

INSOL Europe Technical Series

Comparative and International Insolvency Law Central Themes and Thoughts

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12. *A Practical Approach to Court-to-Court Communication in International Insolvency  
Law*

James Farley

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## 12. A Practical Approach to Court-to-Court Communication in International Insolvency Law

James Farley

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The structural framework for dealing with multinational and cross-border businesses that encounter financial difficulties has not fully evolved from the state it was in several decades ago. 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 frequently for different, if not conflicting, purposes. However, recent experience and developments on the horizon hold the promise of significant improvements. There have been initial and limited domestic legislative initiatives into the area of cooperation in international insolvencies and restructurings, but more profoundly it is the adoption of the UNCITRAL Model Law along with the other cooperative initiatives outlined below that will free the international legal regime for insolvencies of their detrimental compartmentalization. The UNCITRAL Model Law also underlines the importance of communication and coordination.<sup>1</sup>

Consider the contrast in domestic terms, as if traditional international insolvency rules applied to a domestic business in financial difficulty. Suppose that the financially troubled business had operations in Toronto, Montreal, Calgary, St. John's and Vancouver instead of in England, France, China, Mexico and the United States. After a filing, the portions of the business in those Canadian cities would be run separately by different court-appointed officials. None of the courts involved would be obliged to recognize orders made by another court and there would be severe pressure from local creditors for local courts to ignore the proceedings in the other courts entirely. Legislation would typically prefer local creditors over others. Transactions between the different portions of the business would grind to a halt. Receivables would be collected in the jurisdiction of the account debtor and would not be released to any of the other courts or creditors. It is only relatively recently that the insolvency profession and the courts have been able to work toward a system that pays more attention to the interests of the stakeholders than to issues of the national sovereignty of the jurisdictions involved. Unlike many litigators, insolvency practitioners communicate with each other. A legal and economic regime must serve the needs of the people – not the other way around. Insolvency can be very chaotic. Preservation of the debtor's assets and maximizing value are important. Good will should also be considered (including intangibles such as a skilled workforce and distribution channels), as well as the public good (preservation of jobs, less social disruption, avoidance of wasting scarce resources, etc.). The old way was that creditors or lenders would add valuable input, i.e. add capital to debtor's company. Nowadays with the rise of multiple hedge funds, which don't have an economic interest in the debtor's activities, the approach is very different. If a business goes down, the creditors most probably will sell their claims to 'vulture' funds. Also, traditional securities are gone. After the introduction of credit derivative swaps, we are now facing the problem of the 'weakest link'. A creditor may have an interest in seeing the business fail, because then the creditor's insurance company will cover the risks. We see examples in case law as well. For example, recently in *Re Nortel*<sup>2</sup> capital was not raised when it was needed. Restructuring may take time, and if you run out of money before the actual restructuring is finished, then in fact you are already insolvent. Liquidity problems exist

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<sup>1</sup> See the website of the International Insolvency Institute, [www.iiglobal.org](http://www.iiglobal.org), for the text of the Model Law and the other initiatives referred to in this lecture.

<sup>2</sup> Case no 09-10138 (KG), Nortel Networks Inc, et al.

around the world, and in this market situation debtor-in-possession finance is almost impossible. Nortel may have to sell off a very important part of the company, as a restructuring may not be viable, but the market will most probably be a buyers' market.

Current and evolving protocols and judicial practices may be employed to assist in the revival and rehabilitation of otherwise viable global businesses in financial difficulty. There are means by which this increased level of cooperation can be achieved without in any way compromising or infringing upon the local domestic practices and procedures that exist in the courts involved. On the whole, significant stakeholder value can be preserved and maintained if communications between courts in multinational and cross-border cases are facilitated and enhanced.

The most logical and obvious solution to improving the current state of international cooperation in insolvencies and reorganizations would be a multinational treaty or convention to deal with insolvencies and reorganizations of multinational businesses. In practice, however, multinational treaties and conventions have proved exceptionally difficult to arrive at. There are very few functioning examples of international treaties on insolvency and reorganizations. Clearly, multinational conventions cannot be expected to be the primary means of achieving significant improvement in the international insolvency area.

Bilateral treaties between countries are another option. These are easier to negotiate but there are still very few examples of functioning bilateral treaties. The difficulty with bilateral or multinational treaties is that they become exercises in the negotiation of sovereign rights. Treaties or conventions on international insolvency and reorganizations really primarily represent the regulation of commercial interests in the event of a financial failure. As long as the negotiation of treaties remains in the realm of sovereignty and national interest, the road toward a successful conclusion of a treaty or convention will be hard to find and successful efforts will be few and far between.

