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Capturing the Benefits of Arbitration for Cross Border Insolvency Disputes

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The increasing incidence of cross-border insolvencies reflects the continuing global expansion of trade and investment. However, national insolvency laws by and large have not kept pace with the trend, and they are often ill-equipped to deal with cases of a cross-border nature. This frequently results in inadequate and inharmonious legal approaches, which hamper the rescue of financially troubled businesses, are not conducive to a fair and efficient administration of cross-border insolvencies, impede the protection of the assets of the insolvent debtor against dissipation and hinder maximization of the value of those assets. Moreover, the absence of predictability in the handling of cross-border insolvency cases can impede capital flow and be a disincentive to cross-border investment.

UNCITRAL Guide to Model Law on Cross-Border Insolvency, [1997]

INTRODUCTION

Insolvency proceedings are often lauded for providing a relatively quick and efficient means of resolving disputes among insolvent debtors and their creditors. Historically, insolvency courts have adhered to the principle of "territoriality," which posits that bankruptcy proceedings should be brought in the jurisdiction where property or assets of the debtor are located, and that the courts in that forum have jurisdiction and priority over those assets. Based on this principle, in a typical domestic insolvency proceeding, one forum will exercise jurisdiction over the debtor and all of its assets; the adjudicator can thus make decisions that will bind all of the creditors seeking a piece of those assets.

The principle of territoriality has become difficult to apply in our increasingly globalized world. Today's multinational corporations operate in multiple countries and hold assets across the globe. Thus a debtor and its affiliate entities may be subject to multiple insolvency proceedings in various jurisdictions. The efficiency gains of a single-forum insolvency process no longer exist, and instead debtors can find themselves in intractable disputes or subject to inconsistent decisions issued by multiple courts.[1] Over the last two decades, there have been various proposals to address the complications inherent in cross-border insolvency proceedings. In the aftermath of the recent financial crisis, which brought a wake of insolvent debtors with massive international presence, the issue has received increased attention.

Recently, several experts in the insolvency field, most notably U.S. Bankruptcy Judge Allan Gropper, have suggested that international arbitration might play an important role in cross-border insolvency proceedings. This article explores several ways in which international arbitration can be used to bring efficiency and consistency to cross-border insolvency proceedings.

BACKGROUND

In 1997, a United Nations working group formulated a Model Law on Cross- Border Insolvency, with the goal of establishing a "modern, harmonized and fair framework" to address cross-border insolvency. The Model Law defined a "cross- border insolvency" as those instances in which an insolvent debtor has assets in more than one jurisdiction, or where some of its creditors reside in a jurisdiction other than where the insolvency proceeding is taking place.[2]

Prior to the Model Law's enactment, many advocated for the adoption of a principle of "universality" in cross-border insolvencies, or the idea that all cross- border insolvencies should be unified into a single case. Some proponents of the universality approach argued that the proper jurisdiction could be set forth in the debtor's corporate charter;[3] others argued that this was unworkable in practice, as debtors would surely choose a jurisdiction favorable to them, and

[1] "Separate insolvency proceedings lead to the appointment of multiple estate administrators, which creates significant additional costs and normally precludes the possibility of a reorganization given the difficulty of coordinating the administrators' separate responsibilities." Allan L. Gropper, *The Arbitration of Cross-Border Insolvencies*, 86 Am. Bankr. L. J. 201, 204 (2012). [Hereafter "Gropper"]

[2] *See* UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (hereinafter, "Model Law"), *Purpose and Origin of the Model Law*, ¶ 1.

