The Russians Are Coming, the Russians Are Coming: Cross Border Bankruptcy Before Chapter 15 and Beyond, The Strange Case of Yukos Oil

Roxane DeLaurell, Ph.D., J.D., LL.M.
College of Charleston

INTRODUCTION

On March 6, 2008, a local District Court in Amsterdam awarded the shareholders of the insolvent and defunct former Russian conglomerate, Yukos Oil,

over 850 million United States dollars (€424 million) in repayment of a loan made to the debtor prior to the institution of any of the corporation's various proceedings towards dissolution. After years of court battles and political intrigue—including a hastily-arranged meeting between Presidents George Bush and Vladimir Putin in late 2005—the winding up of Yukos seemed at hand.

Of course, a clear demonstration of the breadth of Yukos' troubled history and a contra-indicator that this was the end of the story could, at the time of the Dutch court's decision in 2008, be found languishing in a Russian prison where that government held one of the company's largest shareholders in custody for tax evasion; the same charges which had precipitated Yukos' abortive filing for bankruptcy protection in the United States three years previously. The same facts also serve as conclusory evidence of the contentious nature of international bankruptcy as it implicates far-reaching and conflicting interests.

It is precisely this type of confusion of process and resulting uncertainty of the international business environment that international legal regimes are intended to alleviate. In keeping with this desired outcome in 2005 the United States Congress not only revised and amended the United States Bankruptcy Code ("Bankruptcy Code" or "Code") with regard to domestic filings, but also adopted a new chapter— Chapter 15—which addresses cross-border insolvency specifically, and is supposed to harmonize the actions of United States Bankruptcy Courts with those of courts in other parts of the world, especially Europe.[1]

While the March 2008 ruling in the Netherlands was final, it was only the latest in a string of "final" dispositions of the Yukos case and, as a result, it would be unwise to suppose that it is the last (even though the company itself ceased to exist over 3 years ago). Come what may, this article and author only seek to present here an analysis of the Yukos insolvency as it came before a United States court in 2005, and the manner in which that court's ruling may relate to future implementations of Chapter 15 as the latter becomes law and is interpreted by United States bankruptcy courts.

The case of Yukos' insolvency proceeding in the United States is pertinent in this regard for several reasons: (1) The company sought protection in the United States courts in December of 2005, just at the time when United States law was changing; (2) Yukos was an international concern with decidedly nationalistic roots,

[1] 11 U.S.C. §§ 1501-1532.

and (3) the company was so large that it could arguably qualify as a corporate citizen under just about any legal regime in the developed world all at the same time. Since this last factor—that of jurisdiction—is a fundamental aspect of any legal analysis and forms a large part of eligibility to seek protection from creditors in bankruptcy under United States law, the case study will begin there.

This article will set out in Part 1 the Yukos problem of globalized bankruptcy and the status of cross border filings in the United States. Part II will discuss the jurisdictional issues presented in cross border bankruptcy cases, highlighting the peppercorn problem and its application and will summarize the 2005 reforms as they apply to cross border cases. Part III will return to *Yukos* and discuss the problems of parallel proceedings and international rules of sovereignty avoided by the Texas bankruptcy court in issuing its opinion along with discussion of the decision itself. Part IV will explore the implications of the decision in light of the reforms and conclude that the opinion of the Texas bankruptcy court would likely have been the same under new law analysis although the unique governmental nature of the debtor may have played a role in the decision. It is hoped that this article will contribute to the body of research which explores the efficacy of the international rule of law gained by negotiation and consensus.

PARTI

I. Insolvency in a Globalized Business Environment

The decision of the Dutch court mentioned above was in affirmation of an earlier arbitration court ruling in London.[2] Rosneft, the Russian government-owned successor to Yukos, had asserted a prior claim to the funds in question and, as noted, both courts English and Dutch, found against the corporate claimant and sided with investors. Those investors had argued that the dissolution of Yukos had been nothing more than an expropriation of the company by the Russian government and not motivated by any financial incapacity on the part of the corporation.[3]

The difficulties faced by the Dutch court seeking to resolve the Yukos matter more and for all are in keeping with the oft-repeated coda of the 21st century: globalization of markets and capital is rapidly increasing. Indeed, going back to its roots, the very existence of Yukos as a market-driven, privately owned corporation founded in the former Soviet Union could easily be held as proof positive of the inevitable march of globalization.

2 Yukos shareholders even attempted a Sec. 10b-5 claim under United States securities laws, arguing that the actions of the Russian government reduced their share values. The court dismissed the claim predominantly on the Act of State Doctrine but commented on plaintiffs failure to prove sufficient conduct in the United States to meet the "control test." In re Yukos Sec. Lit., 2006 U.S. LEXIS 78067 (2006).

[3] Danny Fortson, *Dutch court ruling awards jailed Yukos investor a share of $850m* , INDEP., Mar. 27, 2008, at 40; Anatoly Medetsky, *$850 million Released to Yukos Shareholders*, MOSCOW TIMES, Mar. 27, 2008, at 30.

Here was a corporation owned in part by a nation that had not only not known the benefits of a free market for most of the 20th century, but had in fact philosophically rejected same. With the fall of one party rule however, Russia was now embracing free market philosophy as presented to it by nations it had previously considered, at the very least, economically hostile. Add to this the contemporaneous introduction of free market principles into the economies of the People's Republic of China, as well as India and Brazil, and the gathering nature of globalization in the 21st century was undeniable.

