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A Commitment Rule for Insolvency Forum

Based on BFI Working Paper No. 2024-06, "A Commitment Rule for Insolvency Forum," by Anthony J. Casey, University of Chicago; Aurelio Gurrea-Martínez, Singapore Management University; and Robert K. Rasmussen, USC School of Law

A new commitment rule regarding forums for international insolvency would not only benefit debtors and creditors, but also society at large by supporting the development of financial markets, entrepreneurial innovation, and economic growth.

In May 2020, LATAM Airlines, a **holding company** based in Chile and with a Brazilian operating company, filed for bankruptcy protection in New York. Two-and-a-half years later, following legal wrangling between debtors and creditors, LATAM emerged from **bankruptcy** protection with a restructured—and strengthened—financial position, along with a modernized fleet that put it back on a competitive footing.[1]

Just another day in bankruptcy court? Not quite. For example, why did a holding company based in Chile, with operations in Brazil, file for bankruptcy protection in New York? Current international law looks to a company's center of main interest (COMI) to determine the location of **insolvency** proceedings, which might suggest Chile in this case. However, establishing a COMI is not always obvious. Many international firms have operations in multiple countries that, by some definition, could be termed a headquarters. The issue becomes more complicated when one considers such new economy businesses such as tech firms, crypto exchanges, and decentralized finance applications, which are plausibly absent a COMI.

A country's COMI is currently established by the Model Law on Cross-Border Insolvency, promulgated by the United Nations Commission

[1]Wolynski, Todd K., et al. (2023), "Navigating turbulence: Latin American airlines in chapter 11," White and Case: bit.ly/3SRXwnJ

BFI Blackboard

Holding company: a business entity that holds controlling stock in other companies; it does not manufacture products or otherwise sell any products or services.

Insolvency: A financial state wherein an individual or company can no longer meet their financial obligations. An insolvent company or person may establish arrangements with creditors to, for example, set up alternative payment arrangements. Insolvency can lead to bankruptcy.

Bankruptcy: A legal proceeding to address insolvency, initiated when a person or business (debtor) is unable to repay outstanding debts or obligations (to creditors). All the debtor's assets are measured and evaluated and may be used to repay a portion of the outstanding debt.

on International Trade Law (1997). This law is both inflexible (it sets a debtor's COMI as the proper forum for insolvency proceedings), and manipulable, (firms like LATAM can "forum shop" to seek most advantageous venues), introduces uncertainty into debtor-creditor relationships that is ultimately costly and inefficient. Indeed, current law allows debtors to shift their COMI as late as the very eve of court proceedings. For creditors, such uncertainty raises the cost of lending, which ultimately affects all debtors.

This paper addresses this flaw by proposing a new "commitment rule" for the existing Model Law that would allow debtors to signal an advance commitment to a particular insolvency forum, or in which country where their insolvency proceeding would occur. What would prevent firms from manipulating this new rule? The answer is that firms would have to codify their commitment in the company's constitution. The advantages of this new rule are threefold:

- It provides more predictability. Every market participant would know where a future insolvency proceeding would initiate. No more guessing about a company's COMI.
- The new rule would reduce litigation costs once a debtor initiates an insolvency proceeding. No more wasting resources tussling over a debtor's COMI location.
- Finally, a commitment to initiate any future insolvency proceeding in jurisdictions that can provide a more efficient insolvency regime would encourage lenders to extend credit at a lower cost. This lower cost would facilitate firms' access to finance and the promotion of economic growth. It would also contribute to the maximization of the returns to creditors and the effective reorganization of viable but financially distressed businesses.

Bottom line: This new commitment rule offers a rare "win-win" legal reform requiring no major tradeoffs, according to the authors. The rule would reduce strategic forum shopping and minimize litigation costs while also promoting the development and selection of efficient insolvency forums. This benefits all stakeholders, not just debtors and creditors, but society at large by supporting the development of financial markets, entrepreneurial innovation, and economic growth more generally.

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