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THE CASE FOR COOPERATIVE TERRITORIALITY IN INTERNATIONAL BANKRUPTCY

Lynn M. LoPucki*

“[I]t seems unrealistic to think that universalism will be accepted absent roughly similar laws.” — Jay L. Westbrook (1991)¹

INTRODUCTION

Universalism — the idea that a multinational debtor’s “home country” should have worldwide jurisdiction over its bankruptcy — has long had tremendous appeal to bankruptcy professionals. Yet, the international community repeatedly has refused to adopt conventions that would make universalism a reality. In an article published last year, I proposed an explanation.² Universalism can work only in a world with essentially uniform laws governing bankruptcy and priority among creditors — a world that does not yet exist.

Because it is impossible to fix the location of a multinational company in a global economy, the introduction of universalism in current world circumstances would give each multinational company a choice of countries in which to file. By its choice, the company could choose not only the procedure for its bankruptcy, but also the substantive rights its creditors would have. Universalism would require other nations to recognize the effects of that strategic choice. Given the huge amounts of money potentially at stake, governments rightly fear that opportunism would run rampant.³

Universalists insist that the requirement that bankruptcies occur in the “home country” of the multinational company would prevent forum shopping. They premise their defense of universalism on the assumption that each multinational company would have one home country and that everyone could know in advance which it was.⁴ Yet,

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1. Jay Lawrence Westbrook, *Theory and Pragmatism In Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 485 (1991).

2. See generally Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696 (1999).

3. See *id.* at 723-25.

4. See, e.g., Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177, 2199 (2000) (“Under universalism, the creditor can restrict this in-

no universalist writer has been able to define “home country” with any specificity or to describe how their system reliably could determine it.

In this essay, I again raise the three specific questions regarding home countries that universalists seem unable to answer. First, when the principal assets, operations, headquarters, and place of incorporation are in different countries, which is the “home country”? Second, does “home country” refer to the home country of a corporate group or does each corporation in the group have its own “home country”? Third, what rules will govern the inevitable changes in the “home country” that occur after credit has been extended? The inability of the two prominent universalists writing in this symposium to answer these questions, suggests that they are, indeed, unanswerable.

I agree with Professor Westbrook⁵ that it is likely that the globalization of business eventually will harmonize the now-divergent debt collection and insolvency systems of the countries of the world, making conditions ripe for universalism.⁶ That may take decades, however, or even centuries. The issue is what to do while we are waiting for the “new world” society — essentially, a world government — to arrive.⁷ I believe it is to continue to apply principles of sovereignty — territoriality. Westbrook believes it is for countries — and even individual judges — to begin implementing universalist principles on a piecemeal basis today.⁸

Responding to the universalist ideal, some bankruptcy judges already surrender assets to “home country” courts that will distribute them differently. Westbrook applauds these surrenders as steps along the road to universalism,⁹ and he attempts to excuse the injustice to the individual creditors involved by noting that, if the courts of other nations did the same, there might be a “Rough Wash” in which all na-

quiry to the law of one country (the debtor’s home country) . . .”). *But see infra* text accompanying note 65 (Professor Westbrook, the leading universalist, acknowledging that in some cases creditors will have to assume that more than one country might be the debtor’s home country).

5. See Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2292-97 (2000) (arguing that the bankruptcy systems of the world will converge over an unspecified period of time).

6. Professor Westbrook seems to me to make too much of this agreement. First, whether the conditions will ever be ripe for world government is mere speculation on both our parts. Second, I do not agree with Westbrook that even the inevitability of a particular system existing in such a distant, speculative future is a justification for adopting aspects of that system today. Half a loaf is usually better than none, but half a system is usually just a mess.

7. The term is Westbrook’s. *See id.* at 2276.

8. Westbrook, *supra* note 5, at 2323 n.197 (praising cases in which bankruptcy courts have surrendered assets for distribution under foreign law that differed from that of the forum).

9. *See id.* at 2319 (“I am convinced that modified universalism is the best transitional rule, because it moves us in the right direction — toward true universalism . . .”).

tions received about as much value as they gave.¹⁰ Westbrook's analysis ignores that it is creditors, not nations, that have entitlements in bankruptcy estates. The creditor that goes unpaid because its country surrenders the assets to a foreign court for distribution according to the foreign country's laws is not consoled by the fact that some other creditor of the same nationality received a windfall from that foreign court in another case.

Part I of this Essay describes the current, territorial system for international bankruptcy and the potential for international cooperation within it. Part II explains the significance of the universalists' inability to answer the three questions posed above, and adds a fourth. Part III responds to the attacks that Professors Guzman and Westbrook make on territoriality, and Part IV considers Professor Rasmussen's thought-provoking contractualist approach to international insolvency. Part V concludes that territoriality continues to provide the soundest basis for international cooperation in present world circumstances and for the reasonably foreseeable future.

I. TERRITORIALITY

Territoriality — the idea that each country has the exclusive right to govern within its borders¹¹ — is such a basic principle of international law that it often goes unnoticed. It is the default rule in every substantive area of law, including constitutional law, taxation, trademarks, industrial regulation, debt collection, and bankruptcy.¹² When applied to the bankruptcy of a multinational company, territoriality means that the bankruptcy courts of a country have jurisdiction over those portions of the company that are within its borders and not those portions that are outside them. Some nations claim "extraterritorial effect" for their bankruptcy systems, but they recognize that — absent treaties or conventions to the contrary — they can enforce their laws only against assets or persons within their own borders.¹³ With respect to bankruptcy, such treaties and conventions are virtually non-

10. See Westbrook, *supra* note 1, at 465 ("The central argument for the Rough Wash is that a universalist rule will roughly even out benefits and losses for local creditors, who will gain enough from foreign deference to the local forum in one case to balance any loss from local deference to the foreign forum in another.").

11. See, e.g., IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 105-22 (5th ed. 1998); MARK W. JANIS, *INTRODUCTION TO INTERNATIONAL LAW* 322-23 (3d ed. 1999).

12. See, e.g., 4 J. THOMAS MCCARTHY, *MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION* § 29:1 (4th ed. 1996) (noting that international trademark law is "territorial").

13. *But see* Kent Anderson, *The Cross-Border Insolvency Paradigm: A Defense of the Modified Universal Approach Considering the Japanese Experience*, 21 U. PA. J. INT'L ECON. L. (forthcoming 2000) (manuscript at 6, on file with author) (noting that even though extraterritorial bankruptcy laws are in many cases "mere overreaching that has no actual foreign impact" such laws nevertheless allow for the possibility of enforcement by willing countries).

existent. Territoriality is currently the international law of bankruptcy.¹⁴

Most multinational companies have responded to territoriality by placing their holdings in each country in a separate corporation, formed under local law. Some of these local subsidiaries are free-standing, self-sufficient businesses that the local country can reorganize or liquidate in accordance with local law. But other local subsidiaries may own only the local assets of an integrated, international business. And, in yet other cases, a foreign entity may own local assets directly. In these latter two circumstances, international cooperation may be needed to reorganize the business or liquidate its assets for the best price.

In a territorial system, the necessary international cooperation takes place in each case. That is, "parallel" bankruptcy proceedings are initiated in each country in which the corporate group has substantial assets. Each court appoints a "representative" for the estate of each entity filing in its jurisdiction. Those representatives then negotiate a solution to the debtor's financial problems. If the estates are worth more in combination than they are separately, it will be in the interests of the representatives to combine them.

Problems may arise because the bankruptcy laws of particular countries do not authorize cooperation, even when cooperation would increase the value of the local estate. But a country that will not authorize cooperation on a limited territorial basis will certainly not do so on the much more extensive basis of universalism. As a consequence, these deficiencies in authorization in no way bolster the case for universalism.¹⁵

As the international bankruptcy system currently operates, the application of territorial principles to multinational cases presents no serious problems. When the debtor's financial problems are confined to the entities located in a single country, the distressed entity or entities reorganize or liquidate in that country, and the foreign entities are unaffected. When a multinational company's financial problems extend across borders, each financially distressed entity files for bankruptcy in each country where it has significant assets. The effect is to create at least one bankruptcy estate in each country. The representatives of those estates negotiate and obtain court approval of an agreement ("protocol") that provides the terms for cooperation in the particular

14. See, e.g., Jay Lawrence Westbrook, *The Lessons of Maxwell Communications*, 64 *FORDHAM L. REV.* 2531, 2532 (1996) (acknowledging that, as between universalism and territoriality, territoriality is "the one most often applied").

15. The reasons why even a universalist system would require ex post cooperation among countries are discussed *infra* in the text accompanying notes 19-20 and in note 95.

case.¹⁶ In theory, the representatives of a multinational company's estates might fail to agree on a protocol. But territoriality's detractors, as yet, offer no examples of cases in which that has occurred.

The representatives negotiate in light of what would happen if they do not reach an agreement. Absent an agreement, the assets in each country would be reorganized or liquidated and the proceeds distributed in accord with the laws of that country. For example, assume that a financially distressed entity has assets in the United States and Canada. The entity would file in both countries, an estate would be created in each, and the courts of each country would appoint a representative of the estate in that country. Unless the representatives agreed otherwise, the U.S. assets would be distributed in accord with U.S. law and the Canadian assets would be distributed in accord with Canadian law. In this context, "U.S. law" would include U.S. conflicts rules, but bankruptcy conflict rules generally direct that the court look to local law in the distribution of a bankruptcy estate.¹⁷ The result is that the priority rules of the country where an asset is located typically determine the key issue in any bankruptcy case — who shares in the asset and in what proportion.

The system of territoriality described here is not one that I propose. It is the system currently operating in the world. Thus, it is the system that should be compared to the form of modified universalism that Westbrook would implement without waiting for the adoption of an international convention.¹⁸

II. UNIVERSALISM

"Universalism" is the term ordinarily used to refer to a world bankruptcy system in which a single court — that of the debtor's "home country" — would have jurisdiction over a debtor's assets, wherever located, and distribute them in accordance with the law of that country. The term "pure universalism" is used to refer to a universalist system in which law enforcement officers in all countries are bound to enforce the orders of the court of the home country. Even the strongest advocates of universalism realize that this pure form of

16. The protocol and implementing court order from the Maxwell Communications Corporation bankruptcy are reprinted in JACOB S. ZIEGEL, *CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW* 636 (1994).

17. See, e.g., 11 U.S.C. § 304(c)(4) (1994) (authorizing the turnover of U.S. assets to foreign bankruptcy proceedings "consistent with . . . distribution of proceeds of such estate substantially in accordance with the order prescribed by [the United States Bankruptcy Code]").

