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THEORETICAL ASPECTS OF THE CROSS-BORDER INSOLVENCY VIS-À-VIS UNCITRAL MODEL LAW

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Abstract

The phenomenal increase in the globalization has paved the way for various corporate entities to operate business in different countries. International integration amongst countries had been proved useful for accelerating the economic growth. When there is a corporate failure it subverts the economic system at global level. Corporate entity's state of indebtedness does not restrict to one country due to involvement of assets and creditors from various countries. Often domestic countries do not recognize foreign court jurisdiction, proceedings, decisions and its enforcement and recognition of foreign creditors' right. Hence conflict of laws in case insolvency proceeding result into deprivation of assets and a loss of business. The most important question arises in such circumstances is the number of proceedings that should be commenced and which country's law should govern such proceedings. A number of theories addressing cross border insolvency have been advanced in order to the correct reinforcement of transnational insolvency laws but due to their drawback and uncertainties they have led to many adverse effects on the economy. In the present article author has tried to examine the various theories governing cross border insolvency providing different approaches for the adoption of the cross-border insolvency law.

The present article deals with the concept of turnover with due regard to the judgement in the Excel Crop case and also considering the practices followed in other states such as EU and UK.

Keywords: Cross Border Insolvency, UNCITRAL Model Law, Universalism, Territorialism, Modified Universalism.

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Literature Review

Nadine Levratto, in the article "From Failure to Corporate Bankruptcy: A Review," in Journal of Innovation and Entrepreneurship, (2013), stated that a corporate entity is reckoned as insolvent when it does not have an adequate amount of assets to settle its outstanding debts. The term 'insolvency' is many times confused with the term 'corporate failure' due to the reason that they are closely linked with each other but in reality, they are actually different. Both the terms are significant facet of a company in distress. Insolvency is a discrete legal concept that attributes to fiscal aspects. While corporate failure is broad and can be an effect of poor performance and mismanagement which eventually leads to insolvency.

Dr Emilie Ghio, in the article "Cross-Border Insolvency and Rescue Law Theory: Moving Away from the Traditional Debate on Universalism and Territorialism," in International Company and Commercial Law Review 29(12), (2018), pointed out the fact that the due to global economic crisis the need of cross-border insolvency laws are on rise. The UNCITRAL Model Law is a progressive and triumphant international initiative and which demonstrates that the international codes can be developed by the countries for effectively dealing with cross border insolvency issues.

Ramachandran Rr, in his article "International Trade Problems and India: A Case Study," in Journal of Commerce and Trade, (2011), had concluded that the potential of utilizing the resources is slowing down due to the lack of efficient government approach. The present laws do not suggest the efficacious pragmatic approach to deal with the financial crises. Lack of such legal framework degrades the economic growth and financial credibility.

Navita Aggarwal, in her article "Cross Border Insolvency and India," in International Journal of Legal Developments and Allied Issues Vol. 4 Issue 5, (2018), has asserted that the Model Law aims to authorize and promote the cooperation and coordination amongst the countries, instead of a unification of substantive insolvency law. The Model Law depicts that it only aids the countries so to furnish their cross-border insolvency laws to be at par with the modern legal framework so that cross border insolvency issues may be dealt efficaciously.

Terence C Halliday, & Bruce G Carruthers, in the article "Bankrupt: Global Law Making and Systematic Financial Crisis," in Stanford University Press Pg. 1, (2009), stated that the very nature of the competitive market is that it promotes the corporate entities to use the assets in best possible ways and as a result corporate entity capitalize on the economic value. The corporate entity belonging to any jurisdiction in the competitive market may countenances the financial distress and insolvencies. No insolvency issues absolutely belong to one jurisdiction so no monopoly can be claimed over the enactment of insolvency laws by any of the country.

Introduction

Insolvency law plays an important role in the economy as it provides a fair distribution of the assets of an insolvent debtor among his creditors. An international corporate entity involves assets and creditors from various countries and when there is a corporate failure it subverts the economic system at a global level. One of the most common causes or results of corporate failure is insolvency. Corporate entity's state of indebtedness does not restrict to one country due to involvement of assets and creditors from various countries. State of indebtedness deprives the foreign creditors from their legitimate dues as foreign insolvency proceedings are often not recognize in the domestic country in which the assets are situated and it becomes difficult for a foreign creditor to enforce his rights against the debtor. A corporate entity would be willing to invest in that foreign country where its interest would be protected.

