GLOBALIZATION

GENERAL OVERVIEW AS SEEN FROM DEVELOPED COUNTRIES

General Observations and a Case Study – Canada and the U.S.

The Third East African Magistrates and Judges Association Judicial Conference
Dar es Salaam, Tanzania
January 21, 2004

By: Justice James M. Farley
Superior Court of Justice
Toronto, Ontario

Globalization is a tool. It can be well used and therefore be to the advantage of those affected – i.e. affected in a very positive way. It may also be ill used and therefore be to the disadvantage of those affected – initially this will have the negative effect upon the weaker countries or regions of the world but eventually all will have the problem of letting an opportunity slip through their collective fingers of sharing a maximized wealth. That is, both the stronger and the weaker will be poorer than they otherwise could be. I will deal with this topic through the eyes of a judge working in a Commercial Court which deals with many cross-border cases, both insolvency and non-insolvency related. Please refer to www.ontariocourts.on.ca/superior_court_justice/notices/toronto_region/commercial.htm to access our Commercial List Practice Direction. Please also see my paper for the World Bank Global Judges Forum on Commercial Enforcement and Insolvency Systems, held May 19-23, 2003, entitled "Efficient Court Administration: Value Added Techniques for Real Time Litigation, Court Administration and Case Management – The Need for Effective, Efficient and Timely Delivery of Justice – The Superior Court of Justice Experience in Toronto, Ontario, Canada" at http://www.iiiglobal.org/country/canada/commercial_enforcement.pdf as to the operations of our Commercial List in Toronto. The www.iiiglobal.org general website contains a wealth of material concerning insolvency related topics worldwide.

The Need for Globalization and the Cancún Talks

Globalization in its purest sense is the process by which countries (or regions) and their constituents have the greatest choice as to whether or not to produce a certain thing (including goods and services) and whether or not to acquire a certain thing produced either domestically or in a foreign country. Thus a person is able to decide whether he has a better efficiency in producing, say, wheat than in producing automobiles or space vehicle rockets. That person may then choose to produce the wheat and buy the automobile from an exporter in another country, but not choose to buy any space vehicle rockets at all. The prudent purchaser will of course wish to ensure that the automobile purchased will stand up to local conditions in his home country and that he will be able to get parts and service.

Stanley Fischer (formerly of the International Monetary Fund and the Massachusetts Institute of Technology) in his paper "Globalisation and Its Challenges, AEA Papers and Proceedings", *American Economic Review*, Volume 93, Number 2, May 2003, makes a compelling case that globalization has been assisting poorer countries to catch up with the wealthier, particularly if one looks at matters on a per capita basis so that the enormous strides made by China and India are recognized. This was contrasted with the difficulties which countries in sub-saharan Africa have had with economic integration. Indeed many of the world's highest trade barriers are those imposed by poorer country governments on trade with other poorer countries compounded with a lack of security or stability.

The book review in that well regarded periodical *The Economist* of *Ending Hunger in Our Lifetime: Food Security and Globalization*, by C. Ford Runge, Benjamin Senauer, Philip G. Pardey and Mark W. Rosegrant (Johns Hopkins University Press) in its August 23, 2003 edition at pp. 68-9 stated:

> Many of the hungry in poor places are farmers themselves. Their failure to grow–and earn–enough stems from a variety of reasons, from a lack of access to modern farming tools to environmental constraints to poor roads which prevent them from reaching markets. The book offers a clear explanation of the agricultural problems confronting the world's hungry. But its value lies in putting these physical challenges in a wider social context, looking at other factors, such as women's education, which affect household food security.
>
> …
>
> As the authors acknowledge, there is little chance of business-as-usual halving the number of hungry by 2015, a goal enthusiastically endorsed by world leaders in 1996. But with the right "pro-poor" policies, the book predicts that the number of malnourished children in the world could fall almost threefold, to 57m by 2025; if such steps are neglected, however, that number could rise to 178m, with Africa bearing the brunt.

As Ernesto Zedillo, the former President of Mexico stated at p. 35 of the September 1, 2003 edition of *Forbes Magazine* (www.forbes.com) in his article "To Be or Not to Be at Cancún":

> The GATT/WTO multilateral trading system has been a powerful engine of prosperity during the last half-century, delivering a twentyfold increase in world trade. Throughout its existence, however, this system has been more an instrument of progress for developed countries than for developing countries. The trade playing field is tilted against the latter. The remaining protectionism of industrialized countries is concentrated in sectors of big export interest to developing countries, and the system has been increasingly loaded with rules that are more an impediment than an incentive to developing countries' engagement in international trade.
>
> …
>
> Rather than muddling through the meeting at Cancún, trade ministers should use it as an opportunity to reassess the entire process of multilateral trade liberalization. If the objective is to build a system with the greatest potential to support the economic growth of both developed and developing countries, the ministers should conclude that in the long run the system must have two essential features. First: It must achieve the total removal of barriers–tariff and nontariff–to all trade in goods by both developed and developing countries. It must also accomplish substantial, across-

> the-board liberalization of trade in services. Second: To be equitable to all participants, the system must provide universal enforcement of the principles of reciprocity and nondiscrimination. However, this does not preclude the implementation of special and differential provisions to help developing countries adjust more smoothly to free trade. But these provisions must be strictly temporary.

It is very unfortunate for all in the world – rich and poor alike – that the Cancún talks broke down. As indicated in their joint letter to the editor of the *Financial Times* (London, England) in the September 6/7, 2003 edition, The Earl Cairns (Chairman, Friends of Africa Business Group), Cyril Ramaphosa (Chairman, Millennium Consolidated Investments) and Dr. Mohan Kaul (Director-General, Commonwealth Business Council) noted that the World Bank and the International Monetary Fund have estimated liberalization of trade in agricultural products would increase developing countries exports by at least $30 billion U.S. a year and possibly by as much as $100 billion U.S. They went on to state:

> Since 1995, protection and subsidisation in countries in the Organisation for Economic Co-operation and Development has doubled. They now spend close to $350bn every year to support their agricultural sectors, far more than the $50bn spent on aid.
>
> Between 2001 and 2002, farmers from the US, the EU and China (the biggest cotton producers in the world) received cotton subsidies worth an estimated $4.9 billion. African producers, despite many competitive advantages, simply cannot compete in such a distorted market. These subsidies cost Benin, Burkina Faso, Chad, Mali and Togo $250 million a year in lost export earnings.

It would seem that farmers in the United States, the European Union and Japan have great political clout notwithstanding that it does not make economic sense to support their activities to the extent these countries have in the past – and continue to do in the future. But votes are important in getting governments in democracies reelected. Thus it appears that the U.S. spends about the same in cotton subsidies and protection for its domestic producers as the crop is worth.

Apparently Canada is not an innocent: According to the OECD's calculation of producer subsidy equivalent which gauges total support for agriculture as a percentage of the value of production, the European Union support is at 36%, Japan 59%, the U.S. 18% and Canada 20% (up from 14% in 1997). Canada has significant protection for its dairy, poultry and egg producers while at the same time complaining of U.S. trade barriers to Canadian wheat.

It appears that the Cancún talks faltered because poorer countries refused to let the WTO craft a deal which only offered mild cuts in the richer country farm subsidies and at the same time would have forced the poorer countries to consent to starting negotiations on proposals to stop developing countries from controlling foreign investment and multinational activity within their borders. The unfortunate fallout from this is that according to the World Bank, over 70% of the benefits that poorer countries might see from the Doha round would come from freeing trade with each other and without any agreement flowing from the Cancún talks, the poorer countries came away with none of this benefit. In my view all countries would benefit from a return to the bargaining table.