18. Westbrook seems to agree that this is the appropriate comparison. See Westbrook, *supra* note 5, at 2307-08 ("I will therefore compare theoretical, future universalism as I have described it above with Professor LoPucki's theoretical, 'conventionalized' territorialism as presented in his widely read article in the Cornell Law Review. I will then compare modified universalism with the current system of territorialism.").

universalism is so contrary to prevailing notions of sovereignty as to be unthinkable in current world circumstances.¹⁹ No country will permit foreign courts to make and directly enforce orders within its borders. In the most common use of the term “universalism,” the user contemplates that local courts in each affected country will be obligated by local law or international convention to enforce orders of the home country court. As I have put it elsewhere, “one court plays the tune, and everyone else dances.”²⁰ Thus, universalism is not a single-court system, but merely a dominant-court system.

The term “modified universalism” refers to yet a looser form of control. Under modified universalism, the local courts each have some degree of freedom to decide whether compliance with requests emanating from the home country is appropriate.²¹ The legal standard might be that compliance will not alter the entitlements of the parties or that it will not offend the public policy of the complying country. Modified universalism under the first of these two possible standards — the strain adopted by the United States in Bankruptcy Code section 304 — is virtually indistinguishable from territoriality. That is, all distributions from local assets are made in accord with the law of the place where the asset is located at the time of bankruptcy. That distribution can be made by a foreign court, but only with the express acquiescence of the local court in the particular case.

A. Westbrook's Proposals

Professor Westbrook advocates universalism in a shot-gun fashion. That is, he advocates a wide variety of universalist systems, whose adoptions are incompatible with one another. They include a single international bankruptcy law administered by a new system of international commercial courts,²² a single international bankruptcy law enforced by national courts,²³ national bankruptcy laws enforced by international courts,²⁴ and national laws enforced by national

19. See, e.g., Jay Lawrence Westbrook, *Universal Priorities*, 33 TEX. INT'L L.J. 27, 28 n.4 (“There is also the notion of ‘unity,’ which means that one court administers all assets, but that notion is so far from contemporary reality that it is not really part of the working hypothesis of present scholars.”).

20. LoPucki, *supra* note 2, at 699.

21. Those requests might be from the court or from a representative of the estate.

22. See Westbrook, *supra* note 5, at 2309 (referring to “a world with a universalist convention establishing one bankruptcy law and one court system to administer it”); *id.* at 2293 (“[A] single court system, applying a single set of choice-of-law rules with some hope of consistency, would produce a far higher level of predictability in commercial transactions than we now have.”); *id.* at 2294 n.87 (referring to “international courts devoted to bankruptcies”).

23. See *id.* at 2317 (advocating for “Single Law, National Courts”).

24. See *id.* at 2315 (advocating for “Single Court, National Laws”).

courts.²⁵ He advocates pure universalism,²⁶ traditional universalism²⁷ and modified universalism.²⁸ He advocates an international convention to implement universalism, but does not make it a prerequisite to an attempt to implement any particular type of universalism.²⁹ He suggests that each of these reforms might be made applicable to only “large” multinational companies, without offering a definition of large.³⁰ In an earlier article, he suggested that a “special,” non-universalist rule would apply to the claims of “unsophisticated creditors,” but has not said what that rule would be.³¹

His proposals that require the world to agree on a single law would necessitate revision of not only the bankruptcy laws of all nations, but also the laws governing creditor priority, setoff, and security interests. In addition, each country would have to revise its laws governing debt collection in the absence of bankruptcy to make them compatible with the new bankruptcy law. In the absence of a world government, once such a universal bankruptcy law was adopted, it would be difficult to change. Given the low level of experience that the world has with alternative bankruptcy regimes, such a terminal project seems premature. But if such a law were adopted, it would create the conditions necessary for universalism to work.

Westbrook does not explain how the new network of international bankruptcy courts he proposes would differ from the national courts they would replace, or what advantage they would offer over the current system of national courts. Accordingly, I do not attempt to address that aspect of his proposals.

The fault with Westbrook’s proposal to implement modified universalism without an international convention — discussed in the introduction — is already evident in the operation of the system today. The acts of individual judges in surrendering assets to other courts that

25. *See id.* at 2292 (advocating “a uniform set of choice-of-law rules and choice-of-forum rules” as an alternative to “a single international bankruptcy law and a single international bankruptcy court system”).

26. *See id.* at 2293-94 (referring to his “single court system”).

27. *See supra* note 22 and accompanying text.

28. *See Westbrook, supra* note 5, at 2300 (“Modified universalism is the approach that I have suggested as an interim or transitional solution.”).

29. *See id.* at 2283 (describing the goal of his essay as “elaborating the best global bankruptcy system that might be created by a multinational convention on this subject”).

30. *See id.* at 2298-99 (“Limited application of a universalist regime only to large multinationals would permit local policies to be applied to local enterprises.”).

31. *See Donald T. Trautman, Jay Lawrence Westbrook & Emmanuel Gaillard, Four Models for International Bankruptcy*, 41 AM. BANKR. L.J. 573, 624 (1991) (“If cases should arise where the reasonable expectations of unsophisticated creditors (in the United States, ‘the little old lady in tennis shoes’) might suffer unfairly, there is no reason a special rule cannot be applied in such cases.”).

will distribute them differently frustrate entitlements in, and reduce the predictability of, a system that remains principally territorial.

Professor Westbrook responds that no one is “cheated” by such surrenders of assets because they are merely a “transnational solution to a transnational bankruptcy.”³² I take him to mean that he believes creditors of a multinational company should anticipate a universalist distribution of assets and so should not complain when they get one. But the surrenders of assets necessary to achieve such a “transnational solution” are prohibited by reasonably clear language in the United States Bankruptcy Code³³ and the world community consistently has refused to provide for them by convention.³⁴ They seldom occur. As a result, there is no reason for creditors to anticipate them. To put it concretely, the workers in a Chrysler plant in Detroit do not expect to have to claim their wages and benefits in a German bankruptcy court and they do not expect the German law of creditor priorities to determine whether they will be paid. Yet that is precisely what would happen if Daimler Chrysler filed bankruptcy in Germany and a universalist United States Bankruptcy judge decided to surrender the assets of Chrysler to the German court.

The remainder of this Part addresses the proposals by Westbrook, Guzman, and others for the system generally understood to be “universalist” — one in which the national court of the multinational’s home country implements the national bankruptcy law of that country. My assertion that universalists are unable to specify a workable definition of “home country” includes the assertion that they cannot do so by convention. That is not merely because they cannot agree on an answer, but rather, because no answer could render universalism workable.

B. *The Questions Universalists Cannot Answer*

Nearly all of the putative advantages of universalism depend on the assumption that each multinational company has a single home country that will not change over time. The arguments for universalism fail because no universalist scholar has yet proposed a workable

32. See Westbrook, *supra* note 5, at 2322. The passage reads: “Indeed, Professor LoPucki’s notion that local creditors are somehow cheated of vested rights by a transnational solution to a transnational bankruptcy lies at the heart of our disagreement.” *Id.*

33. Section 304(c) of the U.S. bankruptcy code provides that “in determining whether to order turnover of property of the estate, or the proceeds of such property, to [a] foreign representative” the action taken shall be “consistent with . . . distribution of proceeds of such estate substantially in accordance with the order prescribed by [the U.S. bankruptcy code].” 11 U.S.C. § 304(b)(2) and (c)(4).

34. See, e.g., Guzman, *supra* note 4, at 2184 (“Despite the near-unanimous support of the academic community, policymakers have chosen not to adopt universalism.”).

test or method for identifying that country. Without such a method, universalism cannot be implemented.

Universalism cannot operate without the ability to identify a home country for each multinational company for three reasons. First, the home country's law will determine the priorities of creditors in the debtor's estate. Contrary to the arguments presented by Professors Guzman and Rasmussen,³⁵ large differences exist among the bankruptcy laws of different countries.³⁶ Several examples illustrate these differences: (1) The laws of some countries treat a creditor with a right of set off as secured; the laws of others treat them as unsecured.³⁷ (2) In some countries tort creditors share pro rata with commercial creditors;³⁸ in other countries, tort creditors are subordinated to commercial creditors;³⁹ and in yet others, tort creditors who have not yet reduced their claims to judgments before bankruptcy do not share at all.⁴⁰ (3) In some countries employees are willing to extend substantial credit to their employers, because they know they will have first priority — ahead of even secured creditors — in the factories in which they work;⁴¹ in other countries such extensions would be foolish because employees' priorities are limited sharply or even nonexistent.⁴² These differences in legal doctrine occur against even sharper differences in system operation. In some countries, bribery is common. In others — particularly small nations — the local courts might be under the corrupt influence of a multinational company based there. Some countries do not yet have an operating bankruptcy system. If the identity of the home country is arguable or manipulable at the time of bankruptcy, debtors or their creditors could change both substantive rights and likely outcomes, simply by their choices of venue.

35. See, e.g., Guzman, *supra* note 4, at 2195 (arguing that the differences among bankruptcy regimes' treatment of trade creditors are minor); Robert K. Rasmussen, *Resolving Transnational Insolvencies Through Private Ordering*, 98 MICH. L. REV. 2252, 2273 (2000) (referring to the differences in treatment of tort creditors by different countries as "marginal").

36. See LoPucki, *supra* note 2, at 709-11.

37. See, e.g., PHILIP R. WOOD, *MAPS OF WORLD FINANCIAL LAW* 38-43 (3d ed. 1997) (describing the wide variety of "netting" laws in the countries of the world).

38. This is true, for example, in the United States. See 11 U.S.C. §§ 502(b) and 726(a) (1994) (allowing claims and awarding priority without regard to whether the debt is owing for a tort claim).

39. See, e.g., INTERNATIONAL STATEMENT OF MEXICAN BANKRUPTCY LAW 49 (Preliminary Draft No. 3, Aug. 21, 1997).

40. See sources cited in LoPucki, *supra* note 2, at 709 n.62.

41. See LoPucki, *supra* note 2, at 710-11.

42. Under U.S. law the employees' priority would be limited to wages earned within the ninety days prior to bankruptcy. See 11 U.S.C. § 507(a)(3) (1994). By agreeing to defer payment without a bankruptcy filing, the employees would be waiving their priority.

Second, under universalism, the validity of transfers the debtor made in the period before bankruptcy would be tested by the laws of the home country.⁴³ Most national bankruptcy systems have laws providing for the avoidance of various kinds of transfers made by the debtor in the period before bankruptcy.⁴⁴ The transfers typically made avoidable include those that had the effect of preferring one creditor over another, those made to insiders, and those that had the effect of reducing an already insolvent estate. But here too, the laws of the various countries differ widely.⁴⁵ Without a clear identification of the debtor's home country in advance, prefiling transfers would be avoidable or not, depending on the choice of venue.