While investing in any country a foreign investor considers many factors such as credit availability, protected interest and so on. The most important factor is efficient cross border insolvency law.[1] So where the international business and trades are important for economic growth the efficient insolvency regime is also very important. [2] As every venture involves risk, the objective of the insolvency law is to promote confidence in foreign creditors that their interests are secured just like domestic ones. Cross border insolvency law protects the foreign creditors who have the interest in the assets of the debtor which are situated in the different countries.

As far as cross border insolvency is concerned, the most important theoretical question is the number of proceedings that should commence and which country's law should govern such proceedings. The answer of the said issues is not always the same as number of countries have different existing laws in the respect to the choice of applicable law on the insolvency issues. Such laws are not universal.[3]

Issues Posed by Cross Border Insolvency

Cross border trade is done between the corporate entities belonging to various countries and hence such trade is not restricted to the territorial limits of their respective country. The end result of corporate failure results into insolvencies which adversely affects various countries as the state of indebtness do not restrict to only domestic arena. It affects the creditor rights as the debtors have assets in different countries. They suffer because of-

- The countries have distinct legal systems which cannot be always found to be consistent with other countries the corporate entity, or
- The country may not have any legal mechanism to recognize the foreign insolvency proceedings.

The other problem is that not every country's domestic law is efficient enough to successfully deals with cross border insolvency proceedings. Often domestic countries do not recognize foreign court jurisdiction, proceedings, decisions and its enforcement and recognition of foreign creditors' right. Hence conflict of laws in case insolvency proceeding result into deprivation of assets and a loss of business.

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

(a) Universalism- According to this theory a single bankruptcy court has the control over the administration of the debtor's assets. This court is the one in which insolvency proceeding was first initiated. The insolvency proceeding is governed by the laws of such country and will be known as main proceeding. [4]

(b) Territorialism- This theory emphasis on the domicile, residence and nationality of a corporation. The country in which the assets of the company are situated then that country has the jurisdiction no matter the company is carrying its business around the world.[5]

However, such these theories have not helped much in efficaciously addressing the cross-border insolvency issues. The problem is especially when domestic countries do not recognize foreign proceedings, decisions, cooperation, and access of foreign representatives to local courts. As per the universality principle all the properties belonging to debtor can be utilize to pay debts. But the fact that all the countries which are involved do not cooperate proficiently and do not apply uniform procedures so it

makes the universality principle ineffective. Also because of sovereignty issues usually no country agrees to relinquish its autonomy to standardize its own insolvency proceedings or to allow any foreign country to make implementation of the orders directly.

The principle of territoriality says that the country in which the assets of the company are situated then that country has the jurisdiction no matter the company is carrying its business around the world. This is the drawback as the principle of territoriality is only restricted to the assets situated in the country where the insolvency proceeding is initiated. It has also suffered severe criticism, as it could promote creditors to initiate the insolvency proceedings in their jurisdiction as expeditiously as possible in order to sell and dispense the income before some other country could come and claim on the issue of jurisdiction. If any country claims on the issue of jurisdiction then it will lead to numerous and separate proceedings in each country where the debtor owns assets.

These uncertainties have led to many adverse effects on the economy. It has created hindrance in the successfully restructuring the business and prolonged delay in the debt recovery. The various cross border debtors lead to multiplicity of insolvency proceedings in different countries which increases the transaction costs. Consequently, it all results into adverse effect on commercial relations and hence a severe barrier to international trade and investment.

(c) Modified Universalism- This theory advocates the acceptance of a centralized administration of the debts and assets of the debtor but also allows the local jurisdictions to have separate proceedings and to evaluate the fairness of the main proceedings including the creditor priority regime, and determine whether they breach of that local jurisdiction's public policy. Priority regarding choice of law rule is given to the jurisdiction of the main proceeding, subject to a contrary ruling by the local courts. The role of the courts in proceedings is generally to cooperate with the courts controlling the main proceedings.[6]

Modified Universalism has been described by Lord Hoffman as the 'golden thread' of cross-border insolvency[7] and has applied this principle in dealing with an application to remit assets held in England and Australia. Lord Hoffman, in applying this principle, stated that *"the existence of foreign preferential creditors who would have no preference in an English distribution has never inhibited the courts from ordering remittal."*[8] Lord Hoffman stated that:

> *"It follows that 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 English assets notwithstanding any differences between the English and foreign systems of distribution."*[9]

In past couple of decades, many countries have introduced modified or mixed models involving an element of Universalism.[10] UNCITRAL Model Law on Cross Border Insolvency was introduced in response to a perceived need to have a more consistent approach to cross-border insolvency issues. UNCITRAL Model Law is based on the approach of Modified Universalism.