[3] *See, e.g.*, Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 Mich. J. Int'l L. 1 (1997).

the interests of non-voluntary creditors who did not agree to the jurisdiction set forth in the charter would likely be impaired.[4] What eventually emerged as a compromise position was a concept that is commonly referred to as "modified universality," or a recognition of foreign insolvency proceedings while respecting domestic law. The U.S. Bankruptcy Code, adopted in 1978, contains an early embodiment of this principle: it provides that, where a principal insolvency proceeding is pending in a foreign jurisdiction, the U.S. proceeding may be considered an "ancillary" proceeding and the U.S. bankruptcy court should recognize and give support to the foreign "main" proceeding.[5]

The Model Law adopts this principle of cooperation and coordination among the "main" insolvency court and other ancillary jurisdictions where insolvency proceedings are pending. The main feature of the Model Law is the principle that there should be only one "main" insolvency proceeding, which takes place in the debtor's "center of main interests," or "COMI."[6] "Non-main proceedings" are those taking place in all other jurisdictions in which the debtor has an "establishment," defined by the Model Law as a place of operations where "the debtor carries out a non-transitory economic activity with human means and goods or services."[7] The insolvent debtor's "COMI" presumably provides the primary law that will govern the proceeding, facilitating a coordinated and consistent distribution of the assets of the debtor. Proceedings in non-main jurisdictions are considered "ancillary," their purpose being to act as an aid to the main proceeding.

The Model Law was adopted by 19 countries,[8] and was soon followed by similar developments. For example, in 2000, the European Union countries (with the exception of Denmark) adopted the European Union Insolvency Regulation (the "EU Regulation"), which adopts the Model Law's spirit of cooperation and the main/non-main proceeding distinction.[9]

While these laws represent important achievements, and have caused many countries to codify laws on the cooperation and coordination of foreign

4 *See, e.g.*, Elizabeth Warren & Jay Lawrence Westbrook, *Contracting Out of Bankruptcy: An Empirical Intervention*, 118 Harv. L. Rev. 1197 (2005).

5 U.S. Bankruptcy Code, 11 U.S.C. § 304 (repealed 2006); replaced by Chapter 15 of the U.S. Bankruptcy Code, the U.S. domestic version of the Model Law.

6 Model Law, art. 2(b).

7 Model Law, art. 2(f).

8 *See* UNCITRAL's list of legislation based on the UNCITRAL Model Law on Cross-Border Insolvency, *available at* http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html

9 European Union Insolvency Regulation, Council Reg. (EC) No. 1346/2000 of 29 May 2000, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32000R1346:EN:NOT.

bankruptcy proceedings in their own statutory codes,[10] the Model Law's broader goal of achieving a single, streamlined distribution of assets in cross-border insolvency proceedings has had limited success. This is principally because the COMI principle has proved difficult to apply, with litigants advocating for different interpretations of the COMI standard and courts in various jurisdictions issuing conflicting and, often, irreconcilable decisions on what constitutes the debtor's true COMI.

Because of the absence of agreement on how to apply the COMI principle, there remain numerous examples of cross-border insolvencies in which more than one jurisdiction presides over what must be viewed as a main proceeding, even where the insolvent entities have assets in common or are managed from a single home base. Two recent case studies highlight the difficulties inherent in such an approach.

CASE STUDIES: NORTEL AND LEHMAN

1. Nortel

When telecommunications giant Nortel entered insolvency in January 2009, it had affiliate operations in 140 jurisdictions. Three principal insolvency proceedings were commenced on behalf of three groups of affiliate debtors: one in Canada on behalf of Canadian affiliates, one in the United Kingdom on behalf of a group of Europe-based affiliates, and one in the United States on behalf of U.S. affiliates. Nortel as an enterprise had significant assets to sell off, including approximately $3.7 billion in intellectual property assets; these assets were much more valuable if the assets held by the various affiliates were combined and sold as a single unit. After protracted negotiations, the debtors in the three main cases were able to reach agreement to sell a majority of the assets as a single unit.[11]

The debtors were not, however, able to reach agreement on how to distribute the proceeds of the sale among them. Nor could they agree on which of the three courts administering the three main proceedings should decide the allocation. In June 2009, the administrators of the three estates entered into an Interim Funding and Settlement Agreement ("IFSA") that required, among

[10] The United States adopted the Model Law as Chapter 15 of its bankruptcy code.

