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Model Law draftsman responds to COMI proposals

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By Ben Clarke

Responding to a letter urging UNCITRAL to abolish the concept of centre of main interests (COMI), one of the architects of the Model Law on Cross-Border Insolvency has warned that changing the eligibility requirement for recognition will not eliminate the possibility of litigation by opportunistic opponents.

Goodwin of counsel **Dan Glosband**, one of the drafters of the Model Law, tells GRR in a "preliminary" response to the proposals that UNCITRAL made the decision to adopt COMI and establishment requirements for recognition as a counterweight against “unbridled and potentially detrimental” forum shopping.

“In the delegates’ consensus view, a debtor’s proceeding should be in a place where the debtor has an established economic presence so it cannot avoid its responsibilities to stakeholders by absconding to a hypothetical debtor-friendly forum,” Glosband says.

His comments come after University of Chicago professor **Anthony Casey**, Singapore Management University professor **Aurelio Gurrea-Martinez** and USC Gould School of Law professor **Robert Rasmussen** **sent a letter** to UNCITRAL on 14 September arguing that the use of a debtor’s COMI to determine the place where a foreign main proceeding should take place is a “major flaw”.

They said the current policy discourages the initiation of insolvency proceedings in jurisdictions that can provide a more desirable outcome for debtors and creditors.

Instead of using a debtor's COMI, which is presumed to be the place where it has its registered office, the professors said UNCITRAL should adopt an alternative approach to allow debtors to choose their preferred insolvency forum in their incorporation documents.

They said the concept of COMI is "far from clear" in an increasingly global, internationally connected and technology-driven world. "Indeed, many companies nowadays have assets, creditors, subsidiaries, offices, employees and clients in many jurisdictions," they said. "In this context, determining the debtor's COMI is not an easy task."

But Glosband says the **letter** theorises problems that are "rarely encountered" in the types of situations that involve market participants, who he says appear to be the focus of the professors' concern.

"In the real world, COMI is neither disputed nor difficult to determine in the vast bulk of chapter 15 cases," Glosband tells GRR, referring to the law through which the US adopted the Model Law.

But Chicago-Kent college of law professor **Adrian Walters** says the proposal makes "considerable sense" from the perspective of sophisticated parties in restructurings.

"COMI was always an awkward fudge between incorporation theory (hence the registered office presumption) and the notion of a corporation's real seat," he says. "[S]ophisticated parties have been able to exploit the awkwardness either by trying to fix the COMI ex ante through devices such as COMI covenants or by shifting the COMI to a suitable venue for restructuring – with all the cost that this entails."

Debtor-friendly regimes?

Texas-based Akerman special counsel **Adam Swick** agrees with Glosband. "If you change the COMI standard – as the letter points out – you are inviting venue choosing to the jurisdiction with the most debtor-friendly laws, which could ultimately be harmful to creditors – a main constituent that bankruptcy laws are there to protect," he tells GRR.

Swick says the ability to pick a jurisdiction based on efficient and economic reasons could be beneficial but suggests such a system could lead companies to pick overly debtor-friendly regimes. "What's to prevent a small country from enacting amazing and unfair debtor-friendly laws that can be taken advantage of?" he says.

To protect against debtor's opportunistic behaviour, Casey, Gurrea-Martinez and Rasmussen suggested in their letter that UNCITRAL could adopt a series of safeguards, including by giving vulnerable creditors priority status that could be preserved regardless of the insolvency forum choice.

To prevent debtors changing the insolvency forum once they have obtained credit, the professors said debtors could also be required to provide notice and to obtain approval from creditors.

Debtors should not be incentivised to choose an insolvency forum that is not attractive to sophisticated lenders, they said, otherwise debtors would be exposed to higher costs of debt.

"Professors Casey, Gurrea-Martinez, and Rasmussen have developed carefully thought-out responses to the standard objections to contract bankruptcy regimes and are wise to include substantive safeguards for vulnerable creditors such as employees and tort claimants," says Walters.

