award as a judgment of the court, thereby making available all the process normally available to satisfy a civil judgment.¹³⁰ Finally, the FAA makes arbitral awards final by severely proscribing the grounds available for judicial review of arbitral awards.¹³¹ It binds both federal and state courts as long as the matter involves interstate or foreign commerce.¹³² Thus, the FAA and, perhaps more importantly given the brevity of the FAA, the case law interpreting it have come to dominate the law of arbitration.

Arbitration has two goals: resolving disputes efficiently and avoiding lengthy and time-consuming litigation.¹³³ Yet when a party files a motion seeking to arbitrate the matter, the FAA requires courts to compel the arbitration.¹³⁴ The legislative history of the FAA establishes that the purpose behind its passage was to ensure judicial enforcement of privately made agreements to Congress’ main purpose in passing the FAA was to enforce private agreements to arbitrate.¹³⁵ Moreover, the Supreme Court has expressly rejected the notion that an overriding purpose of the FAA is “to promote the expeditious resolution of claims.”¹³⁶

C. Supreme Court Jurisprudence

In *Scherk v. Alberto-Culver Co.*, the Supreme Court held that the international arbitration agreement was enforceable for a claim under the Securities Exchange Act of 1934 brought by a German party against an American party.¹³⁷ In this case, an American company sued a German

128. 9 U.S.C. § 2; see *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 270 (1995) (“[T]he basic purpose of the Federal Arbitration Act is to overcome courts’ refusals to enforce agreements to arbitrate”).

129. See 9 U.S.C. § 9.

130. *Id.*

131. See 9 U.S.C. § 10.

132. *Id.*

133. Biesterfeld, *supra* note 126.

134. *Id.*

135. *Id.*

136. *Id.*

137. *Scherk*, *supra*, note 24 at 506, 508-09, 519-20; see also Fred Neufeld, *Enforcement of Contractual Arbitration Agreements Under the Bankruptcy Code*, 65 AM. BANKR. L.J. 525, 532 (1991). Supreme Court noted “that the refusal to enforce arbitration clauses in international agreements ‘would surely damage the fabric of international commerce and trade, and imperil the

citizen for fraud under the Securities Exchange Act of 1934.¹³⁸ The Court found an important distinction in the fact that the transaction in *Scherk* involved parties to an international agreement.¹³⁹ However, because this case did not specifically address a bankruptcy code issue, the circuit split still exists as to whether to enforce arbitration when it related to core bankruptcy matters.

Similarly, in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, the Supreme Court expanded the enforceability of international commercial arbitration clauses to actions alleging violation of a federal act, the Sherman Act.¹⁴⁰ Like *Scherk*, this case involved a dispute arising out of an international commercial agreement. In this case, the claims were alleged antitrust violations.¹⁴¹ The Supreme Court held that antitrust claims are arbitrable, finding that the statutory rights at issue could be effectively vindicated in arbitration.¹⁴²

Two years later, in *Shearson/American Express, Inc. v. McMahon*, the Court further extended the *Scherk* ruling by finding no congressional intent to impede arbitration in claims under the Securities Exchange Act of 1934.¹⁴³ However, the *McMahon* case is especially important because it provides a limitation to the FAA, which ultimately is the reason why there is a circuit split today regarding whether arbitration provisions should be upheld when it concerns the Bankruptcy Code. The Court found that the FAA could be overridden in limited circumstances.¹⁴⁴ While the Supreme Court upheld the enforceability of arbitration agreements in this case, it nevertheless provided the FAA's limitations:

Like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command. The burden is on the party opposing arbitration, however, to show that congress intended to preclude a waiver of judicial remedies for the statutory rights at issue . . . If Congress did intend to limit or prohibit waiver of a judicial

willingness and ability of businessmen to enter into international agreements.” *Id.* at 532-33 (quoting *Scherk*, *supra*, note 24 at 517).

138. *Scherk*, *supra*, note 24 at 513.