UNCITRAL Model Law on Cross Border Insolvency

The United Nations Commission on International Trade Law (UNCITRAL) issued the Model Law on Cross-Border Insolvency on 30 May, 1997 and thereby on 15 December, 1997 United Nations General Assembly passed the said Model Law. The UNCITRAL Model Law on Cross Border Insolvency, 1997, provide the comprehensive framework to govern the cross-border insolvency matters and it is designed in a way that it assists the countries to get the harmonized cross border insolvency laws.[11] It aims to provide an efficacious, fair and cost-effective procedure for transnational insolvency cases. It provides a legislative framework to the countries and allows them to modify it as per their requirements and to incorporate the Model Law into their respective domestic legislation so as to assure that their cross-border insolvency laws and proceedings are consistent with different countries. The Model Law has been significantly implemented by many countries in their respective domestic legislation. Till date 49 States Model Law has been adopted by incorporating it into their domestic laws.[12]

The model law states that it emphasizes on permitting and promoting cooperation and coordination between various countries [13] more willingly than mandatory unification of substantive insolvency law. It focuses on access of foreign representatives in the courts, recognition of foreign proceedings and relief, cooperation and coordination between with foreign courts.[14]

The Model Law is based on four key principles:

(a) Access- Foreign insolvency professionals and foreign creditors are allowed the direct access to local courts and they 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 found on such recognition.

(c) Relief- A fundamental rule of the Model Law is that the relief which is deemed necessary for 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, foreign representatives and coordination of various foreign insolvency proceedings.

Conclusion

Cross border transactions have been proved as a useful method for accelerating the economic growth. But the dearth of uniform insolvency regime devastates the economy. Domestic countries often do not recognize foreign court proceedings and decisions due to the ongoing issues as which country's law should govern such insolvency proceeding. Various theories have been propounded to govern the cross-border insolvency. The best approach in dealing with the cross-border insolvency is provided by Modified Universalism theory. UNCITRAL Model Law is based on the approach of Modified Universalism. It provides unity in insolvency proceedings by way of recognition of foreign judgments and relief. The aim of the Model Law is to encourage international commercial relations by giving certainty in case of cross border insolvency and it facilitates the parties to compute the legal consequences in the case of a business failure. The objective of the Model Law is to provide recognition of foreign insolvency decisions, relief and cooperation and coordination between the courts. Hence, the Model Law reduces prolonged delay and obstacles in the administration of cross border insolvency procedure. More often the lack of coordination between various foreign courts is due to dearth of efficient legal framework. The Model Law aims to fill this gap by providing efficient universal framework. The Model Law is also capable of boosting the confidence of foreign investors that their interests are secured just like domestic ones and hence, capable of attracting the flow of investments in domestic economy.

Section 27(b) of the Act provides for the imposition of penalty by the CCI upon an enterprise in contravention of Section 3 or 4 after due inquiry, but not more than 10% of the average of turnover for the preceding

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End Note

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[1] Terence C Halliday, & Bruce G Carruthers, *Bankrupt: Global Law Making and Systematic Financial Crisis*, STANFORD UNIVERSITY PRESS (2009)

[2] Fletcher. F. Ian, *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] JAY L. WESTBROOK, THEORY AND PRAGMATISM IN GLOBAL INSOLVENCIES: CHOICE OF LAW AND CHOICE OF FORUM, (1991)

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

[6] Fletcher, *Supra* note 2

[7] *McGrath v. Riddell* (2008) 3 All ER 869, cited in *Ackers v Sand Investment Company Lid* (in liq) (2010) 190 FCR 285, 295 (47); See also Lord Collins comments in *Rubin v Eurofinance SA* (2012) 3 WLR 1019, 1030.

[8] *McGrath v Riddell* (2008) 3 All ER 869 (44)

[9] *Id.*

[10] Bob Wessels, *Cross-Border Insolvency Law in Europe: Present Status and Future Prospects*, PRUCHEFSTROOM ELECTRONIC LAVE JOURNAL (2008).

[11] The UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation (1997)

[12] United Nations Commission on International Trade Law (Nov. 1, 2021 2.50 PM)
https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency/status

[13] Halliday, *Supra* note 1

[14] UNCITRAL Model Law, *Supra* note 12