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DEALING WITH INSOLVENCY BEYOND BORDERS: THEORETICAL INSIGHTS AND THE UNCITRAL MODEL LAW

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CONTENTS

Essay & Comments

DEALING WITH INSOLVENCY BEYOND BORDERS: THEORETICAL INSIGHTS AND THE UNCITRAL MODEL LAW

Chandni*

Abstract

The rapid growth of globalisation has enabled various corporate entities to conduct business across multiple countries. International economic integration has played a crucial role in accelerating economic growth. However, corporate failures can disrupt the global financial system. Due to the presence of assets and creditors in multiple jurisdictions, corporate insolvency often extends beyond a single country. Many domestic legal systems do not recognise foreign courts' jurisdiction, proceedings, or decisions, nor do they acknowledge the rights of foreign creditors. This conflict of laws in insolvency proceedings can lead to asset depletion and business losses. A key issue in such cases is determining the number of proceedings required and identifying the governing legal framework. Various theories have been proposed to address cross-border insolvency and ensure the effective implementation of transnational insolvency laws. However, these theories have also resulted in negative economic consequences due to their limitations and uncertainties. This article seeks to analyse the different theories of cross-border insolvency, offering insights into various approaches for adopting an adequate legal framework in this area.

Keywords-*UNCITRAL Model Law, Universalism, Territorialism, Modified Universalism, Jurisdictional Challenges.*

I

Introduction

Insolvency law plays a crucial role in the economy by ensuring the fair distribution of an insolvent debtor's assets among creditors. In the case of international corporate entities, which have assets and creditors across multiple countries, corporate failure can disrupt the global economic system. Insolvency is both a common cause and consequence of corporate failure, and due to the involvement of foreign assets and creditors, financial obligations are not confined to a single jurisdiction. Foreign creditors often struggle to recover their rightful dues because domestic legal systems may not recognise foreign insolvency proceedings, making it challenging to enforce claims against debtors. Consequently, corporate entities prefer to invest in countries where their interests are adequately protected.

Investors assess various factors such as credit availability and legal protections when investing in a foreign country. One of the most critical considerations is an efficient cross-border insolvency framework.[1]As international trade and commerce are essential for economic growth, a well-functioning insolvency regime is equally important.[2] Since all business ventures carry inherent risks, insolvency laws aim to instil confidence in foreign creditors by ensuring their interests are safeguarded on par with domestic creditors. Cross-border insolvency laws specifically protect foreign creditors with a stake in a debtor's assets in different jurisdictions.

A key theoretical issue in cross-border insolvency is determining the number of proceedings initiated and identifying which country's laws should govern them. This question has no universal answer, as countries have distinct legal frameworks for resolving insolvency matters. The lack of a standardised legal approach adds to the complexity of cross-border insolvency proceedings.[3]

The present work draws its theoretical and information base from other work, including Reuven Glick, 'Country Crises and Corporate Failures: Lessons for Prevention and Management'.[4]wherein he analysed that the corporate entities operating in competitive markets across different jurisdictions may encounter financial difficulties and insolvency due to the ever-evolving nature of the market. This dynamic environment encourages the optimal use of resources and aims to maximise economic value. However, when a corporate entity fails to compete effectively with prevailing market forces, it becomes vulnerable to an inevitable decline.

David O Mbat & Eyo I. Eyo, in the article 'Corporate Failure: Causes and Remedies,'[5] stated that corporate failure is common in the market and does not always

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[1]Terence C. Halliday & Bruce G. Carruthers, BANKRUPT: GLOBAL LAW MAKING AND SYSTEMATIC FINANCIAL CRISIS (Stanford University Press, 2009).
[2]Ian F. Fletcher, *Insolvency in Private International Law*, 7 COLUM. L. REV. 11 (2009).
[3] Sefa M Franken, *Cross Border Insolvency Law: A Comparative Institutional Analysis* 34 OXFORD JOURNAL OF LEGAL STUDIES 97 (2014).
[4]Reuven Glick, *Country Crises and Corporate Failures: Lessons for Prevention and Management?*, FEDERAL RESERVE BANK OF SAN FRANCISCO, ECONOMIC LETTER (2002).
[5]David O. Mbat& Eyo I. Eyo, *Corporate Failure: Causes and Remedies*, 3 BUSINESS AND MANAGEMENT RESEARCH 1 (2013).

necessitate legislative intervention. However, such shortcomings can disrupt the economic system, reduce employment opportunities and increase poverty.