Thus, with regard to Yukos' status prior to any insolvency proceeding, as with all similarly situated corporations, as long as it was managed to the best interests of its shareholders and turned a respectable profit, "legal problems" consisted mainly of external factors such as regulatory issues. This, of course, is usually the case: when times are good the law surrounding parties is the most easily recognized, while the legal relations between them remain more or less invisible. It is only when conflict arises—with regard to the terms of a will, or claims to a bankrupt's estate—that "legal problems" also begin to arise between parties. Indeed, when the health of a business, in particular, takes a turn for the worse, legal problems are suddenly transformed into questions of the value of assets, the priority of claims of indebtedness, and—where multinational concerns are involved—matters of jurisdiction.

II. Cross-Border Petitions Under United States Bankruptcy Law

While the United States Code, as revised by Congress in 2005, has become most notorious for increasing the difficulty faced by individuals seeking protection under Chapter 7—mainly through its adoption of means-testing—access for troubled businesses to Chapters 7 and 11 remained unchanged. As a result, the importance of jurisdiction of the Code's provisions over a would-be debtor corporation and the assets of its estate—the question of eligibility to file in United States bankruptcy court—as a threshold matter, has actually been magnified in importance. This is because, the "second hurdle" of means-testing does not serve to bar any corporate entity that has met minimum eligibility in the same way that it could a natural person filing for protection in the United States courts.

Where debtors are domiciled in the same jurisdiction as all of their assets and seek to file under the laws of that jurisdiction, the question of eligibility is generally moot. However, eligibility is likely to be much more problematic for courts to determine where would-be debtors maintain legal or financial contacts in several, disparate jurisdictions and may hold substantial assets in each of those. Determining eligibility in these latter cases—cases of "cross-border insolvency — however, is particularly important under the United States Bankruptcy Code' because it intersects with questions of authority of the court s orders, powers of the trustee, and—perhaps the most important aspect of the United States bankruptcy

[4] FRANK I. FLETCHER, INSOLVENCY IN PRIVATE INTERNATIONAL LAW 6 (1999).

[5] 11 U.S.C. §§ 101-1532.

court's jurisdiction—the imposition of the § 362 "automatic stay" against action to collect debts outside of the recognized bankruptcy process.

PART II

I. Reforms of 2005

Up until very recently, the Code gave somewhat limited treatment to the issues of eligibility for multi-nationals and to the conduct of cross-border cases in general. Determinations of eligibility as a debtor under the Code, regardless of nationality or domicile, have been (and in purely domestic cases continue to be) controlled entirely by the terms of § 109. Similarly, § 304 was the sole provision of the Code the main thrust of which addressed procedures and issues concerning bankruptcies involving international interests.[6]

As with domestic, individual insolvencies, bankruptcy proceedings that involve multi-national entities have recently become both more complex and more common, raising questions about the need for more efficient administration of such cases. Consequently, Chapter 15—representing a somewhat modified version of the United Nations Commission on International Trade Law's ("UNCITRAL") draft legislation entitled, "Model Law on Cross-Border Insolvency"[8]—was added to the Code as a means of bringing more focus and emphasis to the law's treatment of this rapidly developing area in international commerce.

As might be imagined, eligibility and jurisdiction as defined by the Code in §§ 109 and 304, have, in the past, been the primary confounds to efficient administration of insolvency cases involving multi-national entities. These issues manifested in two separate, but closely related problem areas: (1) the eligibility of otherwise foreign entities as debtors under the United States code, and (2) the extraterritorial legitimacy and authority of United States bankruptcy court orders.

II. Eligibility. § 109, and the "Peppercorn" Problem

Eligibility of otherwise foreign persons and legal entities to be debtors under the Code is an issue primarily because it has become increasingly evident that the United States Code, in many cases, provides somewhat more substantial protections for debtors than do the bankruptcy regimes of other jurisdictions.[9] The United States

6 Section 304 has been repealed from the Code, but § 109 has not and remains the law.

7 Lesley Salafia, Note and Comment, *Cross-Border Insolvency Law in the United States and Its Application to Multinational Corporate Groups*, 21 CONN. J. INT'L L. 297 (Spring 2006). Peter J.Murphy, *Why Won't the Leaders Lead? The Need for National Governments to Replace Academics and Practitioners in the Effort to Reform the Muddled World of International Insolvency*, 34 U. MIAMI INTER- Am. L. REV. 121, 121 -22 (Winter 2002); Paul.E. Garzon, *International Creditors ' Rights and Bankruptcy*, 33 INT'L LAW. 379, 379 (1999).

8 U.N. GAOR, 52"[1] Sess., Supp. No. 17, U.N. Doc. A/52/17/Annex I (1977), archived at http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html).

9 Marc Solomon. *Foreign Companies and Affiliates Under § 109: The Benefits and Risks of "Manufactured" Eligibility*, 23 AM. Bankr. INST. J. 26, 27 (2004); Rafael La Porta et al., *Law and Finance*, 106 J. OF POL. ECONOMY 1113, 1155 (1998).