Third, under universalism, the courts of debtors' "home countries" will adjudicate the claims of creditors from all over the world. While the home country might, under its own conflicts rules, choose to apply the substantive law of the place where the claim accrued, that is a matter that necessarily would be left to the home country.⁴⁶ The home countries presumably would apply their own procedures to the adjudication of the claims — and with them their own notions of due process of law. Thus, the filing of a bankruptcy in some distant part of a universalist world could deprive an injured person of his or her right to a trial by jury, to pretrial discovery, or to the effective assistance of counsel — even though the tort was perpetrated by the debtor in the United States and the injury occurred in the United States. The difference these changes in "procedure" would make were starkly illustrated in two recent mass tort cases. What was thought to be \$3 billion in claims against Union Carbide for the deaths of 4,000 people in Bhopal, India was settled for \$470 million when it became apparent the cases would be tried in India rather than in the United States.⁴⁷ The recent settlement of breast implant claims in the Dow Corning

43. See Jay Lawrence Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT'L L. 499, 500 (1991) ("[A]n avoiding court in a jurisdiction embracing Modified Universalism should generally apply home-country law."). Westbrook states: "As a general rule, the avoiding court should apply the home-country avoiding law if it will turn over the proceeds to the home country court for distribution." *Id.* Under universalism, only the second kind of distribution could occur.

44. See *id.* at 504 ("Most countries seem to have rules that permit the avoidance of transactions that take place after the inception of a debtor's financial crisis.").

45. See *id.* at 504-07 (describing the variety of avoidance powers under the laws of various countries); see also *In re Maxwell Communication Corp.*, 93 F.3d 1036 (2d Cir. 1996) (involving prefiling transfers that were valid under the laws of England but not under the laws of the United States).

46. This follows from the fact that, in a universalist system, the home country has jurisdiction over all of the debtor's assets. Alternatively, universalists could add a complete set of conflicts rules to the agenda for an international bankruptcy convention.

47. See, e.g., Richard L. Abel, *A Critique of Torts*, 37 UCLA L. REV. 785, 809 n.81 (1990) ("Union Carbide ultimately settled all claims by paying \$470 million to the Indian government.").

bankruptcy expressly gave foreign women lower payments than U.S. women for the same injuries, on the theory that those injuries were worth less under foreign procedures.⁴⁸ If the identity of the home country were unclear as bankruptcy approached, so would be the values of these claims.

1. Which Country is the "Home Country"?

Despite the importance of the identity of the home country for any particular debtor, universalists have been unable to specify meaningful criteria for its identification. Each of four different bases is plausible. First, most courts and commentators seem to regard the country of incorporation as having the strongest claim to home country status.⁴⁹ For example, more than half of all large public companies filing for bankruptcy within the United States today file in Delaware rather than in states where their headquarters, assets, and operations are located.⁵⁰ They file there on the basis that Delaware is their jurisdiction of incorporation.⁵¹ Second, companies often are identified with a particular country, because the companies are headquartered in that country.⁵² Third, if substantially all of the employees, operations, and customers of a large company were in a single country, it is difficult to imagine that country would not be considered the "home country," even if the company's tiny headquarters and place of incorporation were elsewhere.⁵³ Fourth, the assets of a company can be almost en-

48. See LoPucki, *supra* note 2, at 747 n.243 (discussing the plan offering foreign women 35-60% of the amounts offered American women for the same injuries).

49. See, e.g., *Felixstowe Dock and Ry. Co. v. United States Lines, Inc.*, 2 All E.R. 77, 93 (Q.B. 1988) (noting that "the English practice is to regard the courts of the country of incorporation as the principal forum for controlling the winding up of a company"); IAN F. FLETCHER, *THE LAW OF INSOLVENCY* 760-61 (2d ed. 1996); Liza Perkins, *A Defense of Pure Universalism in Cross-Border Corporate Insolvencies*, 32 N.Y. J. INT'L L. & POLITICS 787 (2000) (advocating that a company's place of incorporation determines its home country under universalism and criticizing the "principal place of business" or "center or gravity test" as vulnerable to strategic manipulation).

50. See Theodore Eisenberg & Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 985-86 (1999).

51. See *id.* at 985 n.52 (noting that 89% of the large, public companies that filed for bankruptcy reorganization in the United States from 1980 to 1997 were incorporated in Delaware).

52. See, e.g., Westbrook, *supra* note 14, at 2534 (referring to *Maxwell* as having "its true 'seat' in London, where it was administered and nearly all of its financial affairs . . . were managed" even though "its principal assets [were] in the United States in the form of various large operating companies").

53. TV Filme presents a recent example. That company's business is to provide cable television in Brazil. The headquarters of the company and all of the operations are in Brazil, but the company raised substantial investments through its holding company parent, which is incorporated in Delaware and registered with the U.S. Securities Exchange Commission. On this basis, TV Filme filed for reorganization in Delaware. See *TV Filme, Inc. Reports*

tirely separate from its operations, as might occur when a company rents the factories where its employees work, but has substantial land holdings in another country.

Universalists attempt to dismiss this issue with the assertion that the identity of the home country will be obvious in most cases.⁵⁴ But that rationale contradicts their basic premise of increasing globalization. No one can deny the existence of a substantial number of multinational companies whose home countries are either not obvious or in flux. That number will grow naturally with the increasing globalization of business. In a prematurely universalist system, that growth might turn malignant, as financially ailing companies jockey to give themselves bankruptcy options.

Perhaps responding to the rampant forum shopping within the United States based on place of incorporation, Guzman and Westbrook both reject place of incorporation as the standard for home country.⁵⁵ Declining to choose from my list of concrete options, both state a preference for “principal place of business” as the test.⁵⁶ Westbrook defends that choice on the ground that it is a commonplace standard in American law.⁵⁷ But he ignores two key facts about his choice. First, the American courts have been forced to give specific meaning to the phrase “principal place of business” and have interpreted it to mean essentially the same thing as “headquarters” — one of the concrete choices he rejected.⁵⁸ Second, the “principal place of

Filing Plan of Reorganization, PR NEWSWIRE, Jan. 26, 2000, at Financial News Section (noting that the firm’s headquarters and operations are in Brazil but that its place of incorporation and the bankruptcy case are in the United States.). I doubt many universalists would assert that the United States is TV Filme’s “home country.”

The location of the bulk of a company’s assets and operations sometimes has been considered the most appropriate basis for determining its home country for bankruptcy purposes. For example, the universalist bankruptcy treaty negotiated (but never implemented) between the United States and Canada in 1979 used an asset-based test to determine the country that would have jurisdiction. See LoPucki, *supra* note 2, at 716 n.108.

54. See, e.g., Guzman, *supra* note 4, at 2207 (“[T]here is widespread agreement among those interested in transnational insolvency that, in the vast majority of cases, the home country will be easy to identify — making this issue a minor question.”); Ulrik Rammeskov Bang-Pedersen, *Asset Distribution in Transnational Insolvencies: Combining Predictability and Protection of Local Interests*, 73 AM. BANKR. L.J. 385, 418 (1999) (“[I]n most cases determination of the home country will be obvious regardless of which standard is used. . .”).

55. See Guzman, *supra* note 4, at 2207 (“[I]f it is too easy for the debtor to select the main jurisdiction, it could choose in such a way as to disadvantage strongly nonadjusting creditors that are likely to interact with the firm For this reason, a test based on the place of incorporation would be inappropriate.”); Westbrook, *supra* note 5, at 2316 (“I agree that the law of the place of incorporation is unsatisfactory because of the risk of sham incorporation — a company organized under a flag of convenience unrelated to the location of its business, management, and assets.”).

56. See Guzman, *supra* note 4, at 2206-07; Westbrook, *supra* note 5, at 2316.

57. See Westbrook, *supra* note 5, at 2316.

business” standard was the basis for rampant forum shopping in U.S. bankruptcies in the 1980s.⁵⁹

Westbrook also suggests the possibility of a “multidimensional test” based on some combination of factors. He gives the example of a presumption based on place of incorporation “rebuttable only by a clear showing that the center [of the debtor’s main interests] was elsewhere.”⁶⁰ This is the test employed in a model international insolvency law that Westbrook was instrumental in negotiating. Westbrook himself has acknowledged in the past that this test will generate uncertainty:

In those cases where the test does present difficulty, there may well be a “race of creditors” to have a proceeding opened in a favorable forum. Not too much has been lost, because *creditors have had in any event to assume that more than one possible forum exists*. At least the possible fora have been limited to those which can fairly assert jurisdiction on the basis that they are the center of the firm’s main interests; that is to say, the test still imposes some limitation on the possible fora⁶¹

In other words, Westbrook admits that a multidimensional test will not identify a single home country for each debtor.

Westbrook’s willingness to accept a home country standard that merely will narrow the home country of a debtor to one of a few seems grounded in his acceptance of a false analogy between domestic and international bankruptcy.⁶² Westbrook argues that, because use of such a standard domestically has not led to disaster, use internationally will not either.⁶³

The analogy, however, does not hold. Large case bankruptcy is a substantial industry. Courts compete for cases within the United States and internationally.⁶⁴ The effect of having a vague standard for venue nationally has been to give several courts plausible claims to particular cases and there is every reason to believe it would do the

58. See generally Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11 (describing the construction placed on “principal place of business” in American law and the resulting bankruptcy forum shopping).

59. See *id.* at 18 (finding that nine of forty-three \$100 million companies reorganizing at their “principal place of business” (21%) had “virtually no property or operations other than [their] headquarters in the district”).

60. Westbrook, *supra* note 5, at 2317. Professor Bang-Pedersen seems to favor that test as well. See Bang-Pedersen, *supra* note 54, at 419.

61. Trautman et al., *supra* note 31, at 582 (emphasis added). It is unclear what, if anything, is governed by the home country text in the model law.

62. See Westbrook, *supra* note 5, at 2309 (“To argue for territoriality as the goal of an international system is much the same as arguing for state-by-state bankruptcy within the United States.”).

63. See *id.* at 2316.

64. See, e.g., LoPucki, *supra* note 2, at 721.

same internationally. There the analogy ends. Domestically, a national government and an appellate court system exist to moderate forum shopping and its effects.⁶⁵ The international realm lacks comparable institutions. Internationally, the only limit on outrageous claims of jurisdiction would be diplomatic protests or wasteful, messy refusals of cooperation by the courts of other nations. More importantly, rampant domestic forum shopping is not a serious problem, because the bankruptcy law of the United States is a national law that establishes a national system of priorities.⁶⁶ Approximately the same rules of distribution are applicable regardless of the forum.⁶⁷ For Westbrook's analogy between national and international bankruptcy to be sound, a universalist convention equivalent to the U.S. bankruptcy code and the uniform laws that govern security interests, fraudulent transfers, and other subjects within the United States would have to be adopted. In its absence, international forum shopping would effect huge transfers of wealth among the parties to cases.