Andrew T. Guzman, in the article 'International Bankruptcy: In Defence of Universalism'[6], analysed that the rapid expansion of cross-border trade and investment has heightened the challenges and complexities associated with cross-border insolvencies. Consequently, establishing an adequate legal framework for insolvency has become a matter of global significance. Many countries have undertaken legislative reforms to enhance the efficiency and robustness of their insolvency systems.

Lynn M. LoPucki, in the article 'Cooperation in International Bankruptcy: A Post Universalist Approach'[7] has asserted that liberalising international trade and global markets have strengthened commercial relations between countries. International economic integration has played a crucial role in accelerating economic growth and increasing interdependence among national economies. This has enabled corporate entities to expand their operations across borders for new market opportunities.

Malami M Maishanu, in the article 'Corporate Failure and Turnaround Strategies in Banking Industry'[8] stated that a corporate entity is always vulnerable to failure when it struggles to compete effectively against prevailing market forces, ultimately leading to its decline. At the same time, such shortcomings can drive progress by prompting organisational changes and enabling the efficient reallocation of capital and resources.

II

Jurisdictional Challenges in Cross-Border Insolvency

Cross-border trade involves corporate entities from multiple countries and is not confined to the territorial boundaries of any single nation. Corporate failures often lead to insolvency, which has widespread consequences across various countries, as financial obligations extend beyond domestic borders. This situation significantly impacts creditors, especially when debtors hold assets in multiple jurisdictions. Creditors face challenges due to:

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[6] Andrew T. Guzman, *International Bankruptcy: In Defence of Universalism*, 98 MICH. L. REV. 2177 (2000).

[7] Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post Universalist Approach*, 84 CORNELL L. REV. 689 (1999).

[8] Malami M. Maishanu, *Corporate Failure and Turnaround Strategies in Banking Industry*, 22 J. OF APPLIED BUSINESS AND ECONOMICS 48 (2020).

- Differences in legal regimes across countries may not always align with those of the corporate entity involved.

- There is an absence of a legal framework in some countries to recognise foreign insolvency proceedings.

Another significant issue is that not all domestic legal systems can handle cross-border insolvency effectively. Many jurisdictions do not acknowledge the authority of foreign courts, their proceedings, decisions, or enforcement measures, nor do they always recognise the rights of foreign creditors. This legal conflict in insolvency cases often results in asset depletion and business losses.

Over the years, the various theories of cross-border insolvency have been adopted by many countries, such as

(a) Universalism-As per this theory, a single bankruptcy court holds authority over the administration of the debtor's assets. This court is the one where the insolvency proceedings were first initiated. The laws of that country govern the insolvency process, which is referred to as the main proceeding.[9]

(b) Territorialism- This theory emphasises a corporation's domicile, residence, and nationality. It asserts that the country where the company's assets are located has jurisdiction over insolvency matters, regardless of whether the company operates globally.[10]

However, these theories have not effectively resolved cross-border insolvency issues. The challenge arises particularly when domestic courts do not recognise foreign proceedings, decisions, cooperation, or the authority of foreign representatives. According to the universality principle, all the debtor's assets should be available for debt repayment. However, in practice, the lack of cooperation among involved countries and the absence of uniform procedures weaken the principle's effectiveness. Additionally, sovereignty concerns prevent countries from relinquishing control over their insolvency systems or allowing foreign courts to enforce orders directly.

The principle of territoriality states that the jurisdiction over insolvency matters lies with the country where the company's assets are located, even if the business operates worldwide. This principle has been criticised for being limited to assets

[9]Jay L. Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457 (1991).
[10]*Supra* note 7.

within the country where proceedings are initiated. It may also encourage creditors to initiate insolvency proceedings in their jurisdictions as quickly as possible to liquidate assets before another country asserts jurisdiction. If multiple countries claim jurisdiction, it can result in numerous separate proceedings in countries where the debtor has assets.

These uncertainties have had significant negative economic impacts. They create obstacles to effective business restructuring and cause delays in debt recovery. The existence of multiple insolvency proceedings across different jurisdictions increases transaction costs, ultimately harming commercial relations and acting as a significant barrier to international trade and investment.

(c) Modified Universalism- The modified universalism theory promotes a centralised administration of a debtor's assets while allowing simultaneous insolvency proceedings in different domestic jurisdictions. Both domestic and foreign assets are managed through coordinated proceedings, ensuring cooperation among local and international courts. Under this theory, the jurisdiction handling the main insolvency proceeding is given preference in determining the choice of law. In contrast, courts overseeing non-main proceedings are expected to assist the primary adjudicating court.[11] The approach evaluates the fairness of the main proceedings, creditor rights, and any potential conflicts with the public policy of the concerned jurisdiction. It is particularly favoured by those advocating for an international insolvency framework that balances global cooperation with local creditor protection.