[11] *See* Joint Motion For Entry Of An Order Establishing An Allocation Protocol Pursuant To The Interim Funding And Settlement Agreement, And For Related Relief, *In re Nortel Networks, Inc., et al.*, Case No. 09-10138(KG) (Bankr. D. Del. Apr. 25, 2011).

other things, that the sales proceeds be kept in an escrow account, to be distributed only upon (1) agreement by all of the selling debtors on a method of allocation, or (2) if the selling debtors could not agree, upon "determination by the relevant dispute resolver(s)" of a method of allocation, to be decided under the terms of an applicable interim sales protocol to be entered by the parties.[12]

Following entry of the IFSA, the estates entered into nearly two years of negotiations and, eventually, supervised mediation proceedings, in order to try to reach agreement on the interim sales protocol contemplated by the IFSA. The negotiations resulted in extensive delay, legal fees, and related costs, but the parties were unable to reach agreement on an interim sales protocol, or on a process for allocating the sales proceeds.

In April 2011, the U.S. and Canadian debtors filed a joint motion asking the U.S. and Canadian courts to step in to resolve the parties' allocation dispute and approve a process for allocating the sale proceeds.[13] The European debtors opposed the motion and cross-moved to compel arbitration, arguing that it was improper for the U.S. and Canadian courts to decide allocation and that the par- ties had agreed in the IFSA that allocation issues would be decided in a "private, transnational arbitration proceeding and not by any national court."[14] The European debtors further argued:

> [T]he U.S. and Canadian Courts simply do not have jurisdiction to determine how the proceeds of the sales of the global Nortel businesses should be divided among the estates of the 28 Nortel debtors around the world. The courts have no inherent power over assets belonging to other estates. Nothing in any of the parties' agreements can be construed as a consent to such jurisdiction.[15]

The U.S. and Canadian debtors disagreed, arguing that the parties had never reached an agreement to arbitrate and that the U.S. and Canadian courts had exclusive jurisdiction to resolve the allocation dispute.[16]

[12] *Id.* at 7.

[13] The IFSA was governed by New York law, and the Canadian and U.S. debtors argued for the application of New York law to resolve the parties' dispute.

[14] *See* Joint Administrators' Memorandum of Law In Support of Their (I) Objection To Join Motion For Entry Of An Order Establishing An Allocation Protocol Pursuant To The Interim Funding And Settlement Agreement, And (II) Cross-Motion To Compel Arbitration, *In re Nortel Networks, Inc., et al.*, Case No. 09-10138(KG) (Bankr. D. Del. May 19, 2011), at 2.

[15] *Id.* at 5.

[16] Co-author Jennifer Gorskie is an associate at Chaffetz Lindsey LLP; David Lindsey of her firm served as an expert to the Canadian court on behalf of the U.S. debtors on the issue of whether the parties had reached an enforceable agreement to arbitrate. Jennifer is also a former associate of Cleary Gottlieb Steen & Hamilton LLP, which acts

The U.S. and Canadian courts heard the motion in a full-day hearing in 2011, which occurred simultaneously before both courts *via* video-conference. On April 3, 2013, the U.S. and Canadian courts issued two separate opinions, each of which determined that the parties had not entered into an enforceable agreement to arbitrate.[17] The courts directed the parties to continue to negotiate the terms of an allocation protocol, with trial on the allocation issues set for January 6, 2014. As of the date of this writing, nearly four years since Nortel entered insolvency, the proceeds of the Nortel sale remain in escrow.

2. Lehman

The collapse of Lehman Brothers, Inc. ("Lehman") resulted in the largest cross- border insolvency in history, with 75 distinct insolvency proceedings brought in over 40 countries. The solutions devised by the estates of the 18 major Lehman subsidiaries to coordinate this massive insolvency effort have been creative and novel. Yet the *Lehman* case study also provides numerous examples of the difficulties that cross-border debtors will face when more than one court has jurisdiction over the insolvency and applies its own laws to decide key questions in the dispute. In the *Lehman* insolvency, courts administering insolvency proceedings in the United States and England have reached conflicting views on at least two key issues, both involving complex swap transactions entered into by Lehman and various counterparties.