2. *Is the "Home Country" That of the Entity or the Group?*

Multinational companies are almost invariably corporate groups. Some corporate groups operate a single, indivisible business, such as an airline. Individual corporations within the group may perform specific functions, such as holding title to aircraft, conducting operations, or obtaining financing, but none may have a business that could operate apart from the other corporations in the group. Such a group is referred to as having an "integrated" business.⁶⁸ At the opposite extreme, a conglomerate, particularly one that frequently buys and sells businesses, carefully may avoid any interdependence among the businesses it owns, so that the group could sell any of them without affecting the others. Each such business might be owned by a "stand-alone" subsidiary. Most corporate groups probably are somewhere between these extremes. They operate businesses that are integrated, to some degree, but that they can, with varying degrees of effort and expense, separate.

Regardless of how one defines "home country," the home country of a corporate group often will be different from the home countries of corporations within the group. For example, assume that Parent Corporation is a holding company whose only significant assets are its

65. *See, e.g.*, 28 U.S.C. § 1412 (1994) (authorizing the district courts to transfer bankruptcy cases "in the interests of justice or for the convenience of the parties").

66. *See, e.g.*, 11 U.S.C. §§ 506, 726 and 1129(a)(9) (1994).

67. States can grant lien priorities to their local creditors, but only if they meet federal standards. *See* 11 U.S.C. §§ 544(a)-553 (1994).

68. *See* LoPucki, *supra* note 2, at 719-20 (discussing the integration test as it is applied to multinational companies by some bankruptcy courts).

stock holdings in its three subsidiaries. Parent Corporation is incorporated in country P where it maintains its “world headquarters.” Each of the three subsidiaries has its place of incorporation, headquarters, and operations in each of three countries other than P. P probably would be considered the home country of the group, but P could not be considered the home country of any subsidiary.

In which “home country” would the bankruptcy of one or more members of this corporate group take place? That is, would all file in the home country of the group? Would each entity file in its own home country? Or might the home country determination depend on which corporations were in financial difficulty, which ones filed, or the degree of integration among them?

No answer to these questions describes a system that could capture the supposed benefits of universalism. A rule that put the bankruptcy of each entity in the home country of the entity would split the bankruptcy of the group among up to four countries. If the group operated an integrated business, that would, by the universalists’ reasoning, prevent the reorganization of the business or the liquidation of its assets for their best price.⁶⁹

A rule that put the bankruptcy of the entire group in the home country of the group would lead to anomalous results and the resulting system would be manipulated easily. The anomalous results would occur when only a single, entirely foreign subsidiary was in financial difficulty. Even if that entity did business only in country A and had no ties to country P other than ownership by a holding company located in P, its bankruptcy would take place in P, the home country of the debtor’s group. To illustrate, if the stock of the corporation that owned Rockefeller Center in New York had been owned by a Japanese company, the bankruptcy of Rockefeller Center would have been in Japan, even if the Japanese parent had not been in financial difficulty.

The manipulation would occur when P either spun off its ailing subsidiary — to permit it to file in its own home country — or itself was acquired by another company — to permit any member of the resulting group to file in the acquirer’s home country. Recall that each of these changes would change the law governing the subsidiary’s bankruptcy, including the priorities of creditors.⁷⁰

The spin off or acquisition that triggered a change in applicable law in these scenarios would not have to be of any economic significance. Under the home-country-of-the-group rule, any American company could give the Cayman Islands jurisdiction over its bank-

69. See, e.g., Westbrook, *supra* note 5, at 2293 (“A single court would improve dramatically the possibility of reorganization.”).

70. See *supra* text accompanying notes 36-42.

ruptcy simply by incorporating a holding company there and exchanging the company's shares for those of the holding company. That is precisely what Fruit of the Loom — a billion dollar company — did in preparation for its recent bankruptcy filing.⁷¹ Fortunately, in the current territorial system, that did not give rise to a claim that the United States should surrender the company's U.S. assets to the Cayman Islands court. But, under universalism, it would have.

A rule that chose between the home country of the entity and the home country of the group, depending on the circumstances, would be highly unpredictable.⁷² All three factors that might determine the proper forum and applicable law — the extent of integration, the extent of the financial distress, and which entities filed — would be both unpredictable and manipulable. Much of the integration within any corporate group is unintentional. That is, even though prudent business practices or loan agreements require that a debtor respect the separation among entities, that debtor fails to do so. As a result, integration is often a matter of degree. The question may not be whether particular entities could survive on their own, but rather, how much value would be lost if they had to do so. Those in control of a corporate group can integrate it by having entities in the group guarantee the obligations of other entities, or by sharing assets such as trademarks, computer systems, or workforce. They could disintegrate it by reversing these transactions.

A rule based on the extent of the financial distress within the corporate group or on which members of the group filed bankruptcy would be equally unworkable. Within a few days of the time a bankruptcy case is filed in a jurisdiction, it becomes impractical to transfer the case to another jurisdiction. The case grows roots in the first selected jurisdiction as the parties retain counsel or organize committees in the jurisdiction. The judge devotes considerable time to familiarizing him- or herself with the case and makes critical — though sometimes tentative — rulings. One of those decisions may be the approval of new financing that must be disbursed on an emergency basis. Even

71. See Fruit of the Loom, Inc., Form 10-K, at 10 (Fiscal year ending Jan. 2, 1999) ("On March 4, 1999, the Company effected a corporate reorganization pursuant to which Fruit of the Loom, Ltd., . . . a Cayman Islands company and formerly a subsidiary of the Company, became the parent holding company of the Company."). Fruit of the Loom's parent company did file in the Cayman Islands, just months after it gained that status. See Chris Mallon, *Chapter 11 Meets Liquidation in the Middle of the Atlantic*, GLOBAL TURNAROUND, Feb. 2000, at 4.

72. Bang-Pedersen proposes such a solution. See Bang-Pedersen, *supra* note 54, at 419-20. That is, he would make the home country of each entity determinative of the proper place to file, but make an exception where substantive consolidation was justified by the applicable law and lower the conditions for substantive consolidation in unspecified ways. His proposal is incomplete because he does not specify the conditions for substantive consolidation and hence does not reach the issues of their unpredictability and manipulation. Nor does he address the problem of what country's law would determine the issue of substantive consolidation. See *infra* text accompanying notes 74 and 75.

within the United States, courts have found it entirely impractical to uproot a case and transfer it to another jurisdiction.⁷³ An international move would be immensely more disruptive, even if there were some way to cause it to occur.

In the early days of many bankruptcy cases, no one but the debtor's managers know how far financial distress extends within the group — and, in some cases, not even they know. Hence, any rule based on the extent of that distress would be vulnerable to mistake, errors in judgment, or outright manipulation. Once a portion of the group were lodged in the forum chosen by the debtor, the system would have no option but to permit the remainder of the group to file there as well — even if a different country were actually the “home” of the entire distressed portion of the group.

Bankruptcy filings that extend to only part of the group are the norm, not the exception. On average, only about a third of the entities of a corporate group join in its filing.⁷⁴ It is not at all unusual for some members of the group to initiate the case and for additional members to join them later. A rule that looked to the “center of interests” of the filing members of the group would, thus, be easily manipulable. A group could choose its venue by the order in which its members filed.

The issue of corporate groups is further complicated by the fact that courts sometimes disregard corporate entities or consolidate them. Thus, even if a universalist scheme deemed each entity to be located in that entity's home country, the issue of whether a particular corporation would be treated as an entity for this purpose would remain. To illustrate, assume that the world has adopted a universalist system in which each entity is to file bankruptcy in its own home country. Parent Corporation is a Canadian corporation that owns Subsidiary Corporation, a Mexican corporation. Each has filed bankruptcy in its respective country. Creditors wish to assert that the two corporations should be consolidated into one on the ground that assets have been shuffled between the two and their separate existence is a sham. Which country's law should govern the issue and in which country's courts should the matter be litigated? In a universalist system, the inquiry may be circular: which country's law governs depends upon the

73. See GORDON BERMANT ET AL., CHAPTER 11 VENUE CHOICE BY LARGE PUBLIC COMPANIES 7 (1997) (noting that “the longer the original district retains [a] case, the more rational it becomes to retain it”); Eisenberg & LoPucki, *supra* note 50, at 999-1001 (explaining and documenting the inadequacy of transfer as a venue correction mechanism); LoPucki & Whitford, *supra* note 58, at 24 (relaying that “the likelihood of a change of venue in the . . . cases we studied was small”).

74. Examination of data from the bankruptcy cases filed in the United States from 1980 to 1998 by 219 public companies each having more than \$200 million in assets reveals that 1,868 (32%) of the 5,900 members of the groups joined in the cases. See Lynn M. LoPucki, Bankruptcy Research Database (database on file with the author).

home country of the existing entity or entities, but what entity or entities exist may depend on which country's law governs.

Neither Westbrook nor Guzman even attempts to say how a universalist system should fix the location of a multinational company that is a corporate group. Westbrook claims that the problem is "far broader than bankruptcy"⁷⁵ and that "[t]here can be little doubt that the problem of the legal responsibility of corporate groups will be addressed as the world continues to globalize," and then argues that territoriality has no better solution.⁷⁶

In fact, the territorial solution to the problem of corporate groups is remarkably elegant. It does not rest, as Westbrook claims,⁷⁷ on an assumption that all assets within a country are owned by the same corporation. Rather, it assumes only that each asset is located in some particular country. The solution is that the law of that country governs whether the asset is available to satisfy any particular debt, regardless of the corporate structure and regardless of whether the applicable body of law is denominated veil piercing, consolidation, agency, sham, or voodoo. The application of that law will be by the local court, and it will have no extraterritorial effect.

For example, assume that, in a territorial system, Parent Corporation, which has assets in Canada and Mexico, owns Subsidiary Corporation, which also has assets in both. The Canadian court will determine how many Canadian estates will exist and the Mexican court will determine how many Mexican estates will exist. Whether their determinations are consistent on the issue of whether there is one corporation or two does not matter: each court's determination will apply only to the assets located in the country.

Both Westbrook and Guzman attempt to undermine the foundations of territoriality by asserting that the locations of assets are problematic. That is certainly not true of tangible assets, such as factories, equipment, and inventory. Westbrook focuses instead on intangible assets, using the example of a bank account. But even though intangible assets have no physical location in fact, they do, in most cases, have well-established locations under international law. Westbrook's example will illustrate:

75. Westbrook, *supra* note 5, at 2311.

76. *Id.* at 2314. Bang-Pedersen makes the same error. See Bang-Pedersen, *supra* note 54, at 420 n.136 ("This tricky choice of law question will not be analyzed further here, but it should be noted that territorialism would have to struggle with consolidation choice of law problems as well, unless it is assumed that substantive consolidation never takes place in a territorial system.").

77. See Westbrook, *supra* note 5, at 2312 ("[Professor LoPucki] assumes a model in which corporate groups are neatly arranged in national slots. Each country where the group operates has its own local corporation and all of the assets and liabilities relating to that country are concentrated in that local corporation."). Westbrook provides no cite in support of this imputation of claims and I do not recognize them.