In the absence of effective treaty or convention arrangements, the choice in a multinational or cross-border insolvency or reorganization primarily seems to be between a primary/secondary jurisdiction structure and a concurrent/parallel proceedings structure. In concept, a primary/secondary jurisdiction model would involve a filing in the primary jurisdiction where the debtor's central operations are located and subsequent secondary filings in jurisdictions where other assets are located. In the concurrent/parallel jurisdiction model, the reorganizing business would file full proceedings in both the jurisdiction where its central operations are located and in other jurisdictions where key assets are located. Recent experience has shown that some businesses opt to locate their offices in jurisdictions that are inconvenient for their creditors, thereby giving rise to an initial threshold issue in the proceedings as to which jurisdiction is the primary jurisdiction and which jurisdiction is the secondary jurisdiction. In addition, experience has shown that courts in all countries continue to be influenced by the interests of domestic creditors and that the courts of one jurisdiction are generally reluctant to yield authority or concede primacy to the courts of another. Consequently, administrations that appear to fall within the primary/secondary model may in fact be examples of the concurrent/parallel proceedings model.

The UNCITRAL Model Law provides a solution to the blockage encountered between the two primary legal systems that one generally comes across – the common law system on the one hand and civil code regimes on the other. Most simply put, the common law with its ingredient of general and inherent jurisdiction allows judges to do what justice and the law requires, but also what practicality dictates<sup>3</sup>. Gaps in the legislation may be

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<sup>3</sup> See: Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc. (1994), 114 D.L.R. (4th) 176, 27 C.B.R. (3d) 148 (Ont. Gen. Div.) in general and particularly at para. 22.

bridged where necessary. However, the tradition of the civil code is that the judiciary is only allowed to do what the code specifically allows. The UNCITRAL Model Law, if adopted, provides that the courts of the adopting country are instructed to communicate and cooperate with the courts of other countries. However it must be appreciated that a mere change in legislation will not likely be sufficient to break the habits of courts and practitioners who have been brought up in the ‘old regime.’

The Model Law contemplates a high level of cooperation between courts in cross-border cases. Domestic courts are directed to cooperate ‘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. Cooperation 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 coordinating the administration of the debtor’s assets and affairs in both jurisdictions: Article 27. The courts may also approve or implement agreements concerning the coordination of concurrent proceedings involving the same debtor: Article 30.

It is clear, however, that courts in different countries are indeed capable of cooperating with each other and coordinating their administrations in the case of a cross-border or multinational reorganization or insolvency. The key to this increased willingness to cooperate and coordinate may well lie in the experience gained from cross-border insolvency protocols that have been negotiated in recent cases. Many of these protocols have been inspired by the International Bar Association’s Cross-Border Insolvency Concordat or the American Law Institute’s Guidelines for Court-to-Court Communications in Cross-Border Cases.

Recent international experience with concurrent proceedings shows that orderly administrations of portions of business entities in different countries can be successfully carried out. The concurrent proceedings’ model recognizes the reality of a situation in which the courts of one jurisdiction are reluctant to yield their jurisdiction to the courts of another but wish to coordinate their administrations. By working concurrently but also in concert, administrations in more than one country can be carried out in a harmonized fashion that will be to the benefit of all of the stakeholders involved in the process. In case of a legal procedure, in a common law superior court, a joint hearing may be held when it is functionally necessary, even when this is not provided by law. Judges in civil code jurisdictions have a different approach. If the civil code does not allow it, they will not be easily inclined to do something, although it may be practical in that situation. Common law judges have much more flexibility. In civil code jurisdictions, judges tend to be less involved on a continuing basis in cases than common law judges; in that respect the role of the insolvency administrator takes on a greater importance in ensuring that the desired coordination takes place.

The insolvency profession around the world has fostered the development of practices and procedures to coordinate and harmonize international insolvency and restructuring proceedings. Because of the continuing absence of insolvency treaties and conventions, progress in the international insolvency area is highly dependent on the efforts of the insolvency community to develop structures and solutions to cross-border and multinational financial problems. Cooperation among nations in cross-border insolvency cases has been steadily increasing.<sup>4</sup>

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<sup>4</sup> An extensive list of protocols and their texts can be found on the website of the International Insolvency Institute at [www.iiiglobal.org](http://www.iiiglobal.org).