Code not only provides for discharge of indebtedness, but may also offer protection from taxing authorities, as well as the ultimate carrot of reorganization, an option not widely available in other national court systems.[10] In some cases, these aspects of the Code provide such great advantage to debtors when compared with the insolvency regimes of other nations that filing for bankruptcy in the United States has come to be looked upon as something of a viable business strategy on the part of multi-nationals and their counsel.[11] Prior to the adoption of the UNCITRAL Model Law as Chapter 15, bankruptcy courts in the United States applied the terms of § 109 as the sole means of determining any debtor's eligibility to seek the protections of the bankruptcy code. Thus, maintaining or creating eligibility to file as a matter of satisfying the letter of § 109 was the cornerstone of any strategic attempt to use the United States Code by multi-nationals and their investors before 2005.

While § 109 seems relatively clear as a controlling provision with regard to eligibility of wholly domestic debtors, in the international context it proved less than discriminating. The problem was that under the terms of § 109 the standard for measuring "minimum contacts"—whereby a debtor with international holdings might assert inclusion under the Code as a matter of voluntarily declaring bankruptcy—had become so over-broad as to be fairly meaningless for all practical purposes. The wording of § 109, by itself, offered almost no means to exclude otherwise foreign interests from seeking protection under the Code, even in the face of clear evidence that the United States would not, under any other circumstances, qualify as such debtors' "home" jurisdiction.

The pertinent subsection, § 109(a), calls for eligibility to be granted where the debtor "has property" in the United States.[12] Before Chapter 15, rulings on the quantum of property owned which would be necessary for a person or legal entity to fall with the meaning of that standard, ranged from little, to next to nothing, to the possibility that a "peppercorn" might suffice.[13] Indeed, prior to Chapter 15 s adoption, the vague standard of § 109(a) seemed an open invitation to forum- shopping with regard to cross-border insolvencies regardless of scale, giving rise to

10 *See*, for example, LaPorta, et. al, *supra* note 9, at 1138, whose research indicated that the United States is in one way a uniquely "anti-creditor" legal regime because the Code offers reorganization so readily.

11 Solomon, *supra* note 9.

12 The actual wording is "only a person that resides or has a domicile, a place of business, or property in the United States" may be a debtor under the Code (§ 109(a)), the term "person" having previously been defined to include legal entities such as corporations (§ 101(41)).

13 The latter was rhetorically proposed by Judge Michael J. Kaplan in rendering h.s opinion in *In re McTague*, 198 B.R. 428, 428 (1996). In that case a Canadian citizen filed under Chapter 7 within days of withdrawing all but a token amount of the money she had on deposit with a bank in New York such account constituting her lone United States asset. The debtor asserted eligibility to file under the Code, citing the account as the qualifying "property" under § 109(a). Though Judge Kap an e t at is authority did not extend to "examin[ing] the requisite quantity" of property called for by ¡109(a)— "Would a peppercorn be enough?," *id.* at 429, he found that the amount and circumstance of filing were enough to "invite[1 further inquiry under. . . sections 305 and 707." *Id.* In light of that inquiry, the court ruled that Ms. McTague was ineligible as a matter of bad faith, and dismissed her case under § 305, thereby freeing her United States creditors from the burdens of the automatic stay against execution present in § 362. *Id.* at 432.

the peppercorn problem: i.e., if the standard for property upon which a United States bankruptcy court can rely for jurisdiction is so insignificant as to be a peppercorn, then de facto there exists no criterion for jurisdiction other than the pure discretion of the court. Combine this discretion with increased globalization and the possibility that debtors will own property worldwide, and the result is increased opportunities for cross-border interests to push the limits of § 109(a).

In the early 1990's, bankruptcy court cases such as *In re Spanish Cay,*[14] demonstrated the degree to which the advantages offered by the United States Code were often too compelling for a cross-border firm to ignore. In that case, the CEO and chief creditor of a real estate development company which had been incorporated in the Bahamas, joined with other United States creditors to try and force reorganization on his own company by means of an involuntary filing under Chapter 11. The court held that the company was eligible as a debtor under § 109(a), because the company often operated out of a home office on a houseboat moored in Florida and "owned" a $100 checking account with a Florida bank.[15] After much expert testimony, the court ruled that, despite the company's eligibility, the authority of any United States court orders would likely have no effect in the Bahamas. As a result, regardless of the findings of the United States court and its decision on whether reorganization was proper, Bahamian creditors would be allowed to foreclose on the company's largest asset, the real property under development in the Bahamas, thereby ensuring that any reorganization would ultimately fail. The *Spanish Cay* court therefore dismissed the case in favor of an action in a Bahamian court though none had been instituted at that time.[16]

Establishing eligibility under § 109(a) as a matter of pre-petition planning for essentially foreign interests, prior to the adoption of Chapter 15, seemed the most questionable as a practice where vast indebtedness and creditor claims were leveraged by prepaid legal fees, and relatively tiny bank accounts.[17] For example, since year 2000, Global Ocean, an international shipping interest with main headquarters in Greece, Aerovias Nacionales de Colombia, a Columbian airline, and Yukos, all filed for protection in United States court with international assets and liabilities well in excess of 100 million United States dollars in each case; regardless of substantive final orders or dismissals for unrelated cause, the United States bankruptcy court in each case found the named multi-national debtors to be eligible under § 109(a).