Canada and the United States of America

Allow me to turn to Canada and the U.S. The U.S. has a mature broad-based economy which enjoys considerable depth. Canada is very much the junior partner in this relationship. The Canadian economy is mature and broad-based to a fair degree but nowhere near as much as that of the U.S. Given the U.S./Canada population ratio of 10:1 and the earlier business development of the U.S. coupled with a lesser dominance of resource based enterprises, it is not surprising that the Canadian economy does not have as much depth as that of the U.S. However the people of Canada have benefitted greatly from an increased liberalization of trade in goods and services with the U.S. We in Canada can do what we can do best – and yet we still have the ability to choose

from a very expansive menu of goods and services which would not be available to us if we attempted to be self reliant to a much greater degree than we presently are.

The 15-year experience with NAFTA (North American Free Trade Agreement) has weeded out non-competitive companies and indeed industry sectors. However, our GDP, employment and social fabric support system has increased very significantly as a result of our competitive businesses and sectors having full access to the U.S. (and Mexican and now Chilean) market together with the benefit of lower cost imports.

Has it always been milk and honey when dealing with the U.S.? No, certainly not; we have our thorny issues with the U.S. from time to time – and in the case of softwood lumber, it appears that this, at least in recent years, has been with us forever. However, the two economies – and the social structure support in each country for those involved in that economy – are strong enough that there is no risk of being overwhelmed in the sense of domination dictating our ways of life. Indeed the increased economic activity has allowed for a larger and stronger tax base to bolster our existing societal framework safety nets and to foster our separate but similar cultural development. It was, however, a fairly uneasy time in the 1970s and early 1980s, particularly when the Canadian government adopted very tough national self-reliance rules for business operations and investment by the passage of the *Foreign Investment Review Act* (FIRA) and the implementation of the National Energy Policy (NEP). Both FIRA and NEP have been essentially modified out of existence but there is always the spectre of a new government reintroducing elements of these programs notwithstanding that that possibility is very remote given that there have been two changes of government since, including a return of the government which introduced these programs. The danger is that foreign investors have perceptions which die hard notwithstanding recent extensive experience. It is

that concern which raises the cost of foreign capital, if it is to be had at all, over and above what pure business and economic reasons would dictate. If domestic capital is scarce and foreign capital expensive, then the local economy will be starved for capital (– and technology and know how transfer) resulting in a tendency towards an uncompetitive economy.

Instead I would advance the proposition that it is better to have a vibrant economy which will generate income – profits and wages for local entrepreneurs and workers, all of which can be taxed to pay for necessary social programs. Businesspersons and investors crave certainty; they also require that they be dealt with fairly and reasonably; and further that they have access to courts which dispense non-discriminatory predictable justice on a timely basis. That condition is true to a very high degree in the relations between the U.S. and Canada. Possibly the greatest bone of contention between these two countries in the question of access to justice is that there are concerns by Canadian business persons that if they are sued in the U.S. state courts (as opposed to the U.S. federal court system including the U.S. Bankruptcy Courts), they will suffer from the "local jury syndrome" which may result in an "out of stater" being regarded as fair pickings for the local litigants. An example of this would be the Loewen Funeral Homes case where a Mississippi jury awarded a half billion U.S. dollars as punitive damages against a Canadian company in a breach of contract case worth at the maximum $5 million U.S. The fallout of that was Loewen went insolvent and had to engage in restructuring. However, it would be fair to observe that a New York firm in similar circumstances may well have been treated the same way by a Mississippi jury. I note that the state of Mississippi ranks last in per capita income and its social programs leave much to be desired; it has not experienced the benefit of a resurgent southern economy.

Restrictions or No Restrictions and Other Concerns

Foreign investors and those who trade into the local economy reasonably require that they will not be discriminated against merely on the basis that they are foreign. Paying local creditors in priority to similarly situate foreign creditors cannot be defended. If business is doing well then there usually is no need to resort to the courts. But if business turns sour, then both domestic and foreign investors and creditors need concrete assurance that there will be a workable system of an insolvency regime which incorporates the ability to advance credit on the basis of taking legitimate security. If that condition does not exist, then investment, advancing credit and trade to that country's economy will be like going to the casino. One may win big sometimes but one often loses and in the long run one always loses given the house odds.

Should a country have no foreign ownership restrictions on any sector of its economy? Perhaps the best case can be made for certain restrictions in the banking and media sectors (which are two areas in which Canada has restrictions). One may posit that the media sector (including print, radio, TV and movies) is a heavy influence on a country's culture, perhaps the more dominant influence is the way in which people in a locality have developed and interact over a long period of time. Perhaps this can be most readily demonstrated by observing that it is reasonable to expect that even if Canada were to be incorporated into the United States it is extremely likely that the existing (but ever evolving) culture of the various regions of Canada would survive as distinct recognizable cultures in the same way that it can be said that there is no one homogenous culture in the United States but rather identifiable and continuing regional cultures notwithstanding a fairly centralized media sector. I would also add that the mainstay of the Canadian State TV operation is U.S. made programs.

What of the banking sector? It is possible to advance an argument here based upon the linkage between these financial institutions and government monetary policy. However, that leaves open the question of whether the amount of desirable control in this regard could be adequately achieved by certain regulations dealing with ongoing business relations – or indeed more appropriately dealt with on the basis of residency as opposed to citizenship.

The Economist in its May 3, 2003 edition at p. 3 of "A cruel sea of capital: A survey of global finance" recognized the need for a restrained balance about having some control in the financial sector:

> Rapid globalisation has done nothing to undermine the confidence liberals have always placed in trade. No serious economist questions the case for international integration through flows of goods and services, though there is a lively argument over how integration through trade can best be brought about. Trade is good. But even the most enthusiastic advocate of economic integration may be starting to wonder whether unimpeded flows of capital are quite such a blessing.
>
> …
>
> Essentially the same logic applies to international finance. Just as a closed economy can consume only what it produces, it can invest only what it saves–no more, no less. Trade in capital makes it possible for countries to separate their saving and investment choices. They can invest more than they save by borrowing the difference from abroad; or they can invest less than they save by lending out the surplus. Changes in the price of capital will ensure that global supply and demand match up, just as changes in the prices of goods bring exports and imports into global balance.
>
> Debts are also a main reason why mistakes in financial markets, when they happen, can have bigger consequences than errors in an economy's less excitable parts. Losses may cascade across a series of lenders, many of which may not even have realised that they were exposed to the risk. A surprise that is big enough and bad enough may perturb the mood of self-justifying expectations that had up to then been propping valuations across an entire class of investments, and at worst across the economy as a whole.
>
> …

A close-run thing

Trade in goods and services is simple: what governments need to do, through the World Trade Organisation, through this or that regional trade agreement, or best of all unilaterally, is abolish their barriers. When it comes to finance, there is no such straightforward advice. "Let capital flow where it may" is bad policy. Finance must be intelligently regulated, at home as well as internationally, in ways that ordinary commerce does not require. When capital flows are liberalised, it needs to be done cautiously and within prudent limits. To that extent, global finance must indeed be impeded.

Governments and their advisers are a long way from understanding how this should ideally be done, let alone from putting any such understanding into practice. There is no detailed consensus on the right approach to international financial regulation, any more than there is on the domestic sort: there is plenty of activity, but for the most part it is co-operation without conviction.

The risks of international finance need to be frankly acknowledged, and then reduced so far as possible. That means weighing the costs and benefits of different kinds of capital mobility, and setting policies accordingly. It means abandoning certain orthodoxies of international economic policy. The danger cannot be eliminated altogether, but the remaining risk is worth taking because the potential gains from international capital flows are large, especially for the world's poor countries.

To ignore that potential would be an even greater mistake than to liberalise recklessly. The global capital market is a treacherous aid to economic growth, but in the end, above all for the poor, an indispensable one.