Suppose a bank account in the New York branch of a London bank held in the name of a Mexican corporation. The traditional, fictional choice-of-law rule would choose New York law as governing, but there is a substantial argument that the worldwide bank has the ultimate obligation to pay. Thus the New York and English courts would have quite plausible claims to jurisdiction over the account on those grounds, while the Mexican bankruptcy court would be following another established doctrine by asserting jurisdiction over the account by virtue of a worldwide in rem jurisdiction over all of its debtor's property. As to power, both New York and London would have contempt power over the bank, while Mexico could order the debtor's officers to comply under pain of contempt. Which court can "claim" the bank account under a territorial system? All three can do so. The bank and the debtor may well be subject to conflicting orders.⁷⁸

Westbrook is correct in his conclusion that all three countries may lay claim to the account. But the claims of Mexico and England are not territorial; they are *extraterritorial*. That is, they are claims to property located outside the claiming country.⁷⁹ Under international law, the bank account in Professor Westbrook's example is located in New York, because it is in the New York branch of the English bank — even if the branch is not separately incorporated.⁸⁰ In a territorial system the account would be in the New York estate of the Mexican corporation. This result follows not from "de facto power" over the bank account as Westbrook asserts,⁸¹ but from international understandings regarding the locations of intangible assets worked out over centuries.

3. *What Will Prevent Debtors from Changing Their Home Countries Opportunistically After Credit Has Been Extended?*

Given the huge differences in the bankruptcy laws of the countries of the world, the incentives to forum shop in a universalist system would be tremendous. The debtor's managers might want a forum that would leave them in control of the company during reorganiza-

78. *Id.* at 2313-14.

79. Charles D. Booth, *Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts*, 66 AM. BANKR. L.J. 135, 138 (1992) (describing universalism and then observing that "[t]he contrasting territoriality approach presumes that a bankruptcy adjudication is limited to the *res* or property within the jurisdiction and does not have extraterritorial effect.").

80. See generally Joseph H. Sommer, *Where Is a Bank Account?*, 57 MD. L. REV. 1 (1998) (explaining the location of bank accounts). Application of the principle is illustrated in *In re Maxwell Communication Corp.*, 93 F.3d 1036, 1040-41 (2d Cir. 1996). In that international insolvency case, the court had no difficulty in determining the location of any of the bank accounts involved.

81. See Westbrook, *supra* note 5, at 2308 (asserting wrongly that "'Cooperative territorialism' as proposed by Professor LoPucki in his *Cornell* article is a system in which each country exercises jurisdiction over the assets within its de facto power, without regard to legal concepts of jurisdiction").

tion rather than appoint a trustee. They might want one that would allow them to cram down a plan of reorganization over the objections of their creditors, or one that would attempt to override regulatory laws of some of the countries in which the debtor does business. Particular groups of creditors will each want a forum in which the group's claims will have priority. Because any increase in the priority of one group of creditors necessarily is accompanied by a corresponding decrease in the priority of another group, creditor groups will tend to favor different fora.

These differing interests will give rise to conflicting strategies in the period prior to bankruptcy. A debtor may seek to improve its claims to an advantageous venue by manipulating the factors relevant to the venue's test of "home country." Large, public companies frequently change their jurisdictions of incorporation, headquarters, and even operations. For example, Fruit of the Loom is a billion-dollar bankrupt that recently has been engaged in changing all three.⁸² In a universalist system, companies would have greater incentives to do these things, and so would tend to do them more often. If the home country of the *entity* were decisive, debtors could expand their choice of fora by dissolving or merging subsidiaries; if the home country of the *group* were decisive they could acquire or be acquired. If the degree of integration mattered, they could change it. Ultimately, they could place the bankruptcy in any of the countries in which they had significant contacts.

In a universalist system, creditors might use their leverage over their debtors to influence the debtors' choice of venue. Contractual leverage may not, however, be very effective, because the debtor approaching bankruptcy is no longer financially responsible. "Bankrupt debtors," the adage goes, "may breach their contracts with impunity." Creditors may try to choose a forum directly by filing an "involuntary" case against the debtor, but, when they do, they may find themselves in a race with others who prefer a different forum.⁸³

82. "Fruit of the Loom is based in Chicago, although most of the manufacturing is done in the West Indies. The business employs 40,000 people worldwide. It was in the process of relocating its head office from Chicago to Kentucky, and most of its manufacturing out of the US [sic], when the business entered Chapter 11 at the very end of last year." Mallon, *supra* note 71, at 4. The company reincorporated in the Cayman Islands just a few months before filing one of its bankruptcy cases there. See sources cited *supra*, note 71.

83. Universalists have not said how the matter should be resolved when the courts of two or more countries claim worldwide jurisdiction over the property of a multinational debtor. If they were to adopt the rule applicable within the United States — the court in which the first filing is made controls venue — parties would race to be the first to file. That has been the effect of the rule within the United States. See, e.g., LoPucki & Whitford, *supra* note 58, at 28 n.60 (describing the race between Baldwin-United and a group of its creditors to control venue by filing first).

Bankruptcy forum shopping is already rampant among large companies within the United States.⁸⁴ This is true even though the gains from it are so subtle that scholars disagree even on what they are.⁸⁵ U.S. bankruptcy law provides for the transfer of cases on grounds of forum non conveniens, but courts do not transfer them.⁸⁶ Instead, bankruptcy judges in New York, and later Delaware, have sought to attract cases for the benefit of their local economies.⁸⁷ The competition among districts for these cases is so intense that even the appellate courts have been unable to stem it.⁸⁸

Under the current, mostly territorial, international regime, the gains from becoming a bankruptcy haven are small. A country can administer only those assets that are within the country or that other countries willingly surrender. Nevertheless, forum shopping is already a significant factor in multinational bankruptcy cases⁸⁹ and some countries — most notably Bermuda and the Cayman Islands — already are developing as international bankruptcy havens.⁹⁰

In a universalist system, the potential gains to host countries from international forum shopping would be many times greater because all nations would be required to send the debtor's assets to a single forum for distribution according to the law of that forum. The benefit to the forum nation will be in the economic activity it brings to that nation. In a large bankruptcy case today, the professional fees alone may exceed \$100 million.⁹¹ Although only a portion of those fees will remain with professionals in the haven, a haven's cash flow from a series of

84. See Eisenberg & LoPucki, *supra* note 50, at 977-79.

85. See, e.g., *id.* at 989-91 (detailing an empirical study finding no significant differences in case processing times between Delaware and all other districts); David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1, 28 (1998) (stating that "Delaware has successfully addressed the single biggest problem with Chapter 11 in recent years — the inordinate time and expense of the reorganization process").

86. See Eisenberg & LoPucki, *supra* note 50, at 999-1001 (finding that courts returned only five percent of voluntary cases to the district of the debtor's headquarters).

87. See *id.* at 983-87 (describing forum shopping to New York and Delaware).

88. See, e.g., *id.* at 986-87 (describing efforts of the Chief Judge of the United States District Court in Delaware to moderate forum shopping to that district).

89. See, e.g., *Why the Big Restructurings Are Going To Delaware*, GLOBAL TURNAROUND, Apr. 2000 at 6 (quoting U.S. bankruptcy lawyer Keith Shapiro saying that "[p]eople are forum shopping . . . The UK [sic] must change its insolvency laws or lose the big cross-border restructurings").

90. See, e.g., Mallon, *supra* note 71, at 4 (noting the recent filing of two billion dollar cases — ICO, a global satellite company headquartered in England and Fruit of the Loom, a U.S. company — in the Cayman Islands).

91. See, e.g., Yawar Hanif, *BCCI Owners, Liquidators Strike Deal*, UNITED PRESS INT'L, May 14, 1996, available in LEXIS, Wire Service Stories; Joe Ortiz, *BCCI Creditors To Get \$2.65 Billion Payment Tuesday*, REUTER EURO. BUS. REP., Dec. 9, 1996, available in LEXIS, Wire Service Stories ("The English liquidators of BCCI, Deloitte & Touche . . . have been paid a massive \$200 million in fees.").

such cases may be substantial. Because no international courts of appeals exist, the only control on this forum shopping would be the refusal of other countries to honor the forum's rulings. Such refusals probably would be rare, because they would leave the particular debtor's affairs in chaos. Knowing that, some debtors will claim home countries boldly.

Creditors may respond to their forum shopping losses by attempting to adjust the terms on which they extend future credit. But their adjustments will be inadequate,⁹² and will not be visited on either the forum shopper or the haven anyway.⁹³ Havens such as the Cayman Islands and Bermuda will be driven by competition to adopt laws that seek to systematically exploit involuntary and insufficiently adjusting creditors, customers, and other stakeholders. How that can occur is addressed in Section III.B.

4. *What Jurisdiction Is Ceded to the Home Country?*

Under universalism, the court of the home country would have jurisdiction over the bankruptcy case. But what would be included in that jurisdiction? Could the court void an otherwise valid collective bargaining agreement? Relieve the debtor of the burdensome effects of environmental laws? Suspend the payment of pensions to retired workers? Risk the pension fund in a reorganization attempt? Delete from a shopping center lease provisions restricting the purposes for which the debtor-lessee can use the premises? Will litigation pending against the debtor at the time of bankruptcy be transferred to the forum country? Each of these issues of bankruptcy jurisdiction has arisen in the United States and has been resolved.⁹⁴ The same questions either have been or will be resolved differently in at least some other countries. If the world adopts a universalist system, whose jurisdictional rules will determine the scope of the home country's powers?

92. See Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1954-58 (1994) (explaining why unsecured creditors under-adjust).

93. Bankruptcy is, for the most part, an end game. Those who control the company at filing and choose the forum will not control the emerging company. Thus, it would be irrational for even adjusting creditors to discriminate against the emerging company on credit terms. In most cases, the creditors will own the emerging company.

Nor would the haven need to fear that strongly or weakly nonadjusting creditors would discriminate against borrowers who choose the haven as their home country. Those creditors cannot know at the time they lend where the debtor's home country will be at the time they try to collect.

94. See, e.g., 11 U.S.C. § 365(a)(3) (1994) (prohibiting changes in certain provisions of shopping center leases); 11 U.S.C. § 1113 (1994) (detailing the requirements for rejection of a collective bargaining agreement); 11 U.S.C. § 1114 (1994) (requiring the continued payment of retiree benefits during chapter 11 reorganization); 28 U.S.C. § 1334 (1994) (giving bankruptcy courts jurisdiction over certain actions and prohibiting them from assuming jurisdiction over others).