"My lingering concern in cases where distress does reach down as far as operations and impacts vulnerable creditors is what I call procedural remoteness," Walters tells GRR.

“Substantive protection in a far-off venue is one thing,” he says. “A global forum in which parties can actively participate in the vindication of their claims and that assures procedural justice for all is quite another.”

Walters says technology could potentially be used to overcome some issues including time zones and language barriers. “Perhaps local courts have a role to play as adjuncts to the global forum in addressing this question,” he adds.

But Swick argues the safeguards seem more complicated to implement and enforce than the current system. He tells GRR that large, secured lenders could mandate borrowers to choose the most secured creditor-friendly jurisdiction for insolvency. “Different jurisdictions prefer different classes of creditors,” Swick says. “Obviously, a debtor with a large class protected in one jurisdiction would pick a different one to file in.”

Glosband claims COMI is not in issue in most cases. “In many cases where it is put at issue, it is because of tactical use by a distressed investor or other party whose hostility to the debtor is wholly self-interested,” he says. “Changing the eligibility requirement for recognition under the Model Law will not eliminate the possibility of litigation by an opportunistic opponent.”

“Our bankruptcy judges do an excellent job of ensuring the legitimacy of the foreign proceeding as a recognition requirement and changing eligibility standard from the current COMI/establishment economic presence test may change the appearance of things but will not likely change the substance.”

Miami-based Sequor Law shareholder and former IWIRC chair **Leyza Blanco** also notes the letter does not mention a resolution for COMI issues arising from the cross-border cases of individuals, who have no “constitution” document in which to identify a preferred insolvency forum.

Proposals are "worth the discussion"

In the letter - which has been endorsed by several insolvency lawyers and scholars around the globe, including INSOL president Scott Atkins and former INSOL Preisdent **Sumant Batra** - Casey, Gurrea-Martinez and Rasmussen offer a "second-best" proposal if UNCITRAL decides to keep COMI, which would see debtors allowed to initiate insolvency proceedings in any viable jurisdiction that permits the initiation of insolvency proceedings by foreign companies.

They argue that the Model Law should consider the jurisdiction where the insolvency proceeding is initiated as "functionally equivalent" to the debtor's COMI, provided the debtor can show the place of filing is beneficial to creditors as a whole.

Blanco says the proposal is "certainly worth the discussion" but requiring debtors to show a location is beneficial to creditors as a whole may be too subjective and lead to more litigation.

"It could pit certain creditors against others, including certain creditors who may not be similarly situated, such as secured, priority and unsecured creditors," she says.

"How is a court to decide when the debtor says it thinks one forum is beneficial to all creditors and the differently situated creditors each have a different favorite jurisdiction for different reasons?" Blanco says, adding that the location of a debtor's COMI or its main proceeding dictates the rules and priority of payments in many cases.

Glosband thinks the current approach of the courts, at least in the US, is similar to the "second-best" proposal proffered by Casey, Gurrea-Martinez and Rasmussen

After the Model Law was enacted in the US, he says the early cases of *Bear Stearns* and *Basis Yield Fund* exposed a conflict he had not foreseen between

British-tradition countries that anticipate insolvency proceedings in the country of incorporation regardless of economic presence, and the Model Law with its requirement for an economic presence.

Glosband says US courts have navigated the conflict by adopting the position that COMI can become lodged in the country of the foreign proceeding when the proceeding becomes the primary activity of the debtor, most recently highlighted in the “aggressive example” of Chinese real estate company Modern Land, which **restructured** via a Cayman scheme.

Model Law purists think the “lodging” approach improperly evades the legitimacy goal of the economic presence requirement, Glosband says, but he argues US caselaw, including the Second Circuit decision in *Fairfield Sentry* establishing the Chapter 15 petition date as the time to measure COMI, suggest there was no improper manipulation or abuse.

“The important thing is that there be an informed judicial determination that no improper manipulation occurred that would be harmful to creditors,” Glosband tells GRR.

"I am not an academic and I give kudos for our esteemed academic colleagues for initiating this discussion," adds Blanco. "It would be great to see where it lands."