Market liberalization is commendable; it allows the economy to grow at the maximum rate – and in theory for the benefit of all. However, it seems to me that market liberalization – and the opening up of the market to foreign investors and traders – can only take place without undue strain on the social fabric of a country if it is done on a reasonable announced and predictable phase-in basis and with safety nets to avoid transitory disruptions such as currency fluctuation. In this regard I note the 13% change in the exchange rate between the Canadian and U.S. dollars over the past year. Canadian exporters have coped remarkably well, notwithstanding being caught off guard. No doubt some will have extreme difficulty in the coming year. However, consider the situation if the Canadian

economy and particularly the very vital export sector were not so resilient – massive unemployment and bankruptcy with all the seeds of social unrest, stress and strife that would bring. Indeed and especially for lesser-developed countries it is important that there be a financial and political commitment (both externally and internally) to aid the transition of traditional institutions in a measured way so as to minimize the risk of such social disruption. One may well posit that greater attention should be paid to the maintenance of these domestic institutions by the WTO, the World Bank and the International Monetary Fund which have previously mainly stressed economic concerns. An example of such a problem would be the late 1990s financial crisis in Indonesia where it appears that the IMF may not have appreciated that the infrastructure in place would not support the IMF requirements for financial assistance as neither the courts nor the bar were then (rather instantly) capable of handling the task presented to them.

Allow me to cite at length a rather well reflected column in the *Financial Times*, *supra*, where Michael Prowse observed in his piece "Wealthy countries can afford to be big-hearted when it comes to trade":

> A remarkable shift has occurred in the globalisation debate. Until recently, ministers and officials from rich western democracies and international organisations faced no serious intellectual opposition. Their own arguments might often be flawed, but this did not matter because their opponents' arguments were always far worse. The anti-globalisers could break windows and disrupt meetings but they seemed not to grasp even the elementary principles of market economics.
>
> Yet as trade delegates and protestors converge on the Mexico resort of Cancún for next week's World Trade Organisation meeting, the logical gap has narrowed. Many elements in the self-styled "global justice movement" could benefit from a course in economics. There are, for instance, "localisers" who believe passionately in an extreme form of protectionism in which nations (or perhaps regions within nations) only import goods and services that they cannot provide for themselves. This would certainly fatally undermine global capitalism, but it would also plunge most of the world into abject poverty.

Yet the more rational voices within the global justice movement now understand that an attempted reversal of globalisation is neither desirable nor possible. The process is just too advanced. They see that globalisation has entered a phase in which services are being reallocated across national boundaries in response to the logic of comparative advantage, just as commodities were a century ago. British architectural practices now outsource technical work to staff in Vietnam and Wall Street banks are shifting analysts' work to India. Nobody can halt, and still less rewind, such a rapidly progressing division of labour.

Yet what the better advocacy groups now grasp is that one can believe in market economics without necessarily endorsing the arguments of the richest nations. For instance, ardent globalisers regard the removal of trade and investment barriers as sufficient in itself. Their Luddite opponents oppose any deregulation. Both parties miss the main point, which is that market opening offers the greatest benefits only when accompanied by a range of other social policies.

In fact it is often politically possible only as part of a package that includes redistribution and higher investment in public services such as healthcare, education and poverty relief. On the international stage, this balance is hard to achieve because the most powerful agencies – the ones that really influence the internal policies of poorer nations, such as the International Monetary Fund, WTO and World Bank – have a primarily economic rather than social focus.

If you imagine a nation trying to manage the social aspects of economic growth with staff mostly seconded from its finance ministry, central bank and trade ministry, you will see the scale of the problem. Today economic specialists are largely overseeing the growth of a globally integrated market, but that task, seen as a whole, is really little different from that of managing a domestic economy. The problem lies not with globalisation *per se* but rather with the one-sided character of the political instruments available for managing it. Social justice is never likely to be a primary concern when the agencies in the driving seat have a largely economic focus.

On the issue of how best to draw the poorest nations into the global market – the supposed focus of the present Doha trade round – the position of advocacy groups such as Oxfam is more logical in some respects than that of rich nations. The latter are wedded to strict reciprocity: in discussing tariffs and other barriers, they insist on a pound of flesh for a pound of flesh. We will make a concession, they say, but only if you make at least as big a concession in return. Thus they justify their policy of imposing much higher tariffs on imports from poor countries than they do on

imports from their rich counterparts, by pointing to the high tariffs that poor countries themselves impose. Yet while reciprocity might be a sensible stance for negotiations between equals, does it make sense when one party is vastly stronger than the other?

Rich, stable nations find it hard to deregulate in politically sensitive areas. Look at agriculture, where industrialised countries spend more than $1bn a day subsidising their farmers, six times their total foreign aid payments. Or look at textiles and garments, where tariffs and quotas remain high in spite of promises to remove barriers. Yet rich countries have long-established welfare states: they have the capacity to offer income support to the victims of economic change and to provide a wide range of public services in fields such as healthcare and education.

By contrast the poorest nations are far less capable of coping with the transitional social problems created by deregulation. Here social dislocation is felt by individuals who are more vulnerable if they lose their livings than their counterparts in rich nations. The network of welfare provision is patchier, where it exists at all. It follows that economic liberalisation poses a bigger political challenge. And this means the rich nations' "pound for pound" demand is misplaced.

A "big-hearted" strategy of offering much larger trade concessions to developing nations than they demand of them would make greater sense. At present, the rich nations expect the poorest to respect liberal principles that they themselves constantly flout. Might a little less hypocrisy be in order? After all, if the US and European Union believe their own economists, trade "concessions" are not really concessions at all. Most liberal economists argue that unilateral import liberalisation more than pays for itself, because it allows resources to shift into sectors where rich countries have a genuine comparative advantage.

The big-hearted strategy would also be historically realistic. In practice, most nations (and this applies to the US, European states and east Asian tigers) were reluctant to open their markets either to goods or foreign investment before achieving a measure of economic security. Even if protection is illogical in the poorest nations, the desire for it is understandable and, to a degree, forgiveable. The same cannot be said of the richest nations. Hence the right strategy would be to open up unilaterally, and let the poorest countries enjoy the benefits. Once they experience the practical benefits of increased trade, they will be that much keener to integrate fully into the global economy.

Again let me reiterate that a return to the bargaining table, local political concerns notwithstanding, will be to the benefit of all countries, richer and poorer. The residents of all countries will be better off than they are now.

Canadian – American Cooperation in Cross-Border Insolvencies

Economic and Legal Background

Allow me to turn to an example of how Canada has cooperated with the U.S. in the insolvency field – with the result that value has been maximized and scarce resources utilized and not squandered. Harmonization has been to the advantage of both sides. As with the economic elements involved in globalization in the sense of the parties enjoying the benefits of trade liberalization through the removal (or lessening) of tariffs and non-tariff barriers, so too in the legal sector, parties / countries on all sides of any border benefit from the elimination or lowering of legal barriers so that insolvencies / reorganizations can proceed in the most efficient and effective way and in a timely fashion.

Insolvency is a condition which is inherently chaotic. With the effluxion of time and no stabilization of distracting factors, value evaporates. Resources are not fully utilized – indeed in some instances, the scarce resources are completely discarded. Often these resources are intangibles – namely the goodwill which is built up in a business organization and its workforce. This is not the goodwill that enhances the value of a business by its location, say a newsstand in a subway station. Rather it is the goodwill which a business has arising out of a trained workforce, with established ties to suppliers and to customers and with an organized distribution system. Time, experience and capital have been spent in building up such an organization. While this organization has become insolvent, and therefore there will have been a combination of internal and external factors contributing to such condition, it would be a waste to have the business shut

down and its tangible assets liquidated on a piecemeal basis. That result would not maximize value for the creditors of the company (nor for its shareholders); it would throw its employees out of work requiring them to seek jobs for which they may not be readily qualified; it would require anyone purchasing piecemeal assets to rebuild the goodwill discussed.