First, in September 2009, Judge James Peck of the U.S. Bankruptcy Court for the Southern District of New York was asked to decide an issue arising under a swap transaction governed by an ISDA Master Agreement between Metavante Corporation and Lehman Brothers Special Financing, Inc. ("LBSF"). Pursuant to the safe harbor provisions of the U.S. Bankruptcy Code, Metavante was permitted to terminate the swap contract based on LBSF's insolvency, which constituted an event of default under the ISDA Master Agreement. Metavante chose instead to keep the swap open (presumably to avoid having to make a termination payment) and simply withhold payments to LBSF, in reliance on a standard provision of the ISDA Master Agreement, section 2(a)(iii), which, it claimed, required it to make payment *only* if no event of default had occurred. The court

as counsel to the U.S. debtors. This Article does not purport to express an opinion on whether the parties to the Nortel proceedings had reached an enforceable agreement to arbitrate. Moreover, the statements in this Article are attributable to the co-authors alone and do not represent the opinions or positions of Chaffetz Lindsey LLP.

[17] See Opinion in *In re Nortel Networks, Inc., et al.*, Case No. 09-10138(KG) (Bankr. D. Del. Apr. 3, 2013); Endorsement, in *Nortel Networks Corporation (Re)*, 2013 ONSC 1757, 09-CL-7950 (Super. Ct. Ontario Apr. 3, 2013).

rejected Metavante's position, holding that it would violate the automatic stay provision of section 362 of the U.S. Bankruptcy Code for Metavante to with- hold performance under a swap it had not yet chosen to terminate, and stating that Metavante's conduct was "simply unacceptable and contrary to the spirit of . . . the Bankruptcy Code.[18] The court then went even further, holding that Metavante had waived its right to terminate the swap all together by failing to terminate promptly, and suggesting that its failure to terminate within a period of one year was not acceptable under the Bankruptcy Code (even though the ISDA Master Agreement contains no such time limit).[19]

In April 2012, the Court of Appeal of England and Wales handed down its decision in four related *Lehman* appeals, analyzing the very same provision of the ISDA Master Agreement. In the *Firth Rixson* case, the Court of Appeal reached a different conclusion from that reached by Judge Peck in *Metavante*. It held that a counterparty to a swap transaction governed by the ISDA Master Agreement *may* suspend payment upon a filing of bankruptcy by the swap counterparty, although the underlying debt obligation continues to exist and the obligation to pay does not become completely extinguished. The court further held that there was no time limit on suspension and that the decision to terminate remained in the counterparty's hands while the event of default was continuing.[20]

The English court's decision in *Firth Rixson* and the U.S. court's decision in *Metavante* are not technically in conflict. The English court's decision is limited to the interpretation of the ISDA Master Agreement itself against the backdrop of the English anti-deprivation principle and the *pari passu* rule of distribution, while the U.S. court found that the enforcement of 2(a)(iii) of the ISDA agreement was barred by a specific and separate provision of U.S. law.[21] However,

18 *See* Transcript of Hearing, *In re Lehman Bros. Holdings, Inc.*, Case No. 08-13555(JMP) (Bankr. S.D.N.Y. Sept. 15, 2009), at 110; *see also* Davis Polk, Insolvency and Restructuring Update, *In re Lehman Bros. Holdings, Inc.* (Sept. 29, 2009); *In re Lehman Bros. Holdings, Inc.*, Case No. 08-13555(JMP), 2009 Bankr. LEXIS 4349 (Bankr. S.D.N.Y. Sept. 17, 2009).

19 Metavante appealed the decision to a federal district court in the Southern District of New York, but the parties reached a settlement before the appeal was decided. In the settlement, Lehman agreed to revive Metavante's termination right and did not insist on immediate payment on swap transactions as they become due. According to one commentator, Lehman's decision in this regard may be strategic, allowing it to use Judge Peck's favorable ruling as a tool vis-à-vis other debtors, rather than risk its being overturned on appeal. *See* Mark N. Berman et al., *Reading the Tea Leaves: the* Lehman Brothers/Metavante *Settlement*, Nixon Peabody (Mar. 29, 2010), *available at* http://www.nixonpeabody.com/116966.

20 *Lomas & Ors, Joint Administrators for Lehman Bros. Int'l (Europe) v. JRB Firth Rixson Inc. & Ors.* [2012] EWHC 419.