In the case of *In re Global Ocean Carriers Ltd*,,[18] the United States court was faced with a highly-fragmented debtor with holdings so far flung that it truly lived up to the moniker, "global." The case (in the iteration cited here) represents an attempt

14 161 B.R. 715(1993).

15 See id. at 722. In finding that the debtor was eligible, the court held that the houseboat-based "place of business," plus the $100 bank account met the "jurisdictional nexus" required by § 109(a) *Id.* at 721-22

[16]*Id.* at 725-27.

17 See for example, *In re* Maxwell Communication Corp., 93 F.3d 1036 (1996) and the much more recently decided In re Yukos Oil Co., 321 B.R. 396 (2005) discussed below.

18 251 B.R. 31 (2000).

by fifteen affiliates located as far away as Australia, and with legal incorporations in Liberia, Cyprus and Singapore, to consolidate their cases with the named parent debtor that had been incorporated in Delaware, but that held all of its documents, and employees and offices outside of the United States. The *Global Ocean* court found that the parent was eligible as a matter of owning stock in the Delaware corporation, such stock being presumptively located in Delaware by statute regardless of the actual location of any certificates; the court also found that some of the subsidiaries could be eligible on the basis of bank accounts with "relatively small amounts" (total of less than 100,000 United States dollars), and others could assert "ownership" of at least part of an escrow account to pay legal fees.[19] In doing so, the court indicated that eligibility for each subsidiary debtor was a separate issue, and that the burden of proving eligibility falls upon the party filing for bankruptcy, even in the case of an involuntary action.[20]

In *Aerovías,*[21] the court denied efforts by United States creditors to forcibly remove the debtor's reorganization to its "center of main interests," Columbia, where the automatic stay against collections provided by § 362 would not apply under the then newly-adopted, local insolvency laws.[22] The court explicitly chose to ignore the center of "gravity" of the main debtor-airline and held that a main action in the United States was proper under § 109(a) given the substantial property owned by that debtor in the United States. [23] In dicta, however, the court pointed out that in "a perfect world" a multi-national's "center of main interest" would be determinative in deciding under which nation's laws eligibility was proper. [4]

PART III

I. The Russians Come to Texas

With this backdrop it is clear that in December of 2005, Yukos' intent in filing a Chapter 11 reorganization in a Houston bankruptcy court was to place a peppercorn in the United States and turn it into a multinational debtor's estate,' thereby forcing the United States court to include politics and economics in a high-stakes analysis of the oil giant's eligibility to file under the Code.

While prior to petitioning before the court in Houston, Yukos had engaged in some rather overt activities in an effort to ensure its eligibility under § 109, and the lone officer of the company's United States subsidiary, along with the parent corporation's acting CEO, testified before the bankruptcy court in Texas to the effect that those activities were justified by egregious action on the part of the Russian

[19] W. at 37-39.

20 *Id.* at 37.

21 In *re* Aerovías Nacionales de Colombia S.A. Avianca and Avianca, Inc , 303 B.R. 1 (2003).

[22] *Id.* at 16.

[23] *Id.*

24 *Id.*

[25] In re Yukos Oil Co., 321 B.R. 396 (S.D. Tex. 2005).

government, which held a considerable stake in Yukos.[26] The government's actions, the CEO alleged, were "illegal" and intended to forcibly re-nationalize an industrial giant that had only been privatized for a short time.[27] In effect, Yukos' claim was that it was fighting off the Russian government and needed safe harbor in United States courts, which claim squarely placed the Houston bankruptcy court in a political and economic thicket. If the court used the peppercorn to take jurisdiction of the case it risked direct confrontation with the Russian government.

In assessing Yukos' claim to eligibility under the Bankruptcy Code, the court found that Yukos' pre-petition action, in particular transferring 480,000 United States dollars to a Texas bank as payment for legal fees likely to be incurred as a matter of filing for Chapter 11 reorganization in the United States, satisfied the property requirement of § 109(a) granted eligibility.[28] The *Yukos* court, however, acknowledged as many others had before, that it granted eligibility mainly because "there is virtually no formal barrier to having federal courts adjudicate foreign debtors' bankruptcy proceedings" presented by § 109(a).[29] The court noted, but generally ignored Yukos' other actions designed to bolster its argument for eligibility; the latter included creating a United States-based subsidiary in order to establish "a place of business" just one day before filing in Texas, and transferring to that subsidiary 20 million United States dollars and other various monies which amounted to a tiny portion of the conglomerate's net worth, also within one week of filing.[30]

As the debtor had overcome the question of eligibility, the court proceeded to analyze Yukos' petition and creditors' objections to it, as a matter of good faith and fairness. In all cases brought under the terms of the Code, of course, the issues of bad faith and fairness are intended to act as final checks on the question of whether a debtor could proceed to discharge or reorganization regardless of their eligibility.[31]

Good faith, or at least the absence of bad faith, is a determination that a bankruptcy judge must make on the basis of facts; fairness in cross-border insolvency cases, such as Yukos', is more often a matter of comparing legal regimes and anticipated outcomes of parallel proceedings, along with assessing the likelihood of any extraterritorial enforcement of domestic court orders that those might

[26]On July 25, 2006, Yukos was liquidated by action of a Russian bankruptcy court. Steven Theede, the acting CEO mentioned here, had resigned prior to the ruling of that court, citing creditors'—mainly the Russian government's—unwillingness to consider reorganization in the face of the huge tax debt levied in 2005, the same that prompted Yukos to seek protection in United States courts.