There is now general recognition that the sale (or other reorganization disposition) of an insolvent but viable business is the option which should be first explored so as to conserve the scarce resources. That may take the form of compromise of debt (restructuring the balance sheet) with creditors exchanging part of the money owed them into equity, possibly with existing management continuing and possibly with the original shareholders maintaining a (reduced) equity participation. At the other end of the spectrum, the company may be taken over by a new equity investor who will require new management and the original creditors may have sold their debt position to entrepreneurial “vulture funds” which may be counting on a reorganization plan leaving them with a return of more pennies on the dollar than they paid the original creditors, with or without an equity kicker. Existing management may survive if it is perceived that the troubles which beset the enterprise were unexpected by the industry generally; if however existing management were not alert, then their chances of survival are minimized.

If productivity is a fundamental problem, then a balance sheet restructuring will only be a temporary bandaid doomed to failure. Productivity issues require a complete rethinking of the business organization/operation so that the restructured enterprise may be competitive. There must also be a recognition that the “successful restructuring” of an enterprise may only increase the pressure on its domestic competitors which may then find themselves next in

line for insolvency proceedings. That is, there may be overcapacity in an industry sector which cries out for reduction rationalization. The equation may be more difficult to handle with foreign competition.

Can every insolvent enterprise be successfully reorganized/rehabilitated? No. In some instances, technological innovation will have overcome some industries. Amalgamated Buggywhip Inc. may have been a darling of the stock markets in the 1880's but with the advent of the automobile its role as a survivor would be as a small niche player catering to horse fanciers. Some businesses transition themselves – e.g. Studebaker from wagons to automobiles – only to succumb to competition from other vehicle manufacturers a half a century later. Today, with the tariff barriers eliminated or virtually non-existent, foreign imports created increasing pressure on domestic industries. Witness the traditional Big Three vehicle manufacturers. Worldwide overcapacity in the vehicle manufacturing business of some twenty percent virtually assures that at some stage, one or more of the Big Three will disappear.

The economic doctrine of comparative advantage in the long run means that everyone in the world, no matter what country they live in, will be better off if there is specialization in those businesses. That a nation or a region has a comparative advantage (taking into account transportation costs). Simply put, if China is more efficient than Canada both as to the production of clothing and of automobiles, but relatively more efficient at doing clothing than automobiles, then both countries would benefit if China produced all the clothing for both countries and Canada all the autos. However we do not live in a perfect world and governments decide for public policy reasons that they wish to support a variety of businesses. But in doing so, these governments subsidize relatively inefficient industries and the worldwide consumer is penalized. We do however live in the short run, not in the long run. It is not easy nor indeed possible to readily change a textile mill into an operation which produces carburetors. Industries which prospered under a cheap Canadian dollar may have difficulty adjusting to its

newfound strength (or conversely, the newfound weakness of the U.S. dollar), especially when the change was generally unanticipated and so rapid. Many businesses are capital intensive and require many years to emerge from the planning stage to that of full-scale production; a commitment to such an enterprise requires assumptions as to exchange rates, government policy including taxation, inflation and interest rates.

Developing nations may not find it desirable to rely upon one or two primary industries where they have a comparative advantage. For instance, sisal may be cyclical as to production/harvest and as to price competition on a worldwide basis – and it may be under functional competition with, say, plastic rope. Further these developing nations may feel that they need to protect local inefficient industry for a period of time to allow these industries to achieve a critical mass with which to withstand international competition. Short-term subsidies for this purpose may be acceptable, but if they go beyond a legitimate short-term boost, then they become a hidden tax upon the consumer and a direct burden on the taxpayer, meanwhile they signal hope and expectation to other industries that they too should benefit from a hand-up which is in truth a handout.

Business on a worldwide basis is increasingly becoming more and more competitive. At the same time the world economy is becoming increasingly more interdependent. To enjoy the higher standard of living which goes with that, we have to be flexible and adaptable to keep up with that competition. We really do not have a choice of standing still; for if we did, we would be opting out and so becoming poorer.

Canada is a good example of how foreign trade has benefited its economy. NAFTA substantially integrated our economy with that of the U.S. As indicated in *Policy Options* (Institute for Research on Public Policy; August 2003; Vol. 24, No. 7; options@irpp.org) concerning “Globalization, the Canadian Way” at pg. 3:

> In 2002, exports of goods and services accounted for 41 percent of the country's output. That actually represents a slight decline since Canadian exports peaked in 2000 at 45 percent of GDP. Exports accounted for four new jobs out of five in the Canadian economy between 1993 and 2000.
>
> So globalization isn't just a buzzword in Canada. It's about what we do for a living – trade. Most of it, of course, goes to the United States, destination for nearly 82 percent of Canada's exports in goods and services last year, some $382 billion, or one-third of Canada's GDP.

Canada and the U.S. are each other's largest trading partner. Each has substantial investments in the other.

Cross-Border Cooperation in Practice

Cross-border cooperation in legal matters has a firm foundation in the general law of Canada. I observed in *ATL Industries Inc. v. Han Eol Ind. Co.* (1995), 36 C.P.C. (3d) 288 (Ont. Gen. Div.) at pp. 302-3:

> Allow me to start off by stating that I agree with the analysis of MacPherson J. in *Arrowmaster Inc. v. Unique Forming Ltd.* (1993), 17 O.R. (3d) 407 (Gen. Div.) when in discussing *Morguard Investments Ltd. v. De Savoye*, [1990] 3 S.C.R. 1077, 76 D.L.R. (4^{th}) 256, 52 B.C.L.R. (2d) 160, 122 N.R. 81, [1991] 2 W.W.R. 217, 46 C.P.C. (2d) 1, 15 R.P.R. (2d) 1, he states at p. 411:
>
> > The leading case dealing with the enforcement of "foreign" judgments is the decision of the Supreme Court of Canada in *Morguard Investments*, *supra*. The question in that case was whether, and the circumstances in which, the judgment of an Alberta court could be enforced in British Columbia. A unanimous court, speaking through La Forest J., held in favour of enforceability and, in so doing, discussed in some detail the doctrinal principles governing inter-jurisdictional enforcement of orders. I think it fair to say that the overarching theme of La Forest J.'s reasons is the necessity and desirability, in a mobile global society, for governments and courts to respect the orders made by courts in foreign jurisdictions with comparable legal systems, including substantive laws and rules of procedure. He expressed this theme in these words, at p. 1095:

> "Modern states, however, cannot live in splendid isolation and do give effect to judgments given in other countries in certain circumstances. Thus a judgment *in rem*, such as a decree of divorce granted by the courts of one state to persons domiciled there, will be recognized by the courts of other states. In certain circumstances, as well, our courts will enforce personal judgments given in other states. Thus, we saw, our courts will enforce an action for breach of contract given by the courts of another country if the defendant was present there at the time of the action or has agreed to the foreign court's exercise of jurisdiction. *This, it was thought, was in conformity with the requirements of comity, the informing principle of private international law, which has been stated to be the deference and respect due by other states to the actions of a state legitimately taken within its territory. Since the state where the judgment was given has power over the litigants, the judgments of its courts should be respected."* (Emphasis added)
>
> *Morguard Investments* was, as stated earlier, a case dealing with the enforcement of a court order across provincial boundaries. However, the historical analysis in La Forest J.'s judgment, of both the United Kingdom and Canadian jurisprudence, and the doctrinal principles enunciated by the court are equally applicable, in my view, in a situation where the judgment has been rendered by a court in a foreign jurisdiction. This should not be an absolute rule – there will be some foreign court orders that should not be enforced in Ontario, perhaps because the substantive law in the foreign country is so different from Ontario's or perhaps because the legal process that generates the foreign order diverges radically from Ontario's process. (My emphasis added)

<u>Comity and cooperation are necessary in the bankruptcy and insolvency context – but also in the context of all cross-border litigation</u>.