21 Cadwalader, Clients & Friends Memo, *English Court of Appeal Interprets the ISDA Master Agreement* (Apr. 12, 2012).

the decisions clearly result in different outcomes for a counterparty to a swap transaction with a U.S. Lehman entity and a counterparty to a swap transaction with an English Lehman entity.

Similarly, conflicting decisions were reached by the U.S. and English courts on the issue of payment priority for swap counterparties upon an event of default. Typically, rights to collateral to satisfy amounts payable to noteholders under a collateralized debt obligation (CDO) are subordinated to rights to the same collateral held by a swap counterparty. Upon an event of default, however— including a bankruptcy filing—the priority "flips," and the swap counterparty's rights to the collateral become subordinated to that of the noteholders. Upon the Lehman bankruptcy filing, the CDO to which Lehman was a swap counter- party terminated. BNY Corporate Trustee Service Ltd. ("BNY") held the collateral, which had to be distributed upon termination of the CDO.[22]

The collateral was governed by a Trust Deed subject to English law, and the noteholder commenced litigation in the United Kingdom against BNY asserting priority in order to get access to the collateral. The English Court of Appeal upheld a trial court's ruling that the priority had "flipped" to the noteholder; it ruled that Lehman's interest in the collateral had always been limited and conditional, and that upon its bankruptcy filing in September 2008, noteholder priority automatically took effect.[23] In a decision rendered in January 2010, Judge Peck disagreed with the English court. He held that that the provisions of the CDO modifying priority upon a bankruptcy filing constituted unenforceable "ipso facto" clauses and violated the U.S. Bankruptcy Code's prohibition on bankruptcy forfeitures, and that any effort to enforce the flip would further violate the automatic stay provisions of the U.S. Bankruptcy Code.[24] The court acknowledged that its decision subjected BNY to conflicting U.S. and U.K. rulings regarding the distribution of collateral.

These inconsistent decisions, subjecting the various Lehman debtor entities and their counterparties to very different obligations, were handed down by two of the world's most sophisticated courts.

THE ARBITRATION ALTERNATIVE

The complexities of adjudicating cross-border insolvencies in multiple fora, such as those discussed above, contribute to delays, inefficiencies, and increased

22 Kramer Levin, *Enforceability of Subordination Provisions in Synthetic CDOs—A Lehman Perspective* (Feb. 2010).

23 *Perpetual Tr. Co. v BNY Corp Tr. Serv. Ltd.*, [2009] EWHC 1912 (Ch.)

24 *Lehman Bros. Special Financing, Inc. v. BNY Corp. Trustee Services Ltd. (In re Lehman Bros. Holding, Inc., et al)*, 422 B.R. 407 (Bankr. S.D.N.Y. Jan. 25, 2010).

costs. As cross-border insolvencies become ever more prevalent, there has been renewed interest in looking to international arbitration and other forms of alternative dispute resolution as an alternative to the domestic judicial system as a way to reduce some of these inefficiencies.

In 2007, the International Insolvency Institute (III) gave a presentation to the UNCITRAL Working Group on Cross-Border Insolvency, recommending that "UNCITRAL take its largest success, the New York Convention concerning enforcement of arbitral awards, and make clear its application to international insolvency disputes."[25] The III further recommended that UNCITRAL establish an insolvency arbitration commission to study what, if any, changes in the law are necessary in arbitration law or in insolvency law to facilitate the greater use of arbitration in cross-border insolvencies. A Committee on International Alter- native Dispute Resolution was formed by the III to serve as a resource and to promote the use of alternative dispute resolution for insolvency matters.

The use of arbitration as a tool to assist in cross-border insolvency proceedings has also garnered attention among scholars and experts. In July 2012, U.S. Bankruptcy Judge Allan Gropper published an article in the American Journal of Bankruptcy Law entitled "The Arbitration of Cross-Border Insolvencies." Judge Gropper's paper proposes international arbitration as a viable alternative approach to achieve uniformity and cooperation in cross-border insolvency disputes. Judge Gropper advocates the use of arbitration in connection with two particular types of proceedings: (1) disputes among estates of affiliated debtors (or "corporate groups") in various jurisdictions; and (2) in the reorganization of an insolvent or distressed entity that does not have access to an effective reorganization law, as an alternative to the commonly used "workout" process.[26]

Precedent for ADR in Insolvency Proceedings

There is precedent for incorporating alternative dispute resolution procedures into cross-border insolvency proceedings. Particularly in the United States, courts and insolvent debtors are increasingly making use of various means of alternative dispute resolution, including arbitration and mediation, to resolve certain disputes outside of, but in parallel to, traditional court processes. Many of these efforts have achieved excellent results.