I cannot imagine that the United States would allow other nations' bankruptcy systems to override U.S. choices with respect to these kinds of bankruptcy questions. The answers are too integrally a matter of public policy. For example, imagine that, in the exercise of its "bankruptcy jurisdiction" in a universalist system, a Brazilian court authorized a reorganizing Brazilian forest products manufacturer to continue temporarily in its American operations the use of methods that violated U.S. environmental laws. I would expect that, in any universalist bankruptcy convention, the United States and other countries would reserve the right to reject such assertions of jurisdiction. If that is correct, it will mean that reorganizing a multinational company in a purely "universalist" system may still require the ex-post approval of every foreign country involved.⁹⁵ To put it another way, if bankruptcy were to become universalist while the remainder of regulatory law remained territorial, the system would have to grapple with a new, problematic interface between the two. In a territorial system, this problem is much less acute, because the courts that compete for jurisdiction are both domestic courts of the same country.

Subject matter jurisdiction is not the only complex new interface that universalism would create. Economically-minded scholars long have insisted that the entitlements of a creditor should not change when a collection case moves from a state forum into a bankruptcy forum.⁹⁶ One reason is that the change would give legal strategy an even greater role in determining outcomes.⁹⁷

The change in entitlements that would occur on the filing of bankruptcy in a universalist system would far exceed any that now occurs domestically. For example, assume that, in a universalist system, a U.S. bank holds a right of setoff in the funds of the debtor that is the equivalent of a security interest under U.S. law. Also assume that the debtor's home country, Luxembourg, treats the holder of a setoff as an unsecured creditor. If the bank exercises its right of setoff before bankruptcy, U.S. law will govern and the bank will recover in full. But if the debtor files bankruptcy before the setoff, Luxembourg law governs and the bank may recover only a few cents on the dollar. Which

95. For example, in a reorganization case, the forum would first decide what reorganization was preferred and permitted under the law of the forum. Before that reorganization could be implemented, each other country involved would have to pass on whether it would recognize the provisions that would have effects in the country not achievable in a reorganization under local law.

96. See, e.g., Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 822 (1987) ("Whenever we must have a legal rule to distribute losses in bankruptcy, we must also have a legal rule that distributes the same loss outside of bankruptcy. All Jackson and I advocate is that these two rules be the same.").

97. See Lynn M. LoPucki, *Should the Secured Credit Carve Out Apply Only in Bankruptcy? A Systems/Strategic Analysis*, 82 CORNELL L. REV. 1483, 1498-509 (1997) (discussing strategies by which parties could defeat a rule that applied only in bankruptcy).

of these will occur probably will depend on whether the debtor discloses its intention to the bank before it files. That, in turn, may depend on the relationship between the debtor and the bank. Similar games could be played with the differences between jurisdictions in their treatment of security interests, wage claims, or tort claims.⁹⁸

III. IN DEFENSE OF TERRITORIALITY

Professors Guzman and Rasmussen both assume that three kinds of creditors represent all who exist.⁹⁹ In their terminology, “strongly nonadjusting creditors” are those who are unwilling or unable to adjust their terms of credit to take account of the risk of nonpayment. Guzman assumes there are few strongly nonadjusting creditors and that nearly all of them are tort creditors.¹⁰⁰ “Weakly nonadjusting creditors” extend credit on the same terms to all borrowers in a category, without regard to differences in the likelihood that the various borrowers in the category will repay. “Fully adjusting creditors” calculate a set of terms specific to the particular borrower.¹⁰¹ The adjustments made by the latter two groups are perfect, in the sense that creditors in both groups always get precisely the return they anticipated.¹⁰²

Using these assumptions, Guzman proceeds to demonstrate that the distortion in lending terms under universalism is less than is the distortion in lending terms under territoriality, and that the adjusting creditors’ costs of acquiring the information they need to fix lending terms are lower under universalism than under territoriality. Lastly, Guzman asserts that territoriality is vulnerable to forum shopping through the international movement of assets. I address each of these critiques of territoriality separately.

A. *Distortion in Lending Terms from Incomplete Adjustment*

The low levels of distortion costs in Guzman’s model of universalism are the product of two unrealistic aspects of his assumptions. The first is that nearly all creditors adjust; the second is that each creditor that adjusts does so perfectly. The first assumption makes the

98. *See id.*

99. *See Guzman, supra* note 4, at 2182-83 (defining “weakly nonadjusting,” and “strongly nonadjusting” creditors); *id.* at 2184 (defining “fully adjusting creditor”); Rasmussen, *supra* note 35, at 2266 (opting to apply Guzman’s categories).

100. *See Guzman, supra* note 4, at 2182 (appearing to use the terms “nonadjusting” and “tort” interchangeably).

101. *See id.* at 2183-84.

102. *See, e.g., id.* at 2189 (“Notice that, despite the presence of this distortion, weakly nonadjusting creditors are not ‘cheated’ in any way. That is, over their full portfolio of loans, they receive an expected return that is adjusted for the overall risk they face.”).

pool of nonadjusting creditors small so that Guzman can dismiss it as *de minimis*.¹⁰³ The second assumption enables him to ignore the risk that, in the complex labyrinth of a universalist system, strategically-minded debtors could extract wealth transfers from creditors by surprise.

Professor Guzman criticizes the Mexico wage priority example in which I first made the latter point.¹⁰⁴ In my example, Mexican workers in a universalist system extended too much credit to their U.S. employers because they did not anticipate the application of the less generous priority for wages in U.S. law. Perhaps because miscalculation by an adjusting creditor is impossible under Guzman's assumptions, he misinterpreted my concern to be that Mexican values were not honored in the bankruptcy distribution.¹⁰⁵ The honoring of national values is, as Guzman points out, merely a zero sum game. But over extension of credit resulting from imperfect adjustment is an issue of efficiency that Guzman's perfect adjustment assumption causes him to ignore.

In reality, creditors do not adjust their credit terms perfectly. Some overestimate and others underestimate the likelihood of repayment. The two do not cancel each other out. Debtors tend to borrow more heavily from those who overestimate (an adverse selection effect). The result is a continuing subsidy from the least sophisticated creditors to the most opportunistic debtors.¹⁰⁶ The magnitude of this subsidy under a given international bankruptcy system will vary with the level of deception and error possible in that system.

The level of error and deception would be higher in a universalist system than in the current territorial one. In a universalist system, a successful deceit or forum shop could change the law governing the distribution of the entire estate. Under territoriality, a successful deceit or forum shop rarely can affect all of the assets of the debtor company; it would change the law governing only the particular assets involved.

The reaction of havens might further increase the possible variance in outcomes under universalism. That is, under universalism, havens would compete for cases by adopting laws more favorable to those who chose the fora for the bankruptcies of multinational companies, while the laws of other countries remained the same. Because the stakes would be larger for havens under universalism, their laws would

103. See *id.* at 2194 (arguing that the amount at stake in the treatment of nonadjusting debt is small).

104. See *id.* at 2205-06.

105. See *id.* at 2206.

106. See LoPucki, *supra* note 92, at 1954-58.

become more extreme. That, in turn, would increase deceit and forum shopping even further.

B. *Information Costs*

In Professor Guzman's model, each adjusting creditor seeks full information regarding each of its debtor's creditors and each possibly applicable bankruptcy law, calculates its return from each possible bankruptcy proceeding,¹⁰⁷ and uses the result to fix its terms of credit. Because Guzman assumes that, under universalism, the creditors know the home country whose law will determine the distribution, while under territoriality the laws of several countries will interact to determine the distribution, Guzman concludes that creditors' costs of gathering information to price credit will be greater under territoriality.¹⁰⁸

In reality, few creditors make the kinds of calculations Guzman describes. Because bankruptcies are relatively uncommon, the size of the potential return from them is only a small factor in determining the appropriate rate of interest to charge.¹⁰⁹ At the time they extend credit in the current territorial system, most creditors have only the dimmest idea of what their debtors' situations would be in some future bankruptcy. They fix lending rates and terms based on past returns from similar loans, not on the complex calculations Guzman supposes.¹¹⁰ Hence, they have no need for the pieces of data he suggests they would collect. Because active lenders have experience under territoriality — the system currently in operation — they already have the information they need to fix rates and terms. The world would need considerable experience with universalism to reach the same level.

C. *Movement of Assets*

Professor Guzman asserts, without argument, that, in a territorial regime, “[forum shopping] can be accomplished simply by moving as-

107. See Guzman, *supra* note 4, at 2200 (stating the formula for calculating the number of pieces of information supposedly necessary to price credit).

108. See *id.*

109. See, e.g., Ronald J. Mann, *Strategy and Force in the Liquidation of Secured Debt*, 96 MICH. L. REV. 159, 239 (1997) (“[I]n practice both involuntary liquidation of collateral and bankruptcy are quite unusual, even within the relatively small universe of loans that fall into distress.”).

110. See *id.* at 242 n.343 (quoting a banking executive as saying that a proposal to limit secured creditors to 80% of their collateral “would have no effect whatsoever on bank lending” because “loan officers responsible for origination ‘don’t think or give one hoot about bankruptcy/workout scenarios. They hope to hell it won’t happen. . . . [I]t won’t affect one iota how the banks initiate loans’ ” (citing a telephone interview with a Bank Division Manager (Mar. 6, 1997) (brackets in original)).

sets from one jurisdiction to another.”¹¹¹ Such forum shopping does occur, but has not been a particularly serious problem in the current territorialist regime. Elsewhere I have described two possible limitations on such forum shopping: (1) local legal restrictions and contract devices that can, and today do, largely prevent such transfers and (2) treaties or conventions that could provide for the return of fleeing assets.¹¹² Professor Westbrook asserts that I consider such treaties or conventions to be a necessary prerequisite to the operation of a territorial regime.¹¹³ It should be apparent from what I already have said that I do not. A territorial regime is already in operation.

IV. RASMUSSEN'S CONTRACTUALISM

A. *The Foundations of Contractualism*

Contract is the principal weapon in the economic arsenal. The argument goes as follows: No matter what current conditions obtain in an economic system, they can be improved by permitting the parties to enter into contracts. That parties voluntarily agree to the contract terms, the economist argues, proves that those terms make each better off than they would have been without them. Because the contract does not bind third parties, no one is worse off. Thus, every contract is a net gain for society as a whole and, in the absence of transaction costs (which economic theorists seem generally content to ignore), complete freedom to contract optimizes social organization — a condition referred to as “efficiency.” No better outcome than that achieved by contracting is possible; if such an outcome could exist, the economist supposes, the parties would have contracted for it and split the gain among them.

Economically minded scholars have used contractualism to fight regulation in virtually every nook and cranny of the economy, from corporate governance to the family. Regulation, they say, should be employed only when parties are unable to contract.

Professor Robert Rasmussen was among the first to bring this kind of contractualism to business bankruptcy. In an article published in 1992, he proposed that any debtor and all of its creditors be permitted to choose the law that would apply in the event of the debtor's bankruptcy.¹¹⁴ They would make the choice from among a “menu” of alternatives provided by law. In an article published five years later,

111. Guzman, *supra* note 4, at 2214.

112. See LoPucki, *supra* note 2, at 758-59.

113. See Westbrook, *supra* note 5, at 2308.

114. See Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEXAS L. REV. 51 (1992).

Rasmussen took the idea international.¹¹⁵ Essentially, he proposed that the “menu” of his earlier proposal be the existing bankruptcy laws of all the nations of the world.