[27]*Yukos Oil,* 321 B.R. at 400-02.

[28]*Id* at 407.

[29]*Id.*

[30] *Id.* at 406-07. Oddly, the creditor bringing the motion to dismiss—a German bank—did not raise the issue of bad faith in this case, choosing instead to rely on more diplomatically oriented grounds for dismissal including "international comity" and the "act of state doctrine."

[31]11 U.S.C. §§ 707(a) and 1112(b) grant the court the power to dismiss for cause cases brought under Chapters 7 and 11, respectively, and provide non-exhaustive lists of possible reasons for dismissal upon motion, both of which statutes courts have interpreted to include "bad faith."

ultimately require. ~ Prior to the incorporation of the cross-border insolvency law, Chapter 15, into the Code, the question before the court in dealing with a debtor such as Yukos—having so many possible jurisdictional claims on its property—was which of the parallel proceedings that may have been instituted against it, could fairly be judged "main," over and above all others. It was clear that in the case of Yukos, the peppercorn was not enough.

II. **The Problem of Being "Uncentered"**

Coincident with the problems engendered by the ineffectual language of § 109 was the confounding factor of extraterritorial judicial authority over cross-border assets, persons and entities. As indicated by the rulings in *Spanish Cay* and *Aerovías*, even where eligibility could be established, and bad faith was not an issue, the fundamental fairness, both amongst parties to the action and between national court systems, could create conflicting precedent. In *Spanish Cay*, the court deferred to the Bahamian courts because the major asset was outside of the United States court's jurisdiction and as a matter of comity recognized "the interest of foreign courts in liquidating or winding up the affairs of their own domestic business entities"[33]; but in *Aerovías*, the court allowed a foreign interest to avoid its own legal "home field" and use United States law to stay execution by creditors, ironically from the United States, noting that without that stay reorganization would likely have been untenable for the debtor. [4]

In *Yukos*, Judge Letitia Clark was faced with a debtor who was clearly within the bounds of eligibility under the peppercorn test, and though there had been evidence presented concerning the bad faith of at least one creditor—albeit one of the largest, the Russian government—those factors were out-weighed by the issues of jurisdiction and comity, as those could be included in a totality of the circumstances analysis. She would have to address the claims of act of state, comity and international law in order to exercise jurisdiction. In the end, the Yukos court would face the limits of its own extraterritorial authority, namely its lack of authority to assert personal jurisdiction over representatives of another sovereign, to either serve them with process or enforce their compliance with United States judicial orders, in particular the terms of § 362 of the Code: the automatic stay of actions to collect on indebtedness.[35]

Such conflicts of precedent were particularly troublesome where the possibility of parallel proceedings existed. By definition, cross-border insolvencies involve multi-national entities and persons; a multi-national—also by definition—holds a provable identification with more than one country.[36] In the case of multi-national

[32] 11 U.S.C. § 304(c).

[33] *In re* Spanish Cay, 161 B.R. 715, 725 (1993)(citing Cunard Steamship Co. v. Salen Reefer Services AB, 773 F.2d 452,458(1985)).

[34] *In re* Aerovías Nacionales de Colombia S.A. Avianca and Avianca, Inc , 303 B.R. 1, 10 (2003).

[35] *Yukos Oil*, 321 B.R. at 410-12.

[36] While cross-border assets and holdings are generally less of an issue in cases involving individual debtors, the problem is not unheard of. *In re Xacur*, 219 B.R. 956 (1998) provides a good example. In that case, mainly foreign creditor banks sought to force the debtor, a Mexican national, into bankruptcy under Chapter 7 of the Code. Chapter 7 allows for an involuntary action where the debtor is not meeting obligations as "they come due" under § 303(h)(1). The debtor argued that, despite the fact that he was clearly eligible under § 109(a), the court should dismiss the case as he was a Mexican citizen living in Mexico and most of his property was in Mexico. The United States court found that Mr. Xacur, who had owned property in the United States for seventeen years, was eligible under § 109(a). *Id.* at 966.

legal entities, this is generally based on the presence of several legally incorporated subsidiaries in several different nations. For a truly multi-national legal entity of this type, the difficulties with the bankruptcy process may include the financial interrelationships amongst the various subsidiaries (such as when one subsidiary serves as creditor to another), the relative financial and commercial success of one subsidiary versus the others (such as when one branch is more successful than the others and may be quite profitable, while at the same time other divisions face bankruptcy), and the interrelatedness of the separate parts, which are not necessarily monetary (such as when all corporate subsidiaries utilize the same patents or other forms of intellectual property).[3] In the end, prior to Chapter 15's enactment, United States courts could only do what other nations would let them do vis a vis the exercise of judicial authority. Such was the predicament faced by Judge Clark. Should she exercise jurisdiction, the court would be faced with a proceeding in parallel, attempting to supervise actions in the courts of a foreign sovereign with not only all of the conflicts that would normally entail but the sovereign was one that did not have the historical precedent of cooperation with the United States that she would have hoped for.