[25] Zack A. Clement, Address to the UNCITRAL Congress, Vienna, July 12, 2007, *available at* http://www.iiiglobal.org/component/jdownloads/finish/391/4288.html. [Hereafter Clement"]

[26] Gropper, *supra* n. 1, at 223-28.

First, the administrators in a cross-border insolvency often enter into a "Cross-Border Protocol," which serves to promote cooperation and communication among the various courts. In 2000, the American Law Institute and the III adopted "Guidelines Applicable to Court-to-Court Communication in Cross- Border Cases," which encourage insolvency courts to coordinate and communicate with other jurisdictions.[27] The Guidelines, originally drafted for the NAFTA countries, were further developed and in 2012 the ALI delivered a report which expands that work to cover all jurisdictions around the world.[28] Many debtors have incorporated protocols adopting the ALI /III principles in cross-border protocols specific to their own proceedings. The ALI/III Guidelines are somewhat limited, however, because courts remain bound to apply their local law and cannot adhere to the protocol when it conflicts with the court's local obligations.

In recent years some debtors have sought to make their own cross-border protocols more robust. For example, the Lehman Cross-Border Insolvency Protocol, which was negotiated for nearly seven months, encourages courts to coordinate to preserve assets and to reconcile claims to avoid creditors seeking to recover from multiple estates and to maximize value for all affiliate debtors. For "Intercompany Claims," as defined in the protocol, the debtors agree that their representatives should negotiate in good faith to reach consensual resolution of any differences in the accounting of intercompany claims, resorting to a court only if the representatives certify that they were unable to reach consensus.[29]

Large debtors such as Lehman have also made use of mediation to promote consensual recovery of certain complex disputes. At the commencement of the *Lehman* bankruptcy, Lehman was a party to 900,000 derivative contracts. Following the *Metavante* ruling, the U.S. Bankruptcy Court entered an order establishing alternative dispute resolution for all counterparties who had interest rate swaps or other derivative transactions with Lehman entities who had not made required payments or had "purportedly terminated" their swap agreements. The order provided for an expedited notice/response period during which the parties could negotiate a settlement; if no agreement is reached, the matter automatically proceeds to a mediation stage.[30] Pursuant to this order, Lehman served 237 ADR

27 American Law Institute in association with The International Insolvency Institute, *Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases*, adopted May 16, 2000.

28 American Law Institute, *Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases*, Report to ALI March 2012, *available at* http://www .ali.org/index.cfm?fuseaction=publications.ppage&node_id=85.

29 Cross-Border Insolvency Protocol For the Lehman Brothers Group of Companies, Special Procedures for Intercompany Claims, Section 9.2 (May 12, 2009).

30 HinckleyAllenSnyder LLP, Client Update, *Lehman Alternative Dispute Resolution Procedures: A Path To Swap Monetization?* (Oct. 2009).

notices and eventually settled 194 matters with 216 counterparties, resulting in over $1 billion for the estate.[31]

Procedures for mediation—in some cases to be followed, if not resolved, by arbitration—were also established by bankruptcy courts in New York for the Madoff, Ames Department Stores, A&P, General Motors, and Enron bankruptcies.

What Types of Disputes are Appropriate for Arbitration?

As the above section demonstrates, alternative dispute resolution is gaining traction in international insolvency law. Arbitration, however, presents a unique set of challenges, as arbitration is by nature a consensual process and the decisions of an arbitration panel are typically intended to be binding and non-appealable. The remainder of this article will focus on how some of these challenges can be addressed and how arbitration can best be used to assist and improve cross-border insolvency proceedings.