In *Re Babcock & Wilcox Canada Ltd.* (2000), 18 C.B.R. (4th) 157 (Ont. S.C.), a case involving the recognition and enforcement of a *U.S. Bankruptcy Code* Chapter 11 stay of proceedings as to a <u>solvent</u> Canadian subsidiary (as opposed to an insolvent Canadian subsidiary) of the main U.S. parent applicant in the U.S. proceedings, I indicated that it was appropriate to give the relief requested on a weighing of multiple factors (many of which are relevant to any form of litigation) which I described at pp. 167-8 as follows:

…Relying upon the existing law on the recognition of foreign insolvency orders and proceedings, the principles and practicalities discussed and illustrated in the Cross-Border Insolvency Concordat and the UNCITRAL Model Law on Cross-Border Insolvencies and inherent jurisdiction, all as discussed above, I would think that the following may be of assistance in advancing guidelines as to how s. 18.6 should be applied. I do not intend the factors listed below to be exclusive or exhaustive but merely an initial attempt to provide guidance:

(a) The recognition of comity and cooperation between the courts of various jurisdictions are to be encouraged.

(b) Respect should be accorded to the overall thrust of foreign bankruptcy and insolvency legislation in any analysis, unless in substance generally it is so different from the bankruptcy and insolvency law of Canada or perhaps because the legal process that generates the foreign order diverges radically from the process here in Canada.

(c) All stakeholders are to be treated equitably, and to the extent reasonably possible, common or like stakeholders are to be treated equally, regardless of the jurisdiction in which they reside.

(d) The enterprise is to be permitted to implement a plan so as to reorganize as a global unit, especially where there is an established interdependence on a transnational basis of the enterprise and to the extent reasonably practicable, one jurisdiction should take charge of the principal administration of the enterprise's reorganization, where such principal type approach will facilitate a potential reorganization and which respects the claims of the stakeholders and does not inappropriately detract from the net benefits which may be available from alternative approaches.

(e) The role of the court and the extent of the jurisdiction it exercises will vary on a case by case basis and depend to a significant degree upon the court's nexus to that enterprise; in considering the appropriate level of its involvement, the court would consider:

    (i) the location of the debtor's principal operations, undertaking and assets;

    (ii) the location of the debtor's stakeholders;

(iii) the development of the law in each jurisdiction to address the specific problems of the debtor and the enterprise;

(iv) the substantive and procedural law which may be applied so that the aspect of undue prejudice may be analyzed;

(v) such other factors as may be appropriate in the instant circumstances.

(f) Where one jurisdiction has an ancillary role,

(i) the court in the ancillary jurisdiction should be provided with information on an ongoing basis and be kept apprised of developments in respect of that debtor's reorganizational efforts in the foreign jurisdiction;

(ii) stakeholders in the ancillary jurisdiction should be afforded appropriate access to the proceedings in the principal jurisdiction.

(g) As effective notice as is reasonably practicable in the circumstances should be given to all affected stakeholders, with an opportunity for such stakeholders to come back into the court to review the granted order with a view, if thought desirable, to rescind or vary the granted order or to obtain any other appropriate relief in the circumstances.

The stay has now been in place for over three years as the proceedings have been evolving to an anticipated practical solution in the U.S. – and interestingly enough there has been no challenge, objection or questioning of this order in the interim by any affected Canadian interested person using the "comeback clause". It would seem that this lack of further involvement may be taken as a practical approval by those concerned for a common sense solution to a cross-border problem which maximizes the potential for value and minimizes the difficulties of cost.

This has been a short and simplistic economic analysis to set the stage for the legal concerns involved in cross-border insolvencies. In essence, when things go wrong in a business enterprise, there are much more likely to be

implications in various countries, including Canada (and likely at least the U.S.). As Bruce Leonard and I observed in a paper to the Turnaround Management Association Conference in 2001 entitled *Co-ordinating Cross-Border Insolvency Cases*:

> **1. The Globalization of Business and the Globalization of Reorganizations and Restructurings**
>
> The tremendous advances in information technology within the last fifteen years have made it possible for businesses to operate in a variety of different countries at the same time and to link all of these operations as if they were right next door. A multinational business operating profitably and internationally can make decisions quickly that affect its global operations; it can allocate resources internationally in a manner which best suits its objectives and it can utilize its going-concern values to augment the value of its underlying operating assets on the basis that the whole is greater than the sum of its parts.
>
> The onset of an insolvency case, however, stops all that and turns the business into a series of disconnected segments in several different countries. In a typical international insolvency, different sets of creditors assert different kinds of claims to different assets under different rules in different countries. The international business that was once carried on comes to an end and separate, unconnected remnants of the organization attempt to continue until they either starve or implode. It is almost as if a cross-border insolvency system had been set up deliberately to *promote* failures and liquidations.
>
> The structural framework for dealing with multinational and cross-border businesses that encounter financial difficulties has hardly evolved from the state it was in several decades ago although our recent experience and developments that are on the horizon hold the promise of significant improvements and the prospect of the domestic adoption of the UNCITRAL [United Nations Commission on International Trade Law] Model Law is becoming more and more encouraging. There have been initial and limited domestic legislative initiatives into the area of co-operation in international insolvencies and restructurings but until the UNCITRAL Model Law is widely enacted, however, the legal structure internationally for enterprises in financial difficulty can best be described as

> compartmentalized. When insolvency or financial failure affects a multinational business, it is still most commonly dealt with through a variety of independent, separate and often-unconnected administrations, most often for different, if not conflicting, purposes.

For reason of simplicity, I will only refer to a two country Canada - U.S. model; however, in many instances there will have to be more than two countries involved – e.g. ranging from three, Canada, U.S. and England, in the *Olympia & York* insolvency to scores in BCCI (Bank of Commerce and Credit International) to over 150 in *Singer*.

What happens when things go awry in a business that operates and/or has investments on both sides of the border? Usually there will be filings on both sides of the border – Chapter 11 of the *U.S. Bankruptcy Code* and usually the *Companies' Creditors Arrangement Act* (CCAA) in Canada. If the activity in the U.S. is fairly derivative of what might be described as a main centre of activities in Canada, then likely, a s. 304 *U.S. Code* ancillary proceeding will be brought in the U.S. to stay proceedings there and coordinate them with the main Canadian proceedings. In the reverse situation, the s. 18.6 1997 amendments to the CCAA (or indeed Part XIII of the *Bankruptcy and Insolvency Act* (BIA)) may be utilized to the same effect. As a side note, historically and now, the U.S. is used to having a Chapter 11 stay respected essentially on a worldwide basis because so many foreign enterprises have U.S. investments or their principals travel to the U.S. In contrast many foreign enterprises may be willing to run the risk of ignoring a stay order emanating from a Canadian or other non-U.S. court on the basis of having no tangible connection with the country whose court has issued the stay. An example of this would be the seizure of *Canada 3000 Inc.* planes in Europe by creditors notwithstanding Ground J.'s CCAA order. In those types of circumstances, Canadian CCAA applicants would have to obtain foreign recognition of the Canadian order usually on a comity basis so as to allow for practical enforcement. That process may take some time – in which case as illustrated by *Canada 3000* - the horse will have been taken from the barn.

However, at present, it is not unusual for foreign-retained counsel to be waiting by the fax machine for a copy of the CCAA order so that they may obtain a recognition order within a few hours from the U.S. or other major trading partner court, with that recognition order having effect for the whole of the day of issue. Allow me to observe that the Courts of Canada and the U.S. are very cognizant of the doctrine of comity and further that the increased volume of proceedings traffic across the 49th parallel has resulted in that familiarity allowing for significant streamlining of applications.