139. *Id.*

140. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 636-40 (1985).

141. *Id.* at 624-25.

142. *Id.* at 636-37.

143. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 238, 242 (1987).

144. *McMahon*, *supra* note 143. *But see* Kirgis, *supra* note 112, at 524. Kirgis is cautious to take the Supreme Court's ruling in *McMahon* to the bankruptcy issue as he distinguishes that “*McMahon* provides a test to determine whether a claim founded on a federal statute is arbitrable . . . [not] to allow bankruptcy courts decide whether an arbitrable claim would be better heard in bankruptcy court.” *Id.*

forum for a particular claim, such an intent will be deducible from the statute’s text or from an inherent conflict between arbitration and the statute’s underlying purposes.¹⁴⁵

Thus, McMahon provided that the FAA may be overridden if there is a contrary Congressional intent in another federal statute.¹⁴⁶ To that end, there is now a two-part inquiry in deciding whether a court should compel arbitration.¹⁴⁷ The first question is whether the parties agreed to arbitrate their claims.¹⁴⁸ As to the second inquiry, which is the relevant inquiry to our issue, the party resisting arbitration bears the burden to show that the Congress intended to preclude it for the claim at issue.¹⁴⁹ Therefore, in bankruptcy, courts have to consider whether enforcing an arbitration clause as required by the FAA would jeopardize the underlying purposes of the Bankruptcy Code.¹⁵⁰

However, McMahon involved a Securities Exchange Act claim and thus did not involve arbitration agreement issues with the Bankruptcy Code.¹⁵¹ The Supreme Court has not yet answered to the question of whether there is a congressional intent to preclude a waiver of judicial remedies for matters arising in bankruptcy cases.¹⁵² Therefore, there is still a large uncertainty facing arbitrators and parties who may be considering arbitration agreements internationally.

V. INTERNATIONAL COMMERCIAL ARBITRATION IN BANKRUPTCY

A. Lower Courts: Unpredictable Enforceability of Arbitration

The Supreme Court has yet to weigh in on the enforceability of arbitration clauses in bankruptcy.¹⁵³ As a result, the circuit courts have “driven the development of the law in this area.”¹⁵⁴ The current framework

145. *Id.* at 226-27. It is worth noting that, to date, the Supreme Court has never found its McMahon test satisfied. In other words, the Court has never held that a statute was intended to prohibit arbitration. See Kirgis, *supra* note 111.

146. *Jalbert v. Zurich Am. Ins. Co. (In re Payton Constr. Corp.)* 399 B.R. 352, 361 (Bankr. D. Mass. 2009).

147. McMahon, *supra* note 144, at 227.

148. *Id.*

149. *Id.*

150. *Id.*

151. *Jalbert*, *supra* note 146, at 361.

152. *Id.*

153. Kirgis, *supra* note 111.

154. *Id.*

provides a relatively clear distinction between treatment of core and noncore proceedings, but becomes murky when it comes down to the question of when an arbitration clause covering a core bankruptcy matter should be enforced.¹⁵⁵

In an 1987 case, *In re Hart Ski Manufacturing Co.*,¹⁵⁶ a bankruptcy court endorsed the arbitration provision as it ordered the parties to arbitrate a dispute about a creditor's claim and a debtor's counterclaim before the International Chamber of Commerce.¹⁵⁷ In reaching its decision, the Court noted that "[f]ederal law and federal policy unequivocally support the enforcement of private arbitration agreements entered into by citizens of the United States and foreign nationals."¹⁵⁸ This Court also cited the New York Convention implemented by federal statute to "encourage arbitration of disputes arising out of transactions by American businessmen in foreign countries."¹⁵⁹