In the immediate term, arbitration is probably not a viable alternative for every type of cross-border insolvency dispute. Instead, proponents for the use of arbitration in bankruptcy proceedings have identified several types of disputes where arbitration could potentially be useful:

1. Claims Allowance Disputes: These are disputes between the debtor and a claimant who asserts a right to share in the pro rata distribution of the debtor's assets. The debtor may contest the amount of the claim or whether a claim properly exists at all. In cross-border disputes, there may be incentives for both parties to consent to arbitration to resolve these disputes. For example, if the creditor is from a jurisdiction different than where the main bankruptcy proceeding is pending, it may want to avoid bringing its claim before the foreign court. The debtor may also prefer the arbitration award to ensure that the creditor complies with the ruling and does not seek to pursue collection on any contested portions of the claim in its home jurisdiction.[32]
2. Intercompany/Affiliate Disputes: Disputes among debtor affiliate entities that are subject to insolvency proceedings in different nations may be particularly susceptible to arbitration.[33] Here, the incentive for affiliates to consent to arbitration include the added value that can be achieved only

[31] Notice of Lehman Brothers Holdings Inc. Pursuant to Section 105(a) of the Bankruptcy Code and General Order M-390 for an Order Amending the Tier 2 Alternative Dispute Resolution Procedures (Apr. 12, 2012).

[32] Clement, *supra* n. 23.

[33] Gropper, *supra* n. 1, at 223-27.

through cooperation and the potential to avoid intractable disputes that cannot be resolved without the influence of a neutral decision-maker that can bind each of the independent estate administrators. For example, the Lehman Cross-Border Protocol's provision requiring that estate administrators work with a common set of accounting procedures is an example of where arbitration might be useful; a neutral arbitrator might add value in deciding basic principles such as these where the administrators ultimately cannot reach consensus.

3. <u>Allocation of Enterprise Value:</u> Where the assets of a multinational enterprise are subject to the jurisdiction of multiple courts, a coordinated effort to sell the assets for a single "enterprise value" may often be beneficial to all affiliate entities. Arbitration might assist in allocating this enterprise value once sold, not only among affiliate debtor estates, but also among major shareholders and secured/unsecured lenders residing in various jurisdictions. A coordinated process before an arbitration panel selected by the par- ties could minimize the risk of double recovery and result in an award that can be enforced in more than one jurisdiction.
4. <u>Debt Restructurings of Multinational Enterprises:</u> Judge Gropper suggests that arbitration could play a central role in a restructuring or "work-out" of assets that are located in multiple jurisdictions and subject to the control of various administrators. This is particularly so where the COMI nation does not have a robust or developed reorganization law. In these circumstances, the arbitrators could become involved in the process to make a decision "where the parties were unable or unwilling to bring the bargaining to an end."[34] Arbitration might also assist in establishing a governing law or appropriate legal principles to govern the workout.[35]
5. <u>Disputes About Violations of Bankruptcy Orders:</u> Arbitration may be useful for disputes concerning a party's violation of a court order favoring the debtor—for example, an order giving a certain lender liens senior to existing liens, or authorizing a sale of assets. Such court orders are not always com- plied with, and a recalcitrant creditor may want to avoid appearing before the court whose order it violated. Arbitration encourages the cooperation of both parties.[36]
6. <u>Disputes Involving Complex Financial Instruments:</u> Highly complex financial questions, some of which may require equally complex calculations, can hinder and delay the bankruptcy process. While these issues are not necessarily unique to cross-border transactions, the consideration of a complex

[34] Gropper, *supra* n. 1, at 227-8.
[35] Clement, *supra* n. 23.
[36] Clement, *supra* n. 23.

financial instrument in multiple jurisdictions can lead to a greater likelihood of inconsistency in decisions among courts (the *Lehman* swap transactions provide a good example of this). Therefore, affiliate debtors in cross-border insolvency proceedings may want to consider referring certain complex issues to arbitration, relying on experts in the topic to achieve a quick and binding determination and permit the estates to move forward to the process of resolving creditor claims and distributing assets.[37]

Who Must Consent to Arbitration?