Given that the insolvency condition is inherently chaotic, then most of the proceedings are manifestly "real time litigation". However, part of a case may evolve into what might be termed "autopsy litigation"; an example of this would be where there is no contention amongst any of the interested parties that a particular segment of the enterprise be disposed of with the result that it may be transferred to the new owner without dispute in exchange for value but that autopsy litigation may take place, say, a year later as to how that consideration is to be divided up. The important thing with real time litigation is not to get bogged down in procedural issues, but rather that coordination between the jurisdictions be coordinated to the maximum degree. The fundamental cornerstone of that coordination is to have effective and timely communication between the courts of the two (or more) jurisdictions. How is that to be accomplished?

Communication between courts – is that not a radical step? Are there no fundamental issues of procedural fairness involved? The answer is no to the first question and yes to the second, but that procedural fairness questions have been well addressed over the past decade. There has always been communication between courts – in the past this has usually been through one court issuing an order accompanied by reasons and the other court responding in kind with communications being through counsel in either jurisdiction. However, this is rather time consuming and it does not lend itself to brainstorming problems/solutions in real time.

The need for better, that is more efficient, communications was well illustrated by the *Maxwell Communications* case of the early 90s. The U.S. and English judges, Brozman and Hoffmann respectively, sensed that the information they were receiving in their respective courts was askew. They independently raised with their respective counsel that a protocol between the two courts would be helpful, not only to resolve an impasse, but also to facilitate better and more timely exchange of information. Interestingly enough with the protocol in place which provided for an intermediary, these two distinguished judges never spoke directly to each other until they met for the first time at an international insolvency conference shortly after the successful conclusion of the Maxwell case. Needless to say that they have become fast personal friends.

About the same time in the *Olympia & York* proceedings, there was a problem involving governance of the O&Y U.S. subsidiaries. Again a protocol was worked out and accepted by Chief Judge Lifland of the New York Bankruptcy Court and Justice Blair of the Ontario Court. It involved the introduction of another intermediary, the distinguished U.S. diplomat Cyrus Vance who was able to facilitate a *modus vivendi*.

The *Maxwell* and *O&Y* protocols were what might be described as single purpose limited in scope arrangements between the courts. With the appreciation that protocols could, if carefully thought out and responsive to each jurisdiction's needs, eliminate value evaporating wastage of time, practitioners in several countries including Canada thought that it would be helpful to provide an acceptable building block menu of principles to assist those involved in transborder insolvencies to finalize "general" protocols. The philosophy was that good fences / good bridges make good neighbours. Under the auspices of the International Bar Association, a working group of teams from more than a score of countries reviewed the commonalties of their insolvency regimes. This project involved major jurisdictions whose insolvency laws and procedures were based

upon common law, civil code and mixed or other principles. While English was the working language, there was recognition that the principles had to be expressed in absolutely neutral language readily translatable into other tongues and legal concepts, thereby avoiding any actual or perceived bias towards the common law. The threat of unintentional bias was quite real since the judiciary in common law jurisdictions, especially the U.S., England and Canada, had considerably more experience in international judicial cooperation and in this respect had generally utilized the common law philosophy that if something was not forbidden and it made sense to do it, then it was judicially permitted. Key also to the working group success was the participation of judges along with practitioners from the outset of the project. The IBA project culminated with that body's adoption in September 1995 of the principles under the title of "Concordat". The international insolvency community benefited not only from the availability of the Concordat principles, but also from the working sessions allowing the various persons involved to discuss the underlying concerns and commonalties, engage in give-and-take discussions based upon the experience gained in previous cases and to "get to know the other fellows".

Two months after the adoption of the Concordat, a new proceeding *Everfresh* came along. Bruce Leonard, a Toronto lawyer and part of the Canadian team, was involved in this case wherein Everfresh operated legally and functionally intertwined in both Canada and the U.S. By "coincidence", the case came before Judge Lifland and myself and both of us had also been involved in developing the Concordat. It should then be no surprise that the judges on either side of the border enthusiastically supported the concept of developing a more general protocol based on the Concordat principles. While other functional work was progressing, a protocol was developed in a few weeks by the practitioners. Based upon a general consensus of those involved, each court approved the protocol. Matters were proceeding more quickly in Canada than in the U.S. The protocol was then utilized to hold what was the first cross-border joint hearing so that the pace of proceedings on each side of the border could be coordinated.

The hearing was by way of conference telephone with counsel participating. Given the rather limited scope of the problem, the telephone facility did not constitute any particular problem. However, I would strongly recommend that if you are faced with having a joint hearing, it is preferable to conduct it through a videoconference facility to take advantage of what should be better two-way communication (speakerphones are generally one way) and the ability to "see" and react to the other side of the proceedings. Justice Forsyth of the Alberta Court and Judge McFeeley of the New Mexico Bankruptcy Court in the *Solv-X* case in 1996 persevered against significant technological difficulties in their telephone conference hearings. But beware – make certain your videoconference connection is workable a day or two in advance on a wet run (not dry run) basis.

After the *Everfresh* case finished (in about a half year), counsel on all sides were canvassed as to their satisfaction with the process. They estimated that as a result of the more timely and efficient dealing with matters, value was enhanced / preserved by a factor of some 40%. This was particularly significant when one appreciates that *Everfresh* was a fairly small insolvency involving some $50 million of value.

Other protocols followed in short order. These included ones outside the U.S. – Canadian ambit, including *Re Commodore Business Machines* (U.S. – Bahamas), *Re AIOC Corp.* (U.S. – Switzerland), and *Re Nakash* (U.S. – Israel), the latter two being of specific interest because they involved common law and civil code jurisdictions and Nakash interestingly enough had its protocol approved by the courts notwithstanding the objection of the most major party. You will be able to find an extensive list of protocols and their actual text by logging on to the website of the International Insolvency Institute (III): www.iiiglobal.org. The protocols have become more and more comprehensive – procedures have become streamlined, improved and standardized. Counsel should have no difficulty in any future case in developing a readily acceptable protocol tailored to the specific needs of their case based upon these templates. Judges will be able

to appreciate that the judiciary in other cases have been satisfied with the form, content and workability of these protocols. Indeed in many instances the very presence of a protocol has eliminated direct court involvement as the parties merely proceed smoothly according to the principles involved in the protocol. As discussed in the earlier mentioned Turnaround Management Association paper:

> Protocols are intended to reflect the harmonization of procedural rather than substantive issues between jurisdictions. Protocols typically deal with such items as co-ordination of court hearings in the two or more jurisdictions, co-ordination of procedures dealing with the financing or sale of assets, co-ordination in pursuing recoveries for the benefit of creditors generally, equality of treatment among the general body of unsecured creditors, co-ordination of claims filing processes and, ultimately, co-ordination and harmonization of plans in different jurisdictions. Procedurally, recent cases have tended to use Cross-Border Insolvency Protocols from the early stages of a case. Indeed in 2000, *Re Loewen Group Inc.* (Canada – U.S.), there was a protocol actually entered into as a "first day" order. Protocols, however, are invariably expressed to effective only upon their adoption and approval by each of the Courts involved in accordance with the local law and practice of each local jurisdiction.