The Third and Fifth Circuits have similarly espoused a pro-arbitration spirit and held that a bankruptcy court has discretion to refuse to enforce an arbitration clause if the proceedings are based on the Bankruptcy Code provisions and arbitration would inherently conflict with the purposes of the Code.¹⁶⁰ For example, in *Mintze v. American Financial Services, Inc.*,¹⁶¹ the Third Circuit held that the bankruptcy court had no discretion to refuse to compel arbitration. Although this was a core proceeding, the court found that there was no inherent conflict between arbitration and the underlying purposes of the Bankruptcy Code.¹⁶² The Court reasoned that the mere fact that the decision on rescission would have an effect on the rights of other creditors was not sufficient ground to reject arbitration.¹⁶³

155. *Id.* See Matthew Dameron, *Stop the Stay: Interrupting Bankruptcy To Conduct Arbitration*, 2001 J. DISP. RESOL. 337, 340 ("[t]he effect of the core and non-core distinction in the arbitration context is that a bankruptcy judge has exclusive jurisdiction over the issue if it is a core proceeding.").

156. *In re Hart Ski Mfg. Co., Inc.*, 18 B.R. 154, 161 (Bankr. D. Minn.), *amended by*, 22 B.R. 762 (Bankr. D. Minn. 1982), *aff'd sub nom.* Matter of Hart Ski Mfg. Co., Inc., 22 B.R. 763 (D. Minn. 1982), *aff'd*, 711 F.2d 845 (8th Cir. 1983). See also *In re Mor-Ben Ins. Mkt. Corp.*, 73 BR 644, 647 (BAP 9th Cir. 1987) ("[t]he desirability of an arbitration clause especially in an international transaction agreement is well recognized and must be respected.").

157. *In re Hart Ski Mfg.*, *supra* note 156, at 161.

158. *Id.*

159. *Id.*

160. *In re Gandy*, 299 F.3d 489, 495 (5th Cir. 2002).

161. *Mintze v. Am. Fin. Servs., Inc.* (*In re Mintze*), 434 F.3d 222 (3d Cir. 2006).

162. *Id.*

163. *Id.*

However, the Second and Fourth Circuits have added that arbitration agreements are unenforceable if they would necessarily jeopardize the objectives of the Bankruptcy Code, thereby expanding the criteria in which to not honor arbitration provisions.¹⁶⁴ These courts have concluded that a court may refuse to enforce an arbitration agreement if arbitration of the dispute would necessarily “jeopardize the objectives of the Code”.¹⁶⁵ For example, in *In re White Mountain Mining Co.*,¹⁶⁶ the Fourth Circuit refused to compel arbitration in this case involving an international arbitration agreement.¹⁶⁷ In this case, a dispute arose as to whether pre-filing advances made to the debtor company constituted loans or contributions to capital.¹⁶⁸ The Fourth Circuit argued that even though the claims were not created by bankruptcy law, there is an inherent conflict between arbitration and purposes of the Bankruptcy Code which puts importance of centralized decision-making in Chapter 11 to protect reorganizing debtors and their creditors from piecemeal litigation.¹⁶⁹

B. Strong Public Policy for International Commerce

In *Scherk v. Alberto-Culver Co.*, the first Supreme Court case on International Commercial Arbitration and its enforceability in court, the Supreme Court advised that “we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals.”¹⁷⁰

In reaching its ruling, the Supreme Court noted that arbitration provision only helped clear the uncertainty that inevitably exists when a contract “touches” two countries.¹⁷¹ Because such uncertainty almost always exists in contracts that are cross-border in nature, the Court held that “a contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is . . . an almost indispensable precondition to achieving the orderliness and predictability essential to any international business transaction.”¹⁷² Embedded in this reasoning is the

164. See *MBNA Am. Bank, N.A. v. Hill*, 436 F.3d 104, 109 (2d Cir. 2006).

165. *Id.* at 109.

166. *Phillips v. Congelton, L.L.C. (In re White Mt. Mining Co., L.L.C.)*, 403 F.3d 164, 171 (4th Cir. 2005).

167. *Id.* at 166.

168. *Id.*

169. *Id.* at 170.

170. *Mitsubishi*, *supra* note 140, at 626-27.

171. *Scherk*, *supra*, note 24.