It is a fundamental requirement of arbitration that, for an arbitration agreement or award to be enforceable, the parties must have agreed to arbitrate the dispute. For this reason, bankruptcy and arbitration have long been considered some- what at odds: bankruptcy is, by its very nature, a collective process, which often involves “non-voluntary creditors,” while arbitration is a creature of consent.

The arbitration procedures discussed in this paper contemplate a consensual arbitration process which would bind only those parties that have agreed to arbitrate the dispute.[38] In the situations described above, there are clear incentives for the parties to consent to arbitration. Consent to arbitrate is, in theory, relatively easy to achieve among affiliate entities; the administrators of the estates, where they have authority to do so, would consent to the arbitration shortly after their appointment, subject to (depending on the requirements of the various jurisdictions) approval by the court.[39] Where the contemplated arbitration involves a debt restructuring or distribution of assets involving multiple creditors, consent would be more complex. Judge Gropper suggests that “there is invariably a group of financial creditors whose numbers are relatively few even if their claims are vastly greater than those of all other creditors combined”— these are the “principal financial creditors,” or lenders. If the debtor and its principal lenders consented to arbitration, they would have to leave the remaining creditors unimpaired, but Judge Gropper likens this to virtually any workout process, where the principal creditors agree on a partial resolution that leaves the

[37] For further discussion of the use of arbitration to resolve complex financial disputes, *see* Thomas S. Heather, *Arbitration as a Tool in Support of Insolvency Procedures (Concurso Mercantil)*, 6 World Arb. & Med. Rev. No. 1, at 161 (2012).

[38] *See* Gropper, *supra* n. 1, at 228 (“An insolvency arbitration must be based on the same fundamental principle of consent that governs any arbitration proceeding—i.e., that its effects are limited to those who have agreed to the arbitration.”).

[39] Gropper, *supra* n. 1, at 29.

non-financial creditors unimpaired in order to avoid the delays of a court-based reorganization proceeding.[40]

In order to further encourage cooperation, another alternative might be for the parties to agree to "non-binding" or "semi-binding" arbitration. The hope would be that the parties would comply with a reasoned decision of the arbitrators, but if they rejected the decision, they would be permitted to submit the dispute to a court having jurisdiction. The court could consider the reasoning of the arbitrators but would have the power, should it choose to do so, to issue its own separate ruling.

Will Courts Order Arbitration?

Assuming the relevant parties can agree to resolve their disputes in arbitration, another fundamental question is whether the insolvency courts will permit the arbitration to go forward. The courts must take into account the interests of all creditors; courts may be reluctant to relinquish control of some piece of the bankruptcy puzzle without assurance that the rights of other creditors will not be adversely affected. Moreover, courts in various jurisdictions take very different views of whether arbitration agreements are enforceable once the parties have entered into insolvency proceedings. Those courts that take a very strict view may refuse to permit the arbitration to go forward, even where there is clear consent of the parties.

The New York Convention requires signatory states to recognize agreements to arbitrate and to refer to the parties to arbitration where there is an enforceable arbitration agreement. The New York Convention further provides that an arbitration agreement is enforceable unless it is "null and void, inoperative or incapable of being performed."[41] The application of these principles differs among jurisdictions. Historically, there has been a reluctance among insolvency courts to permit debtors to participate in arbitration. Yet recent decisions in the United States, Europe and elsewhere are moving towards allowing parallel arbitration and insolvency proceedings, even where the issues are central to the insolvency proceeding.

40 Gropper, *supra* n. 1, at 230.

41 New York Convention on the Recognition & Enforcement of Foreign Arbitral Awards, art. II(3) (1958).

CONCLUSION

The increasing globalization of the world's economy and the transnational operations of companies around the globe compel further attention to the concerns aptly expressed by UNCITRAL in the promulgation of the Model Law in 1997. Those concerns have become even more pressing. The utility of arbitration to resolve certain classes of cross border insolvency disputes must continue to be explored and solutions to impediments developed. The successful development of robust arbitration procedures for cross border insolvency disputes should serve to maximize recovery for creditors and shareholders and may also serve to make financial commitments in emerging economies more attractive to lenders and investors.