Modified universalism allows foreign stakeholders to participate in domestic insolvency processes, ensuring the equitable distribution of a debtor's assets by national laws. To harmonise concurrent insolvency proceedings, courts handling such cases must coordinate and cooperate, enhancing fairness, equity, and predictability in protecting local interests.

Lord Hoffman described modified universalism as the "golden thread"[12]In transnational insolvency, emphasising that:

> *"The existence of foreign preferential creditors who would have no preference in an English distribution has never inhibited the courts from ordering remittal. In my opinion, the court had jurisdiction in common law, under its established practice of giving directions to ancillary liquidators, to direct remittal of the*

[11]Ian F. Fletcher, *Le enfer, c'est les autres: Evolving Approaches to the Treatment of Security Rights in Cross border Insolvency*, 46 TEXAS INTERNATIONAL LAW JOURNAL 489 (2011).
[12]*McGrath v. Riddell, 3 All E.R. 869 (H.L.).*

> *English assets notwithstanding any differences between the English and foreign distribution systems."*[13]

A landmark example of this approach was seen in the case *In re Maxwell Communications Corporation.*[14] Where the U.S. courts adopted modified universalism, the debtor company had its headquarters in England, while other businesses operated in the United States. Recognising the need for cross-border cooperation, courts in both jurisdictions followed an agreed protocol, allowing the examiner in New York and the administrators in England to work together efficiently. As a result, the corporation's assets were distributed globally through unprecedented judicial coordination.

India has also embraced modified universalism, as demonstrated in the *Jet Airways (India) Ltd. (Offshore Regional Hub/Offices through its Administrator, Mr. Rocco Mulder, v. State Bank of India & Anr.*[15] Here, parallel insolvency proceedings were initiated, one in India and another in Dutch courts. Due to the absence of a legal framework for cross-border insolvency, the adjudicating authority initially followed a territorial approach, refusing to recognise the Dutch proceedings. However, upon appeal, the National Company Law Appellate Tribunal (NCLAT) reconsidered whether multiple insolvency proceedings could be conducted for the same debtor in different jurisdictions with distinct legal frameworks. The NCLAT endorsed modified universalism, allowing cooperation with Dutch Bankruptcy Administrators and approving India's first recognised cross-border insolvency procedure. Under this ruling, India retained primary jurisdiction while ensuring collaboration with foreign courts.

The UNCITRAL Model Law on Cross-Border Insolvency is built on modified universalism and explicitly aims to enhance:

> *"Greater legal certainty for trade and investment,"*[16]And*"fair and efficient administration of cross-border insolvencies that protect the interest of all creditors and other interested parties."*[17]

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[13]*Id.*
[14]*In re Maxwell Communications Corp.*, 170 B.R. 800, 801-02 (Bankr. S.D.N.Y. 1994).
[15]*Jet Airways (India) Ltd. v. State Bank of India &Anr.*, Company Appeal (AT) (Insolvency) No. 707 of 2019.
[16]UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT AND INTERPRETATION (2013) AVAILABLE AT HTTPS://UNCITRAL.UN.ORG/SITES/UNCITRAL.UN.ORG/FILES/MEDIA-DOCUMENTS/UNCITRAL/EN/1997-MODEL-LAW-INSOL-2013-GUIDE-ENACTMENT-E.PDF (LAST VISITED FEB. 5, 2024).
[17]*Id.*

It aims to become a fundamental component of the country that adopts it in its legal system. According to its preamble, the goal is to develop an efficacious procedure for managing transnational insolvency situations to promote and ensure:

(i) Cooperation and coordination in transnational insolvency issues amongst the domestic as well as international courts and authorities;
(ii) The foreign proceedings and judgments are given recognition;
(iii) Rights and duties of insolvency representatives.
(iv) Efficacious and fair administration of transnational insolvency proceedings and granting sufficient shield to the concerned parties' interests, such as creditors, all other interested persons, and the debtor.
(v) Safeguarding and increasing the debtor's property value;
(vi) interests of all the parties concerned are protected;
(vii) Legal certainty in the conduct of international investment and commerce;

The Model Law offers a modern legal framework that enhances transnational insolvency proceedings' efficiency, fairness, and cost-effectiveness. Rather than imposing a uniform insolvency law, it emphasises cooperation between jurisdictions while respecting differences in national legal systems. Countries adopting the Model Law can modify its provisions to align with their domestic legal frameworks, provided such adaptations maintain consistency, predictability, and uniformity in cross-border insolvency matters.