By this ingenious proposal, Rasmussen seeks to finesse the choice between universalism and territoriality. No matter what the advantages of universalism or territoriality, contractualism is guaranteed to be at least as good. Even if one of the other systems were best for every firm (an unlikely possibility), the contracting parties simply would choose it for every firm. And if, as Rasmussen supposes, which system is best differs from firm to firm, contractualism would assure that the parties had the best of both worlds.¹¹⁶

B. *The Trouble with Contractualism*

The principal weaknesses of Rasmussen’s proposal are the weaknesses of the contract paradigm itself. First, the benefits of contractualism are guaranteed only in the absence of transaction costs,¹¹⁷ yet no contracting ever takes place in the absence of transaction costs. The transaction costs of operating under Rasmussen’s proposal would be enormous. Second, the argument for contract only holds so long as third parties are unaffected; if the scheme permits contracting parties to bind third parties and extract value from them, the contracting may no longer have even a tendency toward efficiency. Rasmussen’s proposal would bind noncontracting parties to the choice of forum, making it a possible vehicle for third-party exploitation. Third, the contract paradigm ignores the possibility that creditors may miscalculate and that such miscalculations are more likely in some systems than in others. Rasmussen’s proposed system would be so complex in its operation that creditors reasonably could not anticipate their treatment. I consider each of these points separately.

1. *Transaction Costs*

A multinational company may have thousands — and at the extreme even hundreds of thousands — of creditors, ranging from international banking institutions, to bondholders, trade creditors, employees, and even customers who have advanced down payments or relied upon warranties. Apparently recognizing that the costs of actually contracting among so many parties would be prohibitively expensive, Professor Rasmussen proposes that debtors note their choice of bank-

115. See Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT’LL. 1 (1997).

116. See Rasmussen, *supra* note 35, at 2261.

117. See Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 MICH. L. REV. 79, 106-10 (1992).

ruptcy system in their articles of incorporation.¹¹⁸ All creditors are assumed to have agreed to that choice. Because the circumstances that make the choice of a bankruptcy system appropriate might change, the debtor is free to change its election by amending its articles of incorporation. Rasmussen apparently realizes that sending creditors notice of the debtor's changes in those elections would also be prohibitively expensive, and so does not require it. Instead, he would imply the creditors' consent to a change of election when the change has been on the public record for a reasonable period of time.¹¹⁹

In the resulting system, creditors could be certain which bankruptcy system the debtor elected only if they searched the corporate records for that information. Under Rasmussen's proposal, the search would be by entity,¹²⁰ which might necessitate hundreds of searches in numerous jurisdictions for a single corporate group.¹²¹ To catch changes in the elections, the creditors would have to repeat their searches at frequent intervals. Rasmussen notes that the searchers might employ information brokers of various kinds — such as Dun & Bradstreet — in the process,¹²² but Dun & Bradstreet's services are hardly cheap.¹²³ In even the most optimistic view of those costs, they would still exceed the cost to the debtors of simply sending each creditor notice of each change of election. It follows that Rasmussen must contemplate that most creditors — the smaller ones — will extend their credit without actually knowing the debtor's election. Instead of carefully calculating their return from a bankruptcy filing in the chosen jurisdiction or jurisdictions, these small creditors will be flying blind. The effect is discussed in the next subsection.

Larger creditors can be expected to require that their debtors furnish them with notice of changes in the election.¹²⁴ Knowing that some

118. See Rasmussen, *supra* note 35, at 2254 (“[C]ontractualism allows each independent corporate entity to specify in its corporate charter the jurisdiction that will handle any bankruptcy proceeding involving that entity.”).

119. See Rasmussen, *supra* note 35, at 2255.

120. See Rasmussen, *supra* note 35, at 2254 (“[C]ontractualism allows each independent corporate entity to specify in its corporate charter the jurisdiction that will handle any bankruptcy proceeding involving that entity.”).

121. The Loewen Group, which recently filed for bankruptcy, has over 1100 subsidiaries. See The Loewen Group, Inc., Form 10-K, at Ex. 21 (Fiscal year ending Dec. 31, 1998) (listing the subsidiaries).

122. See Rasmussen, *supra* note 35, at 2266. What Rasmussen posits in this passage is the economists' dream of a world of perfect information and zero transaction costs. I readily concede that his proposal would work perfectly in that world, but so would every competing proposal. See LoPucki, *supra* note 117, at 106-10.

123. See LYNN M. LOPUCKI, INFORMATION LAW: A SYSTEMS APPROACH 216 (2000) (detailing a price schedule for Dun & Bradstreet subscribers showing prices for reports ranging from \$9.33 to \$693.32).

124. See Rasmussen, *supra* note 35, at 2261. (“The firm borrowing the money will simply show the lender the relevant provision in its corporate charter.”).

will fail to comply with the requirement, they will also conduct searches. Each search is likely to require some analysis. Recall that the election is not necessarily for the law of any particular country. It may be an election for territoriality or some other combination of systems.¹²⁵ Thus, for every debtor in the world — multinational or not — numerous creditors would have to conduct frequent searches and analyze the results. That analysis might require familiarity with any — or every — one of the bankruptcy systems of the approximately 268 countries of the world.¹²⁶ In short, the costs of contracting would be enormous.

Rasmussen responds that the negotiations among estate representatives in a territorial system would be both expensive and uncertain in outcome and that as a result “the costs of cooperative territorialism may well exceed those of a bankruptcy selection clause regime.”¹²⁷ That is, however, unlikely. In a territorial regime, negotiation costs are incurred only for the firms that file bankruptcy, only once for each bankruptcy, and only by each of two, or a few, estate representatives. In a contractualist regime, negotiation costs are incurred for all firms, they are continuous over the life of each firm, and they are incurred by every adjusting creditor of those firms individually.

2. *Externalizing Costs*

As noted in the preceding subsection, most creditors will not find it cost-effective to monitor the debtor's election. These creditors must either decline to deal with the debtor (and thus, presumably, with all debtors) or attempt to guess the appropriate terms. To protect against their debtors' opportunism, they should guess that their debtor will choose the most exploitative bankruptcy alternative available, and price their credit accordingly. Given that they would be charged as though they made that choice anyway, debtors would then have to choose the most exploitative alternative available to break even.

Recent experience with asset protection trusts suggests that offshore havens will tailor their laws to provide extremely exploitative alternatives. In the past two decades, about a dozen haven countries

125. See *supra* text accompanying note 116. Rasmussen defends his contractualist approach by analogizing it to generally enforceable “forum selection clauses and choice of law clauses” in contracts. See Rasmussen, *supra* note 115, at 5 (“Private international law generally recognizes the validity of forum-selection clauses and choice of law clauses in private contracts. This principle of contractual choice should be extended to insolvency matters.”). There is, however, an important difference. The parties bound by the latter contracts typically have actual notice of the provisions.

126. As of February 28, 2000, The CIA Factbook listed 268 countries in the world. See Central Intelligence Agency, *The World Factbook* (visited Feb. 28, 2000) <<http://www.odci.gov/cia/publications/factbook/country.html>>.

127. Rasmussen, *supra* note 35, at 2263.

have adopted asset protection trust laws that are specifically designed to prevent foreign creditors from collecting debts owing from anyone who avails him or herself of the haven's services.¹²⁸ The havens do so by validating self-settled spendthrift trusts. These trusts are, in essence, merely declarations by debtors that their assets should be available to themselves, but not to their creditors. These countries protect the assets in the care of their nationals by refusing to recognize foreign judgments, by making the trusts virtually impossible to break, and by recognizing the right of the trustee to move the assets to a different haven in the event that any creditor is foolish enough to attack in the courts of the originally designated haven.¹²⁹ The existence of these asset protection trust laws demonstrate the willingness of a significant number of countries to enact and enforce laws *for the purpose of* frustrating debt collection, and to do so for the benefit of anyone capable of bringing substantial foreign business to the haven. Thus, I would expect that, under a contractualist regime, debtors and their major creditors would join in electing to conduct any necessary bankruptcy proceedings in havens that would offer to exploit the other creditors for their benefit. The havens' reward would be the same as with asset protection trusts — the fees that the havens and their citizens could charge for their services.

Rasmussen expresses doubt that the havens effectively could "target incompletely-adjusting creditors for appropriation" without also harming fully adjusting creditors.¹³⁰ But there are numerous ways the havens could do that, even without going outside the bounds of the current bankruptcy practices in industrialized nations. First, the havens could disallow the claims of particular types of creditors that are unlikely to adjust. That might include all unliquidated tort claims; as is apparently the law of Spain today.¹³¹ Alternatively, the haven could disallow all foreign government claims for taxes; that is the bankruptcy law of most countries today.¹³²

128. See Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 32-34 (1996) (describing the laws).

129. See *id.* at 36.

130. See Rasmussen, *supra* note 35, at 2267 ("Thus, even if the amount of weakly nonadjusting creditors is large, it is far from certain that bankruptcy laws can be targeted so as to transfer value from weakly adjusting creditors to debtors on the one hand, while at the same time not to transfer such value from fully adjusting creditors on the other.").

131. See, e.g., *In re Papeleras Reunidas*, 92 B.R. 584, 591 (E.D.N.Y. 1988) ("Spanish law classifies judgment lien creditors as general unsecured creditors while United States law generally classifies such lien creditors as secured creditors up to the value of the properties to which the liens attach . . .").

132. See NATIONAL BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 364-65 (1997) (recommending that development of the law in this area be left to treaty negotiators and courts); PHILIP R. WOOD, PRINCIPLES OF INTERNATIONAL INSOLVENCY § 1-54, at 30 (1995) ("Many jurisdictions do not permit the claims of foreign

Second, the haven could impose minor costs and other procedural barriers to participation in the case. That would target essentially those contract creditors who would not adjust to their exclusion from the distribution. For example, imposing a filing fee for making a claim would tend to make claiming not cost effective for those with the smallest claims. They are the creditors who would be least likely to take account of whether their future extensions of credit were to debtors who had elected the haven as their forum. Placing the expense of operating a creditors' committee on the creditors rather than on the debtor's estate would have much the same effect.¹³³ Over time, the haven might fine-tune these kinds of burdens so that the creditors without enough at stake to pursue their claims would be precisely the same creditors that did not have enough at stake to adjust their credit terms to avoid repeated exploitation in the future.