172. *Id.*

[Vol. 17: 65, 2017]

Cross-Border Insolvencies

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

Supreme Court's concern that the failure to enforce such an agreement in an international context would harm the United States by discouraging the companies from filing within the United States and instead file in countries where the law is more favorable to them.¹⁷³ The Supreme Court was concerned with damaging "the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements."¹⁷⁴

Scherk was decided in 1974.¹⁷⁵ If the Supreme Court believed that we were well past the time of judicial suspicion in arbitration more than four decades ago, the lower courts must now move past its stubborn interpretations in disfavor of honoring arbitration provisions.

C. Provides a Single Proceeding: Subsidiaries Invited

International commercial arbitration provides the kind of a single proceeding both Chapter 15 and the Model Law fail to provide: a centralized control which leads to economic efficiencies, lower administrative costs, and most importantly, a standardized policy to provide predictability to creditors.¹⁷⁶

The above illustrates that arbitration could be particularly useful in cross-border insolvencies with connection to subsidiaries and affiliates. In a world where proceedings are usually opened in multiple jurisdictions, there appears to be few effective means to resolve disputes between affiliates. Furthermore, because affiliate claims in the same entity only require consent of the estate administrators to arbitrate, the collective process of gaining consent would not be as complex and difficult as it would be if the parties resorted to a Chapter 15 case where one can spend a bulk of their time trying to convince the court to honor orders from foreign jurisdictions.¹⁷⁷ For example, a recent study by PwC reported that most corporations are able to enforce arbitral awards within one year.¹⁷⁸

In using arbitration, parties would enjoy the benefits of a speedier and less expensive proceeding.¹⁷⁹ Because of the complexities of adjudicating

173. *Id.*

174. *Id.* at 517.

175. *Id.*

176. Wouters & Raykin, *supra* note 1, at 388.

177. *Id.*

178. *Corporate Choices in International Arbitration*, PwC (2013), <https://www.pwc.com/gx/en/arbitration-dispute-resolution/assets/pwc-international-arbitration-study.pdf>.

179. *Corporate Choices in International Arbitration*, *supra* note 178.

cross-border insolvencies in multiple foreign jurisdictions, such cases will see delays, inefficiencies, and increased costs.¹⁸⁰ In cross-border litigation, international commercial arbitration filled a need created by the great diversity in national legal systems and the perceived inability of some courts to enforce the law fairly.¹⁸¹

VI. A CASE STUDY ON SOUTH KOREA

Underlying concerns in both Chapter 15 and U.S. International Commercial Arbitration arise from the harsh truth that multinational businesses—no matter how big they are—can fail. This is the very reason why parties seek the comfort of predictability: in the event that it fails, how will they resolve their insolvency disputes in multiple jurisdictions? Therefore, to encourage international investment and commerce, it is imperative that the Supreme Court provides this predictability in the United States. For example, South Korea’s fast economic growth has been attributed to its prioritizing International Commercial Arbitration:

Korea was barely visible in the international arbitration community just ten years ago; yet, Korea is now a major player. Korea not only generates numerous large cases, it hosts frequent arbitration conferences, has created a new international arbitration center, and is even touted as a possible alternative to Hong Kong and Singapore for arbitration in Asia.¹⁸²

South Korea’s drastic progress in both its economy¹⁸³ and as a major player in international commercial arbitration after the Asian Financial Crisis in 1997 reminds us that where there is failure, there is opportunity.¹⁸⁴ This crisis served as a “sobering reminder” that even the large corporations can fail and this failure “often meant the need to account for assets and

180. *Id.*

181. Loukas Mistelis & Crina Baltag, Recognition and Enforcement of Arbitral Awards and Settlement in International Arbitration: Corporate Attitudes and Practices, 19 AM. REV. INT’L ARB. 319, 322 (2008).