Therefore, various theories have been proposed to govern transnational insolvency, but modified universalism has emerged as the most effective approach. India's case, *Jet Airways (India) Ltd. (Offshore Regional Hub/Offices through its Administrator Mr. Rocco Mulder) v. State Bank of India &Anr.,*[18] exemplifies its practical application, demonstrating how courts can balance sovereign interests with international cooperation. Since the UNCITRAL Model Law is based on modified universalism, it offers a structured legal mechanism for recognising foreign insolvency proceedings, granting relief, and ensuring coordination among courts. Ultimately, the Model Law promotes international trade stability by providing certainty in cross-border insolvency cases and enabling stakeholders to predict legal outcomes in the event of business failure.

III

UNCITRAL Model Law on Cross-Border Insolvency

[18]*Supra* note 15.

The United Nations Commission on International Trade Law (UNCITRAL) introduced the Model Law on Cross-border Insolvency on May 30, 1997, which the United Nations General Assembly adopted on December 15, 1997. This Model Law provides a comprehensive framework for handling cross-border insolvency matters and is designed to help countries establish harmonised insolvency laws.[19] Its primary objective is to ensure an efficient, fair, and cost-effective approach to transnational insolvency cases. The Model Law is a legislative guideline that countries can adapt and integrate into their domestic legal systems, ensuring consistency in cross-border insolvency procedures across different jurisdictions. Over the years, numerous countries have incorporated their provisions into their national insolvency laws.

The Model Law emphasises cooperation and coordination among nations rather than imposing mandatory unification of substantive insolvency laws.[20] It prioritises granting foreign representatives access to domestic courts, recognising foreign insolvency proceedings, providing necessary relief, and promoting collaboration between national and foreign courts to facilitate seamless cross-border insolvency resolution.

The Model Law is based on four key principles:

(a) Access- Foreign insolvency professionals and foreign creditors are allowed direct access to local courts and can participate in and initiate domestic insolvency proceedings.
(b) Recognition- The Model Law permits the recognition of foreign proceedings and the relief provided by local courts based on such recognition.
(c) Relief- A fundamental rule of the Model Law is that the relief which is deemed necessary for the systematic and fair conduct of cross-border insolvencies should be made obtainable to aid in foreign proceedings
(d) Cooperation and Coordination- This principle addresses cooperation amongst the foreign courts and foreign representatives and the coordination of various foreign insolvency proceedings.

Conclusion

Cross-border transactions have proven to be an effective means of driving economic growth. However, the absence of a uniform insolvency framework poses significant risks to the global economy. A major challenge arises from the reluctance of

[19]*Supra* note 16.
[20]*Supra* note 7.

domestic legal systems to recognise foreign court proceedings and decisions, primarily due to ongoing disputes over which country's laws should govern insolvency cases. Various legal theories have been proposed to address cross-border insolvency, but neither territorialism nor universalism has successfully resolved these issues.

The territorialism approach is limited, as it only applies to assets located within the country where the insolvency proceedings are initiated, lacking extraterritorial reach. On the other hand, universalism advocates for a single insolvency proceeding in the debtor's home country, encompassing all assets and creditors worldwide. Ideally, such proceedings would be recognised and enforced across all involved jurisdictions. However, many countries do not accept foreign insolvency proceedings or cooperate effectively, making the universalist approach impractical due to inconsistent legal frameworks and enforcement mechanisms.

To address these shortcomings, the modified universalism theory has emerged as a middle ground between territorialism and universalism. This approach ensures adequate protection for local creditors while allowing foreign stakeholders to participate in domestic insolvency proceedings. It also promotes coordination and cooperation among courts handling concurrent insolvency cases, fostering fairness, equity, and legal predictability.

The UNCITRAL Model Law on Cross-border Insolvency is based on the principles of modified universalism. It aims to create a unified insolvency framework by recognising foreign judgments, granting appropriate relief, and facilitating cooperation between courts. The Model Law helps eliminate unnecessary delays and legal obstacles by streamlining cross-border insolvency procedures. One of the primary reasons for inefficiencies in cross-border insolvency cases is the lack of coordination between foreign courts, often due to the absence of a robust legal framework. The Model Law seeks to bridge this gap by establishing a structured and efficient system. Moreover, the Model Law is crucial in fostering investor confidence by assuring foreign investors that their interests will be safeguarded on par with domestic creditors. This assurance, in turn, helps attract foreign investments, ultimately contributing to the growth of the domestic economy.