There seem to be many threads which have been developing over the past decade, all with a view to making a suit to fit the requirements of international insolvency. Another example of this would be the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency. The Turnaround paper observed:

> UNCITRAL began a study of the feasibility of achieving higher levels of co-operation in the international insolvency area in April 1994, as a result of an international insolvency colloquium in Vienna sponsored with Insol International. The objective in developing the Model Law was to establish a set of uniform principles that would deal with the requirements which a foreign insolvency representative would need to meet in order to have access to the courts of other countries in cross-border cases. The Model Law Project, however, evolved into a much broader work and ultimately became an agreed-upon international model for domestic legislation dealing with cross-border insolvencies that could be adopted anywhere in the world with or without variations that would reflect the local domestic practices and

> procedures. The Official Text of the Model Law has now been published and widely disseminated and is available on UNCITRAL's web site at http://www.UNCITRAL.org and on the International Insolvency Institute web site at www.iiiglobal.org (at "Organizations - UNCITRAL").
>
> The primary goal of the Model Law is to facilitate domestic recognition of foreign insolvency proceedings and to increase international co-operation in multinational cases. Foreign insolvency proceedings are divided into two categories in the Model Law, i.e., "main" proceedings and "non-main" proceedings. A main proceeding is one which takes place in the country where the debtor has its main operations. If the foreign proceeding is recognized as a *main* proceeding, the Model Law provides for an automatic stay of proceedings by creditors against the debtor's assets and the suspension of the right to transfer, encumber or otherwise dispose of the debtor's assets. The scope and terms of the stay of proceedings are subject to the normal requirements of domestic law.
>
> The Model Law contemplates a high level of co-operation between courts in cross-border cases. Domestic courts are directed to co-operate "to the maximum extent possible" with foreign courts and foreign insolvency representatives in the Model Law: Article 26. The courts may communicate directly with each other and may request information or assistance directly from the foreign court or from the foreign insolvency representative: Article 25. Co-operation can, for example, consist of appointing someone to act on the direction of the court, communicating information by any means considered appropriate by the court and co-ordinating the administration of the debtor's assets and affairs in both jurisdictions: Article 27. The courts may also approve or implement agreements concerning the co-ordination of concurrent proceedings involving the same debtor: Article 30.

The UNCITRAL Model Law was being formulated at the time of Canada's 1997 amendments to the CCAA and BIA. Many of the significant concepts of the Model Law are therefore present in our present legislation, although not expressed in the language of the Model Law. The current review of our insolvency legislation will determine whether to keep the present form and incorporate the additional concepts by supplementary language or to delete the present form of s. 18.6 of the CCAA and Part XIII of the BIA, replacing that with the specific language of the Model Law, possibly with some amendment. While

Canadian courts prior to 1997 relied on their inherent jurisdiction and the principles of comity, specific authorization to engage in court to court communication is now found in s. 18.6(2) of the CCAA and s. 268(3) of the BIA.

Mexico, Eritrea, South Africa, Montenegro, Romania, Poland, the United Kingdom and Japan have passed legislation to enact the Model Law, in some cases with some modifications. Many features of the Model Law were incorporated into the Canadian CCAA and BIA in the 1997 amendments prior to the finalization of the Model Law; its complete adoption is being discussed as part of the ongoing periodic review of insolvency legislation in Canada. Unfortunately its adoption in the U.S. has stalled as a result of lobby pressure directed at another portion of the U.S. Code overhaul; proposed Chapter 15 of the Code which would enact the Model Law has been variously approved by both the Senate and the House of Representatives over the past several years.

The UNCITRAL Model Law is a procedural initiative. There is another UNCITRAL initiative to develop a menu of substantive law presently underway. It is anticipated that the working group will be able to finalize its work on this project (a menu of alternatives, with a review of considerations to be taken into account with each possible selection and observations on the harmonization of the constituent parts) either at this September's Vienna session or at the next session to take place within a half year. Developing countries will be able to tailor their insolvency regimes to fit their own requirements – an improvement over past initiatives where consultants from a developed jurisdiction would essentially recommend the adoption of the insolvency regime from the consultant's home jurisdiction – e.g. U.S. financial consultants invariably recommended that the post-Communist countries adopt what in essence was the *U.S. Bankruptcy Code*. In many of these instances, these countries have gone back to the drawing board after appreciating that such a wholesale incorporation of foreign law did not address their business, social and cultural requirements. (I have previously cautioned against wholesale adoption of provisions of the U.S.

Code concepts into Canadian jurisprudence given that the U.S. Code has evolved to meet specific U.S. conditions which may not be present in Canada.) In the remainder of those countries, problems continue on a limp along state. This is completely unsatisfactory, given that a workable insolvency law and regime is essential to a viable economy and especially necessary in order to attract foreign capital (loan and equity) on any reasonable basis, if at all! This Model Menu will allow developed countries to conduct a checkup on the efficiency and effectiveness of their present insolvency regimes and will therefore assist in recognizing the need for any change. The World Bank is also engaged in a complimentary program to upgrade the insolvency regimes in countries around the world.

There is a further initiative by INSOL International, an international organization comprised of insolvency practitioners with an emphasis on practitioners from the accounting and lending sectors. Aside from the biennial Judicial Colloquium sponsored jointly by INSOL and UNCITRAL (1994, 1995, 1997, 1999, 2001 & 2003), INSOL has developed an INSOL Lenders Group. This Group has developed a statement of principles for cooperation among financial institutions during multinational reorganizations. Maximization of value, preservation of viable enterprises and jobs and the avoidance of inefficient cratering have been the guidelines for the Statement Principles for a Global Approach to Multi-Creditor Workouts. Key to the underlying foundation is that the parties involved can negotiate “within the shadow of the law”; that is, that the insolvency regimes in the various countries be predictable with certainty and fairness so that negotiations can take place with a minimum of guesswork as to what would be the outcome if the courts were resorted to on any minor or major point along the way.

Additionally, there has been an American Law Institute (ALI) project on NAFTA Insolvency Law. The Restatement Paper of substantive laws of the U.S., Mexico and Canada was the first international program undertaken under the

supervision of this prestigious U.S. body with major international connections. Once that Paper had been completed and accepted, it was thought helpful to see if there could be agreement on procedural matters so that there could be harmonization and coordination of the insolvency proceedings in cases which involved more than one of the NAFTA jurisdictions. This aspect was completed by the tripartite country teams and accepted by the ALI in 2000. One of the most important elements of this was the preparation of Guidelines Applicable to Court Communications in Cross-Border Cases. These Guidelines were largely based upon examples of actual cross-border cases involving protocols. The Guidelines may also be accessed through the III website. As indicated in the Turnaround paper:

> The *Guidelines* recognize that one of the most essential elements of co-operation in cross-border cases is communication among the administrating authorities of the countries involved. Because of the importance of the courts in insolvency and reorganizational proceedings, it is essential that the supervising courts be able to coordinate their activities to assure the maximum available benefit for the stakeholders of financially troubled enterprises. (This summary is largely derived from Prof. L. Westbrook's very eloquent Introduction to the topic in the ALI's Transnational Insolvency Project *Statement*.)
>
> It is reasonable to expect that many jurisdictions, including most common law jurisdictions, have prohibitions against *ex parte* communications with a Court by one party to a proceeding in the absence of the party to the proceeding. In some jurisdictions, by contrast, the prohibition may be milder and may not even exist at all. Arrangements for court-to-court communications in cross-border cases must not promote or condone any contravention of domestic rules, procedures or ethics. The *Guidelines* in fact specifically mandate that local domestic rules, practices and ethics must be fully observed at all times.
>
> The *Guidelines* are intended to enhance coordination and harmonization of insolvency proceedings that involve more than one country through communications among the jurisdictions involved. Communications among courts in cross-border cases, however, is both more important and more sensitive than in domestic cases. The *Guidelines* are intended to encourage such communications and to permit rapid co-operation in a developing insolvency case while ensuring due process to all concerned. The concept of court-to-court

> communications is better seen as a linking of two concurrent court hearings, all conducted in accordance with proper systems and procedures. The only change form a purely domestic hearing is the technological link to the other Court.
>
> …
>
> The *Guidelines* are intended to be adopted following the appropriate notice to the parties and counsel as would be given under local procedures with regard to any important procedural decision under similar circumstances. If communication with other courts is urgently needed, the local procedures, including notice requirements, that are used in urgent or emergency situations would be employed, including, if appropriate, an initial period of effectiveness, followed by further consideration of the *Guidelines* at a later time. Questions about the parties entitled to such notice (for example, all parties or representative parties or representative counsel) and the nature of the court's consideration of any objections (for example, with or without a hearing) are governed by the Rules of Procedure in each jurisdiction and are not addressed in the *Guidelines*.
>
> One of the issues that a communication linkage may raise however, is the issue of whether the participation by a party in one country in arguments or submissions being made in the hearing in the other country constitutes a form of attornment to the jurisdiction of the other Court. The *Guidelines* attempt to anticipate that difficulty by indicating that such participation will not constitute an attornment to the jurisdiction of the other Court unless the party who participates in the hearing in the other Court is actually seeking relief from that Court. This is consistent with Article 10 of the UNCITRAL Model Law which indicates that an application by a foreign representative does not subject the foreign representative or the foreign assets or the affairs of the debtor to the jurisdiction of the domestic Court for any purpose other than the actual application.