III. **The Turmoil of Proceeding in Parallel**

As noted by the court in *Aerovias*,[38] the concept of the "center of main interests" was long ago proposed as a palliative to the problems raised by the vague standards of eligibility for foreign debtors under United States and other national legal regimes. Most significant of those problems of course were the inefficiencies involved in having debtors file and establish eligibility under § 109(a), only to find that administration of the case was blocked by jurisdictional issues; most significantly, the question of whether a foreign action would be more appropriately "main" than one in a United States court, or vice versa.

In some ways, then, it could be said that an amorphous concept corresponding to "center of main interests" has always been present in the Code as a matter of answering the jurisdictional question: i.e. of typing actions which involve foreign interests and representatives as either main or ancillary to main actions in United States court.[39] To the extent that the possibility of parallel proceedings in two or more separate national court systems was contemplated by the Code in § 304, its treatment generally consisted of an indirect requirement that courts make such determinations on a case-by-case basis. Eventually and perhaps inevitably such analyses devolved into questions of fairness of outcomes, and of precedence in time.

However, the court further held that the authority of any orders it issued in an involuntary case would likely be ignored in Mexico, and that the authority of the trustee would also be very limited, particularly because lawsuits covering most of the assets had already been filed in Mexican courts and it would likely prove not cost-effective to proceed against the debtor's limited United States assets. *Id.* at 968-69.

37 In *re Singer,* 262 B.R. 257 (2001), for example, involved a contest over a patent that had been licensed from parent to subsidiary prior to the parent filing for reorganization; by finding an implied license, the court allowed the intellectual property to remain part of the debtor's estate and subject to the reorganization plan, thus defeating the interests of others claiming the patent. *Id.* at 265.

38 In re Aerovias Nacionales de Colombia S.A. Avianca and Avianca, Inc , 303 B.R. 1, 17-18 (2003)(citing *In re* Maxwell Communication Corp., 93 F.3d 1036, 1053 (2d Cir. 1996), among several other sources).

[39] 11 U.S.C. § 304.

The concept of the proceeding ancillary to a main action, in the context of cross- border insolvency,[40] was that a multi-national, the main interests of which lay overseas, could gain jurisdiction over assets and creditors located in the United States. In many cases, §§ 304 and 305(a)(2)(A)—providing for the United States court to abstain if a foreign parallel proceeding is already under way—forced courts to engage in a rather lengthy battle of experts to determine which pending proceeding was "main," and which "ancillary to," and further, to weigh the fairness of the outcome of cases in the parallel jurisdictions involved.[41]

Such was the case in *Spanish Cay.*[42] The evidence presented there by the creditor group attempting to force reorganization under United States law, stressed the lack of a provision like Chapter 11 in Bahamian bankruptcy law. As a result, the creditors argued, Bahamian law did not provide similar protection to investors, particularly United States investors, to the degree called for by the Code as a matter of deferring to foreign proceedings.[43] The court concluded that an absolute mirror- image of United States bankruptcy law and its provisions is not necessary to defer, rather simply that the "scheme for distribution of the assets of an insolvent debtor" be compatible with that found in the United States Code, in this case with the terms of Chapter 7.

The decided cases in this area seem to indicate that "fairness" to United States interests generally meant a sufficient similarity between the law of the foreign jurisdiction and United States law, and that, given a comfortable level of such similarity, any choice of law question would default to a "race to the courthouse" between interested parties, each seeking to stamp their proceeding as "main," all jurisdictional matters therefore resting on the outcome of the race. In practice, courts have generally refused to accept the situation as a simple race, but, as with eligibility under § 109(a), acknowledged the letter of the law, but chose to find separate grounds upon which to rule. Indeed, this was the reason that the *Spanish Cay* court went some distance to treat the issues before it as if ancillary to a foreign case, while acknowledging that the latter would only be instituted at some point in the future.

[40] Note that actions "ancillary to" main actions may also occur in purely domestic matters. A Texas bankruptcy court could take ancillary jurisdiction of an action involving the debtor s property in New Jersey.

[41] That is where a United States bankruptcy court is asked to find that the recognition of ancillary proceedings runs afoul of the rights of United States creditors and investors by bringing only United States creditors under the restrictions of the United States Code.

[42] 161 B.R. 715, 726(1993).

[43] 11 U.S.C. § 304(c)(2).

[44] The *In re Spanish Cay* court analyzed Bahamian insolvency law as if the Code s requirements for filing for ancillary proceeding had already been met. The company s domestic United States ere itors, including its president, had sought protection in the United States court because Bahamian law would allow creditors in that jurisdiction to dispose of the company s real property hoi ings> t (.re, w ic a so comprised the company's only major asset. Bahamian creditors sought dismissa un er t e terms o 305. The court noted that § 305 (a)(2)(A) requires a "pending foreign proceeding in order to dismiss as a matter of comity (amongst other factors), but chose to expedite its finding an went a ea an app le Bahamian law.

Still, the analysis required to determine which action was main and which ancillary to, represented at the very least an inefficiency in the overall process.