The first major modern protocol was developed in *Maxwell Communication*, which had administrations in both the United States and England. Courts in Canada and the US developed a more modest protocol in *Re Olympia & York Developments Limited*, which involved governance of O&Y's US subsidiaries. The *Maxwell* and *O&Y* Protocols were what might be described as single-purpose arrangements between the courts, which had a limited scope. Once it became accepted that protocols could prevent the wasting of time, practitioners in several countries, including Canada, considered that it would be helpful to draft a list of principles to assist those involved in cross-border insolvencies to finalize 'general' protocols. This gave rise to the IBA's Concordat in 1995. The *Everfresh* case that year utilized a protocol that was endorsed by the courts in the US and Canada (the two judges involved had been part of the Concordat task force). A joint hearing was held by conference telephone, with counsel participating. Given the rather limited scope of the matters dealt with, a telephone conference was an effective form of communication for the case. However, I would strongly recommend that generally a joint hearing be conducted through a videoconference facility, which provides an ability to 'see' and react to the other side of the proceedings. In 2004, courts in the US and UK also approved the first UK-US court-to-court communications protocol.

Protocols have become more and more comprehensive, and procedures have been streamlined, improved and standardized. Counsel should have no difficulty 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 has 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 proceeded smoothly according to the principles involved in the protocol.

There is no prescribed format for a typical cross-border insolvency protocol. Protocols are intended to address the issues that are important to the actual case before the courts and these issues will vary from case to case. It must be remembered that protocols are intended to reflect the harmonization of procedural, rather than substantive, issues between jurisdictions. Special attention must be given to the treatment of foreign creditors so that they are not unduly disadvantaged. Protocols typically deal with coordination of:

1. court hearings in the two or more jurisdictions,
2. which court will determine particular issues,
3. what national law applies to the determination of specified disputes,
4. interim support financing and charge priority,
5. where various assets are to be administered,
6. procedures dealing with the financing or sale of assets,
7. recoveries for the benefit of creditors in general and equality of treatment among the general body of unsecured creditors,
8. claims filing processes including language of filing, and,
9. ultimately, plans in different jurisdictions.

In recent instances, cross-border insolvency protocols have been adopted in the early stages of a case; indeed many draft protocols are submitted to the courts upon the initiation of the insolvency proceedings. Protocols, however, are invariably expressed to be effective only upon their adoption and approval by each of the courts involved in accordance with the law and practice of each local jurisdiction.<sup>5</sup> It should also be noted

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<sup>5</sup> It is important to note that protocols may be functionally effective even if a court 'declines' to approve some of them, whether or not the draft has been presented to the court for approval. For instance, a court (usually in a civil code jurisdiction) may only 'take note' informally of the protocol but accept the principles in practice. Additionally it may be that the protocol does not directly involve the courts, but rather the representatives of the insolvent estate in the various jurisdictions, which may be more commonplace in civil code jurisdictions.

that, as a case progresses, additional supplementary or separate protocols may prove useful. Cross-border insolvency filings these days have, however, been characterized by a high degree of respect by the courts of each country for one another. The use of cross-border insolvency protocols has been a major step forward in the progress toward ever-increasing levels of international cooperation in cross-border and multinational insolvencies.

Many jurisdictions, including most common law jurisdictions, have prohibitions against communications by one party to the court in the absence of the other party. In some jurisdictions, by contrast, the prohibition may be milder or 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. At least in common law jurisdictions, the role of the judge includes the added responsibility of supervising the proceeding to see to it that a viable restructuring is not derailed by any purely selfish tactic. The Guidelines for Court-to-Court Communications in Cross-Border Cases<sup>6</sup> 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 amongst the jurisdictions involved. Communication amongst courts in cross-border cases is both more important and more sensitive than in domestic cases. The Guidelines are intended to encourage such communications and to permit rapid cooperation in a developing insolvency case, while ensuring due process to all concerned. The concept of court-to-court communications is best seen as a linking of two concurrent court hearings, all conducted in accordance with proper systems and procedures. The only change from a purely domestic hearing is the technological link to the other court, while allowing submissions to be made to the other court without attornment for any other purpose.

The Guidelines are intended to be adopted following the appropriate notice to the parties and counsel, as would be given in 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<sup>7</sup> and the nature of the court's consideration of any objections<sup>8</sup> are governed by local rules of procedure and are not addressed in the Guidelines.

One of the issues that may arise is whether a party's participation in arguments or submissions being made in a hearing in the other country constitutes an attornment to the jurisdiction of the other court. The Guidelines attempt to anticipate this difficulty by indicating that such participation will not constitute an attornment to the jurisdiction of the other court unless the party that 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

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<sup>6</sup> The Guidelines were reviewed by the reporters and advisors in each of the three NAFTA countries and approved by the membership of the American Law Institute at its Annual Meeting. The Guidelines are, in fact, largely based on examples from actual cross-border cases involving cross-border insolvency protocols. The Guidelines recognize that one of the essential elements of cooperation in cross-border cases is communication among the administering authorities of the countries involved.