A third possibility for targeting small contract creditors would be for the haven to permit the debtor and a simple majority in dollar amount of its creditors (usually just one or two creditors) to impose a plan of reorganization or liquidation on the minority.¹³⁴

Rasmussen attempts to compare "the benefits that can be achieved by selecting the most efficient insolvency law" with the "benefits that could be garnered by subordinating the claims of tort victims."¹³⁵ But, in doing so, he misses the point in four respects. First, the range of creditors vulnerable to attack includes not just tort creditors but also trade creditors, employees, customers, taxing authorities, retirees, persons with any kind of litigation pending against the debtor, and many others. Second, bankruptcy regimes need not, as Rasmussen asserts, sacrifice the flexibility of contract to assure the compensation of tort creditors. In a territorial regime, the estate representatives and the parties remain free to contract around inefficiencies; they simply cannot contract around the obligation to compensate tort creditors¹³⁶ as they could in a contractualist regime. Third, the loss from failure to compensate tort creditors is not limited to the currently existing amount of tort liability. There is profit in torts such as patent in-

revenue authorities or foreign penal demands."); Westbrook, *supra* note 19, at 37-38 (discussing the disallowance of foreign government tax claims in insolvency proceedings).

133. This is currently the law of Canada. See Lynn M. LoPucki & George G. Triantis, *A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies*, 35 HARV. INT'L L.J. 267, 335 (1994).

134. This could be accomplished by authorizing them to ignore the nonbankruptcy entitlements of the other creditors or by permitting the majority to impose a plan by voting that discriminates against the minority of voters.

135. Rasmussen, *supra* note 35, at 2271.

136. The representatives are fiduciaries for all persons having an interest in the estate. See, e.g., *Ford Motor Credit Co. v. Weaver*, 680 F.2d 451, 462 n.8 (6th Cir. 1982) ("A trustee in bankruptcy or a debtor in possession, as a fiduciary, represents both the secured and unsecured creditors of the debtor.").

fringement, tortious interference with contractual relations, and fraud. If tortfeasors need not pay for their torts, they will commit more of them and we have no reliable way of calculating how many more.¹³⁷ Last, Rasmussen assumes that the savings to the debtor from filing in an anti-tort haven is limited to the excess of the tort debt over the debtor's insurance.¹³⁸ But in a world where debtors could opt out of tort liability simply by choosing an anti-tort haven's bankruptcy regime, debtors would have little incentive to buy liability insurance.¹³⁹

Realizing the threat that externalization poses to contractualism, Rasmussen would require that the "bankruptcy regime selected by a firm accord at least nominal priority to tort victims similar to what they achieve in their home country"¹⁴⁰ and permit any country to enforce it by refusing to enforce a forum-selection clause "as applied to the involuntary creditor."¹⁴¹ Despite my prodding,¹⁴² Rasmussen does not say how the country refusing to enforce would give effect to its decision. I can see only a single way: by asserting territorial jurisdiction over the assets within its borders in favor of the involuntary creditor. By this move, Rasmussen would make his contractualism merely a superstructure on a territorial base,¹⁴³ and open a can of worms over which I have already gagged elsewhere.¹⁴⁴

3. *Wrongly Adjusting Creditors*

Both Rasmussen and Guzman assert that a debtor and its major creditors can gain nothing through the exploitation of contract credi-

137. On this basis, I challenge Rasmussen's statement that "the gains generated by lowering priority only occur in cases with substantial tort liability." Rasmussen, *supra* note 35, at 2271. In fact, the corporation frees itself from the deterrent effect of tort liability as soon as it elects an anti-tort bankruptcy haven.

138. See Rasmussen, *supra* note 35, at 2269 ("In most situations, firms will have insurance sufficient to cover the claims of the few tort victims it may have. . . . Thus, when adequate insurance exists, tort creditors are compensated in full despite the nominal low priority that their claims receive in bankruptcy.").

139. See LoPucki, *supra* note 128, at 76-79 (discussing the incentives to buy liability insurance).

140. Rasmussen, *supra* note 35, at 2271.

141. Rasmussen, *supra* note 115, at 35.

142. See LoPucki, *supra* note 2, at 740-42.

143. As further evidence of this territorial base to Rasmussen's contractualist superstructure, Rasmussen also finds it necessary to permit "a domestic court to ignore the edicts of a foreign jurisdiction" if the foreign jurisdiction failed to recognize "property rights" such as a lien or security interest granted to a local creditor by the domestic country. Rasmussen, *supra* note 35, at 2275. This grant of authority effectively allows each nation to decide who gets the assets located within the nation (territoriality), leaving only those assets unspoken for to be distributed by the law of the selected forum (contractualism).

144. See LoPucki, *supra* note 2, at 740-42.

tors.¹⁴⁵ Guzman reaches that conclusion by positing a universe of three kinds of creditors, none of whom ever lose money as a result of miscalculation or deceit; all creditors who adjust at all charge enough for the credit they extend that on the average they lose nothing.¹⁴⁶ Rasmussen realizes the implausibility of Guzman's assumption and recognizes the possibility that debtors can extract value from weakly nonadjusting creditors.¹⁴⁷ But, by assuming that category of creditors will "shrink dramatically" as a result of future improvement in private markets for information, he still manages to join in Guzman's conclusion.¹⁴⁸

In reality, miscalculating creditors are ubiquitous. They range from banks that lend on the basis of false financial statements, to bondholders who trade on inadequate or incorrect information, trade creditors who take unwarranted risks in the hopes of increasing sales, and employees or customers who never consider the possibility that they will be creditors at all. None of these types of creditors is likely to disappear as a result of improvements in information markets.

When these creditors suffer losses, they cannot recoup them by charging someone else above-market rates. The market rate is, by definition, the highest rate creditors can charge and still have customers.

Creditors that miscalculate too often may indeed be forced out of business and replaced by others who can be fooled less often. But, as I have explained elsewhere, normal turnovers of people and firms will generate a continuous subsidy to those debtors capable of exploiting them.¹⁴⁹ When the incentives established in a legal system are poor, an entire industry systematically can miscalculate, producing gigantic, unrecoverable losses. Such was the case with the Savings and Loan crisis of the 1980s, in which those institutions suffered losses in excess of

145. See Guzman, *supra* note 4, at 2189 ("Notice that despite the presence of this distortion, weakly nonadjusting creditors are not 'cheated' in any way. That is, over their full portfolio of loans, they receive an expected return that is adjusted for the overall risk they face."); Rasmussen, *supra* note 35, at 2265 ("Professor Guzman also demonstrates that weakly nonadjusting creditors cannot be systematically disadvantaged by any given bankruptcy regime. Regardless of the regime, they will be able to price their so loans so as to obtain a market rate of return.").

146. See Guzman, *supra* note 4, at 2180-81.

147. See Rasmussen, *supra* note 35, at 2266 ("Thus, the dominant strategy for all debtors is to select a bankruptcy regime that transfers value to debtors from weakly nonadjusting creditors.").

148. See Rasmussen, *supra* note 35, at 2267 ("In light of these observations, the concern over debtor havens must be a concern about the exploitation of strongly nonadjusting creditors.").

149. See LoPucki, *supra* note 92, at 1954-58.

\$500 billion on loans.¹⁵⁰ Such may also have been the case with recent forum shopping to Delaware in bankruptcy reorganization cases.¹⁵¹

The best systems for economic organization are simple and intuitive. Territoriality fits that description; contract choice does not. By contrast, contract choice would reward strategic activity by countries, by debtors, and by their major creditors. That activity would be most intense in the period shortly before bankruptcy, when the probability of bankruptcy was high.¹⁵² Whether the strategies involved were legal or illegal would matter little in the outcome. Each time an adjusting creditor was surprised by the harshness of its treatment under the law of a bankruptcy haven, the economic loss would be real and unrecoverable. A contract choice system would generate some tendency toward efficiency, but it might generate a more powerful tendency toward exploitation.

The problems with Rasmussen's contract choice result largely from the fact that the parties must incur the expense and go to the trouble of contracting regarding bankruptcy at a time when bankruptcy is only a remote possibility.¹⁵³ Because so few borrowers actually will file bankruptcy, the difference in creditors' expected recoveries resulting from different bankruptcy regimes is likely to be less than the transaction costs necessary to contract for those recoveries.¹⁵⁴ Territoriality offers the same parties the opportunity to contract regarding bankruptcy only in the cases that reach bankruptcy. That is the context in which bankruptcy contracting is most likely to succeed.

V. CONCLUSION

This round of essays made substantial progress in the international bankruptcy debate. As to Rasmussen's contractualism, the analysis frames essentially three issues. The first is whether future developments in information systems will make possible the transmission of a debtor's choice of bankruptcy regimes to, and analysis of that choice by, thousands of individual creditors. The second is the extent to

150. See generally STEPHEN PIZZO ET AL., *INSIDE JOB: THE LOOTING OF AMERICA'S SAVINGS AND LOANS* (1989).

151. See Sara D. Kalin & Lynn M. LoPucki, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 *VAND. L. REV.* (forthcoming 2001) (showing failure rates for Delaware reorganizations of up to seven times the failure rates in U.S. jurisdictions other than Delaware and New York City).

152. See *supra* Section II.B.3.

153. See generally Lynn M. LoPucki, *Contract Bankruptcy: A Reply to Alan Schwartz*, 109 *YALE L.J.* 317 (1999) (refuting a bankruptcy contracting proposal).

154. Only about one-half of one percent of publicly held companies file for bankruptcy in a given year. See Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 *CORNELL L. REV.* 597, 608 n.43 (1993) (calculating the rate).

which bankruptcy systems can target for exploitation creditors who do not completely adjust. The third is whether the gains to be had from the exploitation of those creditors are sufficiently large that the system will pursue them at the expense of efficiency. In my opinion, contractualism is likely to fall short in all three areas.

As to universalism, this exchange highlights the fact that it is no longer a single proposal, but is now a multitude of them. That multitude includes the adoption of a world-wide law governing debtor-creditors relations and the establishment of a system of international bankruptcy courts as well as the traditionally universalist idea that the court of the debtor's home country would administer the worldwide assets of the debtor according to the law of that home country.

Westbrook and I agree that traditional universalism would present no great problem in a world in which the bankruptcy and priority laws of all countries were essentially the same. We disagree on whether an international convention could establish a traditionally universalist system without first eliminating the sharp differences that exist among the bankruptcy systems of the various countries. As I see it, the results of such a premature attempt at universalism would be rampant forum shopping by multinational companies and their financiers for favorable systems and the rise of offshore bankruptcy havens that would specialize in providing such systems. Choosing universalism prematurely may be choosing, in effect, to have most multinational bankruptcies take place in secret in Bermuda or the Cayman Islands — under laws made by the legislatures of those countries.

Assuming I am correct in that analysis, the universalist guerillas who exhort bankruptcy judges to surrender local assets today to "home country" courts that will distribute them differently inject uncertainty and injustice without advancing the cause of reform. Bankruptcy professionals, including bankruptcy judges, understandably look forward to the time in which they will be free of sovereign power. But, if they are not more cautious, they may destroy the territorial system in which they now practice before the foundations of a viable new system are in place.