Just as under § 109(a), a United States court could fairly decide that any debtor meeting the "peppercorn" eligibility test to file in United States courts and thereby avail itself of the advantages of the Code, the "first in time" and "fairness" standards that evolved under § 304 could also allow debtors to evade the law of this jurisdiction as well, as in the rather notorious *National Warranty* case from 2004.[45] The urgency felt by creditors seeking to exploit both § 109 and § 304 in anticipation of the Reform Act,[46] while clearly demonstrating the elastic nature of the rules prior to Chapter 15's adoption, are also evidence, of course, of the distaste with which those same creditors viewed the priorities and protections present or lacking in jurisdictions not of their own choosing. Beyond mere inefficiency of process, it seemed perhaps a bit unseemly that Congress' will in formulating the laws of bankruptcy for United States creditors and debtors—charged with knowledge of those laws by citizenship—was being flouted in such overt ways. It was for these reasons that Chapter 15 was included among the reforms of 2005. The primary objective of the reform, with regard to cross-border insolvency, was that the existing uncertainties of debtor eligibility, and of the relationship amongst parallel actions be summarily resolved in the future. Towards that end, the new law seeks to unify both issues under the single standard, "center of main interests."[47]

IV. **The Decision**

In deciding the fate of Yukos' petition before her court, Judge Clark began with a recognition that the debtor was unique in that it represented a "corporation which is a central part of the economy of the nation in which the corporation was created."[48] Although prior cases dealing with foreign debtors had involved significant enterprises, Yukos was different; it was principally formed to facilitate the privatization of the Russian oil industry and it served as a holding company for

[45]*In re* Nat'l Warranty Ins. Risk Retention Group, 306 B.R. 614 (2004) involved a rather overt attempt on the part of a "re-insurance" company to subvert United States bankruptcy law—and a class-action suit on the part of United States consumers—by shifting its corporate headquarters from Lincoln, Nebraska, to the Cayman Islands. National Warranty accomplished this by incorporating under Cayman law, transferring twenty-four million dollars in assets to the new subsidiary, and then filing for protection under the Caribbean nation's bankruptcy code, all in a very short period of time and just ahead of the potential class action. The bankruptcy court found National Warranty did successfully establish "domicile" outside the United States for the purposes of bankruptcy. As such, the United States court granted relief to creditors from the United States as a matter of comity via § 304. The court further enjoined any legal action against National Warranty because the recognition of the foreign proceeding provided for the granting of injunctions operating like the automatic stay granted by § 362. By Cayman law, the court noted in dicta, class action status would be nearly impossible to obtain and each consumer claimant would have had to bring a separate suit, so, remedy for consumers was effectively blocked.

[46] *See* Roxane DeLaurell, *Accessing the Effects of Chapter 15: Cross Border Insolvency Cases in U.S. Bankruptcy Courts from 1995-2006*, 4 S.C.J OF INT'L L.& Bus. 1 (Spring 2008).

[47]11 U.S.C. § 1502(4).

[48] In re Yukos Oil Co., 321 B.R. 396, 399 (2005).

several hundred subsidiaries of various nationalities, primarily Russian.[49] One of the grounds for jurisdiction was the formation of a United States subsidiary in Texas, days before the filing, which subsidiary held funds in a United States bank account earmarked for lawyers' fees.

Judge Clark proceeded to address the traditional bases for declining jurisdiction of the case: forum non conveniens, comity and the Act of State Doctrine. As to the first point, because *Yukos* was a voluntary filing she declined to rely on forum non conveniens.[50] The comity question also turned on the voluntariness of Yukos' filing. Judge Clark could find no reason to dismiss based on respect for another sovereign's authority to act when the parties were acting voluntarily and not in disregard of foreign judgments.[51] In fact in considering the act of state doctrine as a grounds for dismissal, Judge Clark noted that the Russian government had refused to become a party in the bankruptcy proceeding and she could see no basis for a dismissal on the grounds of the act of state doctrine.[52] Having dispatched these traditional arguments, Judge Clark proceeded to the heart of the matter, that the act of state doctrine must play a part because the debtor is such a large part of the national economy:[5']

> The vast majority of the business and financial activities of Yukos continue to occur in Russia. Such activities require the continued participation of the Russian government, in its role as the regulator of production of petroleum products from Russian lands, as well as its role as the central taxing authority of the Russian Federation.
>
> Finally, although the act of state doctrine, standing alone, does not compel dismissal of the instant case, the evidence indicates that Yukos was, on the petition date, one of the largest producers of petroleum products in Russia, and was responsible for approximately 20 percent of the oil and gas production in Russia. The sheer size of Yukos, and correspondingly, its impact

[49] *Id.* at 400.
[50] *Id.* at 408.
[51] *Id.* at 409.
[52] *Id.* at 410.
[53] *Id.* at 411.

> on the entirety of the Russian economy, weighs heavily in favor of allowing resolution in a forum in which participation of the Russian government is assured.

Judge Clark recognized the obvious problems a United States court would have in ordering the Russian government to comply with its orders, all the while holding firm to her court's ability to take jurisdiction of the case. In the end, common sense prevailed and deft legal reasoning returned Yukos to its principal place of business, saving face for all involved. The problems faced by Judge Clark were precisely those faced by the drafters of the Model Law, now Chapter 15 of the Code. By adopting the "center of main interests" ("COMI") language from the Model Law, Chapter 15 seeks to solve several problems of law through procedural means. The difference between a main and nonmain proceeding, under Chapter 15, is that a main proceeding may only take place where a multi-national legal entity has its center; filing anywhere else—for example, in those jurisdictions where the entity merely has an "establishment"—creates a per se nonmain proceeding.[54] As a result, external factors such as precedence in time have been eliminated from the process of determining jurisdictional issues.

In the end, Judge Clark was acknowledging that the long arm of United States Bankruptcy protection could not wrap itself around a multi-national corporation, the core of which lay outside of her jurisdiction. Essentially then, she performed a COMI analysis and correctly applied its terms, though the law, at that time, required neither of those things. Now, of course, such an analysis is the letter of the law.

Formalizing COMI is also supposed to do away with any implied duty on the part of the court to analyze possible outcomes or their inherent fairness. The new standard is simply that the bankruptcy law of debtor's COMI will be applied in administering the estate. That will be the case whether local laws mirror the United States Code in pertinent part or not, and regardless of any coincident hardships due to any perceived or actual differences in law, e.g. no provision comparable to the automatic stay under § 362.

PART IV

I. Implications

Under Chapter 15 then, it is likely that disposition of Yukos' petition in the United States court would have had the same result: the COMI lies in another jurisdiction and is unreachable by § 362. It is unclear, however, if that result is based on the unique character of the debtor, Yukos, and one is left to conjecture whether a foreign national with less governmental connections would have been similarly

[54] 11 U.S.C. § 1502(5).

treated by Judge Clark. It was intended by the Reform Act and Chapter 15 in particular, to avoid uncertainty and increase efficient administration of bankruptcy proceedings. However, at least one commentator from Europe (where the Model Law was enacted in year 2000) has already noted that as a legal term of art, "center of main interests" itself is not devoid of uncertainty and may contain the seeds of future contentious interpretation.[55]

Future cases will determine what the required quantum will be to establish a multinational's "center"—presumptively more than a peppercorn—and, having determined same, it is likely that international interests and their counsel will immediately begin planning around the new standard in the event of an unforeseen crisis. The uncertainty about such a new standard is not so different in kind from those that existed under the older version of the Code. Namely: Will choice of forum in the event of bankruptcy become part of international financing agreements? To what extent would such a clause outweigh the imperatives of Chapter 15 and whatever COMI standards have been established to that point? Would a choice of law clause on involuntary bankruptcy be part of a totality of the circumstances test in a voluntary filing involving the same parties? And, perhaps most importantly, would mutually agreed upon contractual terms such as these, constitute pre-petition planning of a type that a court might rule to be bad faith?

For United States courts at least, Chapter 15 by itself, absent judicial interpretation, cannot answer these questions. It is possible that the traditional arguments of international comity, act of state doctrine and forum non conveniens will continue to be part of the decision making process just as they were for Judge Clark.

CONCLUSION

This article seeks to utilize the insolvency proceedings of Yukos, a large multinational, to examine the state of United States law on cross border bankruptcy prior to and after the adoption of Chapter 15, and observe whether or not the outcome would have been different. Granted the nature of the debtor may have been the most significant factor in the court's decision, but the jurisdictional requirements that moved the law from something more than a peppercorn to a center of main interests test certainly support the conclusion that the outcome of *Yukos* would have been the same pre and post adoption of the Model Law.

The United Nations Commission on International Trade Law (UNCITRAL)— author of the model law upon which the new Chapter 15 was based, as discussed herein,—serves in an advisory role to nations seeking to expand their economies through increased opportunities for international trade. An unfortunate, though not unpredictable concomitant of economic expansion, is a consequent rise in the number of business and individual insolvencies. It would be impossible, if not

[55] Peter Burbidge, *Cross Border Insolvency Within the European Union: Dawn of a New Era,* 27 EUR. L. REV. 589, 589-609 (2002).

merely foolish, for nations not to legislate in the light of this reality. Having taken steps to adopt more international trade-, and investment-friendly legal regimes, such as the United Nations Convention on Contracts for the International Sale of Goods[56] (CISG) amongst others, legislators would be remiss not to provide a system for dealing with the inevitability of bankruptcy in the same realm. In that sense, Chapter 15's incorporation into United States bankruptcy law may also be said to have been a direct result of the United States' agreement to become signatory to CISG and other international trade agreements and to the inevitable march of globalization.

Coincident with the adoption of Chapter 15, the United States Congress undertook a complete reform of the domestic bankruptcy code, though the greatest changes came in the area of individual, consumer bankruptcy. While Chapter 15's elements, in the main, have all previously been a part of the United States bankruptcy code in one form or another, there is cause, as noted above, to consider the law "new" in that sense. The eventual efficacy of Chapter 15 as far as accomplishing its intended goals of streamlining and easing the job of bankruptcy courts and the work of United States bankruptcy attorneys and trustees remains to be seen. In the present, as is the case with all emerging legal regimes, a great amount of uncertainty still exists. As the reality of application becomes clear through the actions of debtors, creditors and courts, some of the expected benefit of the new law may, ultimately, be lost.

Ultimately as well, each individual nation choosing to participate under Chapter 15— or any other variant of the Model Law—must engage in a cost-benefit analysis, formally or informally, in order to gauge the balance of economic gain against attendant burdens. As they do, those nations will give the future of international commerce, including the conduct of cross-border insolvencies, its eventual shape.

[56] 3 U.N.T.S. 1489.