<sup>7</sup> For example, all parties or representative parties or representative counsel.

<sup>8</sup> For example, with or without a hearing.

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.

In actual practice, court orders made in cross-border cases usually indicate that any informal participation in the proceedings in the foreign court does not constitute an attornment. It is also true, moreover, that a party in one jurisdiction would have to be represented by counsel admitted to the bar of the other jurisdiction in order to even receive an audience from that court. In practice, therefore, a properly prepared joint court hearing need not unnecessarily or unexpectedly expose a party in one country to the risk of attornment to the jurisdiction of the other court.

The Guidelines are not meant to be static, but are intended to be adapted and modified to fit the circumstances of individual cases and to change and evolve as the international insolvency community gains experience from working with them. They are intended to apply only in a manner that is consistent with local procedures and local ethical requirements. They do not address the details of notice and procedure that depend upon the law and practice in each jurisdiction.

The preference regarding insolvency communications is that these are conducted by way of video conference. Most insolvency matters involve numerous parties; it is difficult to regulate an audio conference, particularly if it is done on a conference call basis, so that submissions are made in an orderly fashion with an appreciation of who is speaking. However, an audio conference may well be a better vehicle if the scope of the proceeding is routine or not complex; it is certainly easier to organize. Conducting communication with different time zones can be inconvenient but one must appreciate that no two places in the world have more than a 12 hour time difference whereas a good night's sleep is 8 hours, leaving 16 hours available. Language differences may present some difficulty. It is ideal if the judges (and other participants) are comfortable in a common language. However, it is unrealistic to expect that this will happen in every case; indeed, it may be the exception. Therefore it may be necessary to engage the services of a skilled interpreter. One should be mindful of 'faux amis', though, as the same word may have different meanings in the two legal regimes. Care should be taken to ensure that there is a common understanding as to the meaning of technical words or concepts. In insolvency matters, the courts have used specific-for-the-purpose officers of the court. The *Maxwell Communication* appointment is a specific example. Conceivably, if a court would not feel comfortable with a live communication because of language or other difficulties, it may be possible to accomplish the objective by using a similar officer appointment.

It is possible that in a judicial communication a judge may be asked to advise on that judge's domestic law. In that regard the judge would be akin to an expert. I would think it helpful that such advice is usually given by a judge not involved in the following substantive decision making. In any event, it would seem appropriate for the substantive decision-making judge to advise the parties that such 'expert' evidence has been received, giving the details of this evidence. This should then be followed by the proposition of whether the parties accept this evidence as correct or take issue with it, with them being offered the opportunity to produce their own expert witness in that regard, who could be cross-examined.

In looking back twenty years, the strides that have been made in improving coordination and cooperation in cross-border insolvency cases are truly amazing. Waiting for the negotiation and adoption of international treaties was simply not feasible; most likely, another century would have passed. I would like to note that the courts are there to serve the public and do justice. Principle and pragmatism should be coordinated. We should not be reluctant to use new methods to achieve this, albeit that we should be cautious to ensure that no one is truly prejudiced in the outcome of the case. Although it is always

unwise to generalize, it would seem that the courts in the major trading countries, on the whole, are demonstrating an increased willingness to cooperate with each other and to coordinate activities to secure commercially-oriented results in international restructurings and insolvencies. The protocols that were approved in the *Everfresh*,<sup>9</sup> *Maxwell Communication*,<sup>10</sup> *Olympia & York*<sup>11</sup> and *Nakash*<sup>12</sup> insolvencies are fine early examples of international cooperation between courts, and they are examples that will, almost certainly, be built upon by the courts in future multinational insolvencies. For example, it is interesting that the 2009 draft protocol developed in the *Lehman Brothers* case relied heavily upon the protocol used in *Everfresh*.

The courts seem more and more prepared to work toward a framework that encourages coordination and cooperation between jurisdictions in multinational cases. They simply need the active and innovative participation of the insolvency community to create structures that are conducive to increasing cross-border coordination in multinational cases. Nonetheless, there are still cases where particular courts overlook trends in international coordination. As such, the trend toward greater international cooperation should not be taken for granted.

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<sup>9</sup> See B. Leonard, Committee J's Initiatives in Cross-Border Insolvencies and Reorganisations: The Experience of the Everfresh Case, in: International Insolvency Review 1997, 127.

<sup>10</sup> Maxwell Communications Corp., Re [1992] BCLC 465 160.

<sup>11</sup> Re Olympia & York Developments Ltd. v Royal Trust Co (1993), 20 C.B.R. (3d) 165.

<sup>12</sup> Nakash (US-Israel 1996) published in ZIP 1998, 1013.