These Guidelines have been incorporated into protocols – e.g. *Re Matlack Inc.*; *Re PSINet Limited*; *Re Systech Retail Systems Inc.*

The United States Third Circuit Court of Appeals in a 2002 decision *Stonington Partners v. Lernout & Hauspie Speech Products N.V.,* 310 F. 3d 118 (3rd Cir. 2002) had a number of very direct and pointed observations on the need for international cooperation between courts in cross-border cases. It indicated:

> We strongly recommend, in a situation such as this, that an actual dialogue occur or be attempted between the Courts of the different jurisdictions in an effort to reach an agreement as to how to proceed or, at the very least, an understanding as to the policy considerations underpinning salient aspects of the foreign laws…
>
> While we do not know whether the cooperation [in *Maxwell*] was initiated by the court or the parties, there is no reason that a court cannot do so, especially if the parties (whose incentives for doing so may not necessarily be as great) have not been able to make progress on their own.
>
> … we urge that, in a situation such as this, communication from one court to the other regarding cooperation or the drafting of a protocol could be advantageous to the orderly administration of justice.

I believe that the watchwords for any of the protocols and procedures to be tested is as follows: would the informed objective observer say that what was adopted by the Courts after receiving all submissions was fair and reasonable in the circumstances – and indeed, why has this not been adopted before as it is truly common sense.

When one looks back ten or twelve years, it is truly amazing what strides have been made in improving how to deal with cross-border insolvency cases. Waiting for the negotiation and adoption of international treaties was simply not feasible; by the time that would have happened, likely another century would have passed. I gave the following report on behalf of the 1997 UNCITRAL/INSOL Judicial Colloquium:

> Under the auspices of INSOL and UNCITRAL 50 judges from 30 different countries were involved in the Second Judicial Colloquium over the previous two days. The judicial regimes represented were common law, civil law, a combination thereof, and from other traditions besides these. It is not surprising that judges may vary in their approach to matters to reflect different concerns in different parts of the world. However, given that the judicial perspective is to ensure that justice is done in the cases before the court, it is also not surprising that, despite these differences, there is a general

consensus of thoughts on international judicial co-operation and communication. The Colloquium has allowed the judges to explore these matters and to appreciate that we have a common interest over a wide variety of subjects.

Of course, law cannot operate in isolation and insulation from the society and economy in which it is to function and regulate conduct and activities. The economy is not merely a domestic one, as it will be influenced by foreign trade and investment going both ways. Therefore, no country's legal system can operate without having regard for the activity of neighbouring states. Given the high degree of internationalism in trade and investment, the world has, in this respect, become a very small place; I believe we must regard each and every state as being neighbours.
…

Judges at the Colloquium were of the consensus that it was important to avoid these problems. This could be achieved not only through agreement to co-operate, but they were also of the view that, in essence, where there are concurrent proceedings it should be determined whether deferment to the other court on material issues more directly affecting that jurisdiction may be possible and with reciprocal treatment. We must, of course, recognize the sensitivity of the situation – countries will have concerns about the integrity of their jurisdiction, including substantive and procedural concerns. These must be accommodated and on a two or multiple way basis. In addition, there is the aspect that, through improved communication, there could be a timely exchange of valid information amongst the concerned courts. …
…

… INSOL and UNCITRAL will continue to hold a Judicial Colloquium, and INSOL will initiate a separate section for the judiciary to deal with these matters on a continuing basis between Colloquia.

How do the bar and insolvency practitioners fit into this equation?

1. The judiciary rely upon you as professionals – skilled practitioners in the field – to implement these proposals and generally to assist in these matters.

2. As a result of this initiative you will know what is expected of you and how to implement it through building on the Concordat and the UNCITRAL model law and other valuable initiatives from time to time. There will be the desirability of your taking the opportunity during the immediate stabilization period provided by stays to see whether using the Concordat and the draft

UNCITRAL model there can be harmonization between the various concurrent proceedings – both as to procedures and timing. This hopefully will lead to the timely and cost-effective development of a protocol to be entered into amongst affected parties and thereafter submitted for consideration and approval by the respective courts. Once you review the Concordat and the UNCITRAL draft you will see that there is a fertile field of possible steps to consider and adopt with suitable changes into a protocol. It is expected that you will be significantly advanced on the learning curve through the use of Concordat and UNCITRAL so that you will be able to "shortcut" the negotiating time required to table a protocol. It will be helpful to the parties concerned and the legal system generally to make every effort to effect this protocol harmonization.

3. The courts will rely on you to carry their message of co-operation and communication as expressed in formal orders and accompanying reasons to the other courts – reliably and faithfully.

4. In this regard we in the judiciary may need your assistance to ensure that where transcripts are not a regular feature of the domestic court a transcript to the extent desired by the judge can be made available forthwith. We will also need your assistance with respect to excellence of translation (not mere words but concepts – the opposite to legal research by computer which is based upon word identification and not concept analysis).

5. You will be expected to advise the local court of what procedures are taking place in other jurisdictions, and to maintain an update of that situation.

6. The courts will recognize the need for you to return to them to obtain appropriate relief from time to time, including adjustment of any initial order or orders which may have been deployed in the immediate emergency circumstances.

We, as judges, will rely upon counsel and insolvency practitioners to take the lead in providing the conduit for judicial co-operation and communication. We are confident that we can rely upon you as professionals to ensure that justice is done.

The key in this Colloquium is that the participating judges have reached consensus about being outward-looking – rather than inward-looking. International insolvencies are truly international; they are not local, with merely local solutions. We have progressed

> beyond national interests; we are now clearly looking at international concerns. As we approach the next millennium, we must not be looking backwards toward the nineteenth and early twentieth centuries; rather, we must be forward looking to solve our problems.

Cross-border insolvency matters between the U.S. and Canada have been dealt with smoothly and expeditiously between the courts of these two countries. Clients and their counsel have ably assisted in this regard. The end result is that both countries have benefitted. This cooperation has a firm foundation in the general law as discussed above.

Concluding Observations

It is important that the court system in any country be set up in such a way that the public and litigants have the utmost confidence in it. This is particularly important where there may be a high degree of foreign participation in the lawsuits. Needless to say the court system must be blind as to the nationality or domicile of a litigant (except as to security for costs concerns). Otherwise needed foreign investment will tend to dry up or become considerably more expensive, thereby depriving the domestic economy of the opportunity to fully develop its growth potential and deprive the society of the economic engine working to efficiency to fund social needs. In any event the courts should, in fact, must be independent of the rest of government, accountable according to publicly available criteria only in the same way that courts are in other parts of the world. Judges must be neutral and objective. Their remuneration and tenure of office must be sufficient to attract competent appointees. They must be and perceived to be beyond reproach. I know that all of you here take a particular and justifiable pride in this regard.

Allow me to conclude by observing that what I have been describing is the way by which courts and the practitioners have dealt with cross-border insolvency matters. However, the general principles and approaches involved

here are not restricted to the insolvency arena. Indeed, colleagues who have been engaged in class actions and other general litigation cross-border matters have begun to ask “Why not our sector?”, appreciating that there is a need for harmonization and coordination in their fields across provincial and national boundaries. Why not indeed!

James M. Farley

Prepared: October, 2003