182. Korea’s Emerging Importance in the Practice of International Commercial Arbitration, 15 PEPP. DISP. RESOL. L.J. 461, 471-72 (2015). Moderator Jack Coe quoting guest speaker Grant Park on South Korea’s drastic transformation in International Commercial Arbitration. *Id.*

183. South Korea’s GDP skyrocketed from \$400 billion in 1998 to \$1.2 trillion in 2013 while Korean companies’ overseas investments increased from \$5 billion to \$30 billion in just 13 years. Coe et al., *supra* note 182, at 464.

184. Park acknowledges that while the New York Convention is one of the most important pieces to make Korea become a successful player in international arbitration, as well as an arbitration center in Asia Pacific regions, he emphasized that it was the Asian Financial Crisis and the demand for resolutions to these large corporate failures that allowed South Korea to become a major international player. Coe et al., *supra* note 182, at 466-67.

liabilities scattered across various jurisdictions and legal systems.”¹⁸⁵ Only upon realizing that the courts were not sufficient to deal with cross-border insolvency did international commercial arbitration become introduced to South Korea.¹⁸⁶

In South Korea, both the practice and role of international commercial arbitration and its economic growth as demonstrated by GDP have grown drastically since the Asian Financial Crisis.¹⁸⁷ After the financial crisis, South Korea flourished due to its dedication and willingness to adopt international commercial arbitration as an alternative form of dispute resolution that would eventually prove quicker and more predictable for both courts and investors.¹⁸⁸

While the need for international commercial arbitration in South Korea arose in response to foreign investors’ reluctances in conducting mergers and acquisitions due to fear of protection of their investments, there are crucial similarities to the current issue at bar. First, they both arise out of transnational relationships, whether it is between a foreign investor and a domestic acquisition or between an insolvent parent company in one jurisdiction and its subsidiary in another. Second, they both have presented issues that require predictability.

Perhaps Chapter 15’s failure to resolve cross-border insolvencies for multinational companies can push the Supreme Court to address the issue with the same globalized vision it had in *Scherk*, especially considering that the current forces of globalization are directed towards maintaining and encouraging international commerce.¹⁸⁹

CONCLUSION

While both Chapter 15 and arbitration present their own set of issues, the key distinction is that the issue with Chapter 15 lies within its provisions while the issue with arbitration lies within the courts’ judicial hostility against arbitration. In other words, while arbitration is not exactly the most predictable and reliable solution to cross-border insolvencies, the root of this very problem is due to the courts’ narrow interpretation of the FAA and its continued skepticism towards arbitration. However, there is no question that

185. Bernardo, *supra* note 29, at 827.

186. *Id.*

187. *Id.*

188. Coe et al., *supra* note 182, at 464.

189. Bernardo, *supra* note 29, at 827.

arbitration can offer a number of advantages and a level of predictability in resolving cross-border insolvencies.

While there have been many critiques of the promotion of arbitration within the Model Law and Chapter 15, none of these critiques have taken the issue of enforceability into account. While some present a sharp analysis of how Chapter 15 disappoints, they fail to take into account, or simply ignore, that the courts have not enforced arbitration in a predictive manner.

While arbitrations would resolve cross-border insolvencies in a much more efficient and speedy manner, it is nonetheless being held back from reaching its full potential as an effective alternative to lengthy and unpredictable litigation in multiple jurisdictions. Without a clearer direction from the Supreme Court on the enforceability of arbitration in cross-border bankruptcy, the question “to universalize or to arbitrate” becomes “which one is the lesser evil”—because deciding to arbitrate would ultimately mean risking the possibility of the arbitration agreement being struck down.

The Supreme Court has already recognized that U.S. courts must be sensitive to “the need of the international commercial system for predictability in the resolution of disputes.”¹⁹⁰ Perhaps the Supreme Court should address the issue by enforcing an agreement to arbitrate a core bankruptcy proceeding—ending the guessing game once and for all.

190. Mitsubishi Motors Corp., *supra* note 140, at 629.

[Vol. 17: 65, 2017]

Cross-Border Insolvencies
PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL