

The co-ordination of cross-border bank insolvency

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Abstract

The question to be answered in this dissertation is whether the same principles contained in the *Dodd-Frank* Act can be implemented in South Africa in order to develop an effective cross-border bank insolvency regime. The answer to the above mentioned question is twofold, firstly an understanding of what is meant by the terms cross-border insolvency is required and secondly it is important to understand why there is a need for a uniform cross-border insolvency regime.

After the economic crises in 2007, specifically after the collapse of Lehman Brothers, the US determined that their current bankruptcy procedures are insufficient to adequately resolve a matter of cross-border bank insolvency. As such the US developed and implemented the *Dodd-Frank* Act. The *Dodd-Frank* Act contains specific provisions that will provide legal certainty when a matter of cross-border bank insolvency occurs, specifically relating to the determination of jurisdiction as well as how failing banks should be administered.

These provisions will critically be examined in order to establish if similar provisions can be implemented in South Africa. The rationale for such implementation is to strengthen international trade not only within the SADC region but across the globe.

Key words

Dodd-Frank Act

Cross-border Insolvency Act

SADC

Cross-border bank insolvency

Extraterritorial jurisdiction

List of abbreviations

PER – Potchefstroom Electronic Law Journal

EU – European Union

UNCITRAL - The United Nations Commission on International Trade Law

SADC – Southern African Development Community

MoU - Memoranda of understanding

USA – United States of America

OLA – Orderly Liquidation Authority

FSOC – Financial Oversight Stability Council

1 Introduction

Due to globalization and international trade, the world has become a global village.¹ The increased use of technology brought about certain problems, not only on a national level but also for international trade markets.² The proper functioning of international trade relies on financial support, with banks being the largest provider of such financial support and services. It is thus understandable why banks play such a crucial role in the development of international trade.³

An increase in international investors in various banks and banking activities has created a growing need for regulating insolvency procedures that affect banking operations in more than one country.⁴ The regulation of these insolvency procedures, through the development of uniform cross-border insolvency law, is however being hampered. The reason for this is the fact that each country has a distinct legal framework, resulting in very diverse insolvency regimes and procedures.⁵ Furthermore, each country wants to benefit its own creditors and its own investors. In all insolvency law systems there are crucial differences in the treatment of the various types of creditors, for example, the rights afforded to personal and *in rem* rights.⁶

Cross – border insolvency law deals with those situations where insolvency proceedings have been instituted in a specific jurisdiction against a debtor (which may be an individual, a company or a financial institution, such as a bank) while that debtor has assets or investors situated in another jurisdiction.⁷ Consequently the appointed liquidator must attach the assets in the foreign jurisdiction,⁸ by complying

¹ Weideman and Stander 2012 *PER* 133. Also see Devling 2001 *UMKC Law Review* 436.

² Weideman and Stander 2012 *PER* 133.

³ Weideman and Stander 2012 *PER* 133.

⁴ Dotevall 2012 *Scandinavian Stud* 64.

⁵ Garrido 2010 *Unif L Rev* 779.

⁶ Garrido 2010 *Unif L Rev* 780; Stander 2015 *TSAR* 738.

⁷ Olivier and Boraine 2005 *CILSA* 373.

⁸ For recognition and attachment see Chapter 2 of this study.

with that country's legal principles.⁹ This usually occurs by means of a court application.¹⁰ An alternative to the aforementioned is to institute concurrent insolvency proceedings in every jurisdiction.¹¹ There is, however an inherent risk that creditors (local and foreign) will be at a disadvantage or even treated differently in the various jurisdictions.

The main risk involved in cross-border bank insolvency, is that the interests of investors may be in conflict with those of the creditors of the bank, especially when they are located in different jurisdictions.¹² Banks involved in cross-border operations originate from different regulatory backgrounds. In some cases the bank's actual country of origin may even be unknown.¹³ A good example is Absa bank which is a well-known and established bank in South Africa which also operates in some African countries.¹⁴ Another example is the Standard Bank group which has complex holding companies in various jurisdictions across Africa.¹⁵ In light of the above mentioned it is understandable why the consequences of the insolvency of a bank situated in a specific country of operation, is likely to spread across borders and effect other affiliated banks as well.¹⁶ If a bank involved in cross-border operations becomes insolvent, the issue pertaining to determine the jurisdiction of the bank and the applicable legal system arise. In the absence of a statutory provision that provides for the cross-border insolvency of a financial institution and how it is to be dealt with, countries turn to their domestic law to regulate the proceedings. As already mentioned, this can be problematic.

In an effort to eliminate the aforementioned problems relating to cross-border insolvency two important legal international instruments were implemented. In 1997

⁹ Olivier and Boraine 2005 *CILSA* 374.

¹⁰ Olivier and Boraine 2005 *CILSA* 374.

¹¹ Olivier and Boraine 2005 *CILSA* 374.

¹² Garrido 2010 *Unif L Rev* 782.

¹³ Cabello *et al Banking on the African Moment* 36.

¹⁴ Cabello *et al Banking on the African Moment* 36. Absa bank is a South African bank with international ties and banking activities.

¹⁵ Cabello *et al Banking on the African Moment* 36.

¹⁶ Cabello *et al Banking on the African Moment* 37.

the United Nations Commission on International Trade Law¹⁷ adopted the UNCITRAL *Model Law on Cross Border Insolvency*,¹⁸ which aimed to provide a specific set of rules in the adjudication of cross-border insolvency matters. These rules include how recognition of foreign insolvency proceedings should be determined, the access to courts by a foreign representative, the right, that are afforded to the various creditors and the co-ordination of concurrent insolvency procedures.¹⁹ The second instrument was adopted in 2000 by the European Union, the title of which is the *European Council Regulation on Insolvency Proceedings*.²⁰ The purpose of the *European Council Regulation on Insolvency Proceedings*²¹ is to provide co-operation of cross-border insolvency procedures.²² In 2005 the *Model law* was adopted by the United States of America as Chapter 15 under Title 11 of the *United States Bankruptcy Code*.²³ South Africa also continued to adopt the *Model Law*, by promulgating the *Cross-Border Insolvency Act*.²⁴ Even though the *Cross-Border Act* is not yet in operation it aims at providing legal certainty when a matter of cross-border insolvency presents itself.

Even though Europe and the United States are the leaders in the development of cross-border legislation, the specific problems relating to cross-border bank insolvency has not been resolved. The reason being, as already mentioned, that the actual country of origin or the bank's place of its main interest is not easily determined. This aspect is of the utmost importance for economic development within Southern Africa, especially due to the fact that reciprocal trade in the SADC region has become extremely popular. Trade between SADC countries has expanded rapidly and as a result well known banks, such as, Nedbank²⁵, United Bank of

¹⁷ Herein after referred to as UNCITRAL.

¹⁸ Herein after referred to as the *Model Law*.

¹⁹ Berends *Tulane Journal of International and Comparative law* 312.

²⁰ Weideman and Stander 2012 *PER* 134. Also see Story 2015 *Arizona Journal of International and Comparative Law* 431.

²¹ Hereinafter referred to as EU regulations.

²² Story 2015 *Arizona Journal of International and Comparative Law* 440.

²³ Story 2015 *Arizona Journal of International and Comparative Law* 432.

²⁴ *Cross-Border Insolvency Act* 42 of 2000, herein after referred to the *Cross-Border Act*.

²⁵ <https://www.nedbank.co.za>

Africa²⁶, Eco bank²⁷, afriland²⁸, the Standard Bank Group²⁹ and First Rand Group³⁰, are now found across the SADC region.

To resolve the specific problems pertaining to cross-border bank insolvency the United States of America went further and developed a specific act and regulations that determines how the jurisdiction of a financial institution, such as a bank, is to be determined.³¹ The purpose of the act and regulations is similar to that of Chapter 15; it is therefore aimed at enhancing legal certainty and strengthening co-operations between countries when a matter of cross- border bank insolvency presents itself.³²

Clearly, the development of the *Dodd-Frank Act* not only brought about legal certainty in the handling of cross-border bank insolvency matters, it also placed the United States of America at the forefront of development in this particular field of law. This study focused on the United States of America's *Dodd-Frank Act*. In order to establish whether the same principles can be applied in South Africa for the development of an effective cross-border bank insolvency system, this study critically examined how the *Dodd-Frank Act* establishes jurisdiction and regulates the treatment of creditors and investors.

In an effort to accomplish the aforementioned, the question of what specifically qualifies as a cross-border insolvency matter is explored in Chapter 2. In doing so, a brief background of how current cross-border insolvency matters are being dealt with is provided in paragraph 2.3. This is done by examining not only the South African perspective but also examining the current situation in both the European Union as well as in the United States of America.

²⁶ <https://www.ubagroup.com/countries>

²⁷ <https://www.nedbank.co.za>

²⁸ <https://www.afrilandfirstbank.com/index.php/en/branches>

²⁹ <https://finmark.org.za/wp-content/uploads/2016/02/SADC>

³⁰ <https://finmark.org.za/wp-content/uploads/2016/02/SADC>

³¹ *Dodd-Frank Wall Street Reform and Consumer Protection Act* 2010, hereinafter referred to as the *Dodd-Frank Act*.

³² *Dodd-Frank Act*.

The aim with Chapter 3 is to provide a background of the problems related to cross-border bank insolvency. This is achieved in paragraph 3.2. The specific problems that are related to cross-border bank insolvency are explored in paragraph 3.3. In order to accomplish the aforementioned cross-border bank insolvency within the SADC region was examined. The reason for this is because cross-border bank insolvency is a common occurrence within the SADC region. Paragraph 3.4 is dedicated to an examination of the Lehman Brothers collapse. The purpose thereof is to explain how the collapse affected the global financial markets. In the final paragraph of Chapter 3, a conclusion is reached as to the importance of a uniform cross-border bank insolvency regime.

After the importance of a uniform cross-border bank insolvency regime has been established, the study proceeds to critically examine the *Dodd-Frank Act*. In paragraph 4.1, an introduction and brief background are provided as to the development of the *Dodd-Frank Act*. The determination of jurisdiction is discussed in paragraph 4.2. Paragraph 4.3 aims at shedding a light on the specific procedures that has been implemented in order to achieve harmonisation. The final paragraph of Chapter 4 examines how the *Dodd-Frank Act* treats various creditors and investors.

This study concludes by providing recommendations for South African law.

2 Cross-border insolvency law

2.1 Background

With the increase in the existence of multi-national entities³³ and development international trade has caused an upsurge in the number of international insolvencies.³⁴ This in effect created a global economic crisis.³⁵ The term "cross-border insolvency" is used to express those situations where insolvency has occurred which in some way surpasses the boundaries of a solitary legal system.³⁶ In these circumstances the use of one domestic law or provisions cannot be absolutely applied without considering the concerns that are raised by the foreign element.³⁷ These elements occur for example in cases where insolvent debtors possess assets which are located in different jurisdictions.³⁸ To the author's mind this means that the insolvency not only affects one legal system but in order to adjudicate the matter more than one legal system needs to be considered and in some cases they will have to work in harmony with each other. In many of these instances, the creditors are located in a different jurisdiction than the one in which the insolvency proceeding is taking place.³⁹ As a result of the aforementioned situations numerous questions present themselves, for example, should concurrent proceedings be opened or will a singular proceeding be sufficient?⁴⁰ If it is determined that a singular proceeding will be sufficient, which country will have jurisdiction to adjudicate the matter and according to which legal system?⁴¹ An additional problem that goes hand in hand with the aforementioned is how a foreign trustee, liquidator or other insolvency

³³ A multinational entity is when an entity has offices situated in more than one country; the company therefore operates its business in more than one country. For example the Standard Bank Group not only has offices in South Africa but they also conduct business across the African Continent. Other multinational entities include Absa Bank, Bank of Montreal, Barclays, First Rand Bank, Pick 'n Pay, the MTN group as well as the Vodacom group.

³⁴ Olivier and Boraine 2005 *CILSA* 374. Also see Garrido 2010 *Unif L Rev* 779; Stander 2002 *Journal for Juridical Science* 73.

³⁵ Stander 2002 *Journal for Juridical Science* 73.

³⁶ Zulman 2009 *SA MERC LJ* 804.

³⁷ Zulman 2009 *SA MERC LJ* 804.

³⁸ Devling 2001 *UMKC Law Review* 436. Also see Stander 2002 *Journal for Juridical Science* 73.

³⁹ Stander 2002 *Journal for Juridical Science* 73. Also see Devling 2001 *UMKC Law Review* 436; Zulman 2009 *SA MERC LJ* 804.

⁴⁰ Zulman 2009 *SA MERC LJ* 804. Also see Devling 2001 *UMKC Law Review* 436.

⁴¹ Zulman 2009 *SA MERC LJ* 804. Also see Devling 2001 *UMKC Law Review* 436.

representative goes about being recognised in the foreign jurisdiction. In practice, in the absence of a treaty or any legislative tolerance that may be in force,⁴² the representative of the entity has to apply to court in order to gain recognition.⁴³ This was evident in the matter of *Maxwell Communication Corporation v Société Generale, Barclays Bank*.⁴⁴

As the situation currently stands various models are generally approached in order to adjudicate a matter pertaining to cross-border insolvency.⁴⁵ The first model is based on territory.⁴⁶ This model is mainly concerned with the law of jurisdiction, in that the interest of local creditors receives preferential treatment.⁴⁷ Assets that are situated locally will first be utilised for the benefit of the local creditors before it is utilised in respect of foreign creditors.⁴⁸ The territoriality approach supports the idea of a multitude of insolvency procedures.⁴⁹ In other words, in terms of this approach an insolvency procedure should be opened in every jurisdiction. Devlin explains that by using this approach the proceedings are limited to the assets which are found in each jurisdiction.⁵⁰ According to Devlin local creditors prefer this approach as they are not forced to litigate their claims in a different jurisdiction, therefore they have the advantage of being able to understand and follow the local proceedings.⁵¹ When a multinational entity goes insolvent and the court confirms its jurisdiction, an order

⁴² This refers to the notion of comity between nations, analyses of this notion takes place in paragraph 2.3 below.

⁴³ Olivier and Boraine 2005 *CILSA* 374.

⁴⁴ *Maxwell Communication Corporation v Société Generale, Barclays Bank* 93 F 3d, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>) This case is a perfect example of a cross border insolvency matter as the company had business operations situated in more than one country. The debtor's headquarters was situated in England and the majority of its debt was incurred in England. The majority of its assets were, however, located in the United States of America. Separate bankruptcy proceedings were opened in England and United States.

⁴⁵ Olivier and Boraine 2005 *CILSA* 374.

⁴⁶ Devling 2001 *UMKC Law Review* 437.

⁴⁷ Devling 2001 *UMKC Law Review* 437. Also see Olivier and Boraine 2005 *CILSA* 375.

⁴⁸ Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 533-534. Also see Olivier and Boraine 2005 *CILSA* 375.

⁴⁹ Stander 2015 *TSAR* 110. Also see Devling 2001 *UMKC Law Review* 437-, and Olivier and Boraine 2005 *CILSA* 375.

⁵⁰ Devling 2001 *UMKC Law Review* 437.

⁵¹ Devling 2001 *UMKC Law Review* 437.

will be granted in terms of which the liquidators can seize the assets under their control and distribute the proceeds thereof in accordance with the local law.⁵²

The second model is referred to as the universality approach,⁵³ which is a complete opposite of the territoriality approach. This approach entails that the insolvency matter is treated as a singular event.⁵⁴ In other words cross-border insolvencies are adjudicated by a singular authority.⁵⁵ This results in the creditors, even if they are located in different jurisdictions, being treated equally.⁵⁶ All the applicable debts and assets are assessed universally and they all obtain equal weight, despite being located in a different jurisdiction.⁵⁷ When using this approach the creditor who is in a jurisdiction that is foreign to the main proceedings⁵⁸ can still receive precedence over the liquidation of the assets located in another jurisdiction.⁵⁹ In other words this means, for example, that when a debtor files for insolvency in the main proceedings in a country other than South Africa, but he possesses assets in both South Africa and the other country (the foreign jurisdiction) creditors located in both jurisdictions will be treated equally as if they are located in the same jurisdiction.⁶⁰ With the universality approach co-operation between nations is required.⁶¹ A practical example of how the universality approach works is the following: Pick n Pay, which is a multinational company doing business in South Africa and in Mozambique, files for insolvency in South Africa. In this case South Africa is the host country. The South African courts will then administer all of Pick n Pay's assets found in South Africa as well as in Mozambique. The assets found in Mozambique would be dealt with in

⁵² Westbrook 1991 *Brooklyn JINT'L* L 513.

⁵³ Olivier and Boraine 2005 *CILSA* 374.

⁵⁴ Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 533. Also see Olivier and Boraine 2005 *CILSA* 374, Devling 2001 *UMKC Law Review* 437 and Westbrook 1991 *Brooklyn JINT'L* L 514.

⁵⁵ Stander 2015 *TSAR* 110.

⁵⁶ Olivier and Boraine 2005 *CILSA* 374. Also see Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 533, Devling 2001 *UMKC Law Review* 437 and Westbrook 1991 *Brooklyn JINT'L* L 514.

⁵⁷ Story 2015 *Arizona Journal of International and Comparative Law* 433. Also see Westbrook 1991 *Brooklyn JINT'L* L 514 – 515, and Stander 2015 *TSAR* 110.

⁵⁸ Main and non-main proceedings is discussed in Chapter 2.3.1 of this study.

⁵⁹ Story 2015 *Arizona Journal of International and Comparative Law* 433.

⁶⁰ Story 2015 *Arizona Journal of International and Comparative Law* 432.

⁶¹ Devling 2001 *UMKC Law Review* 437, this again refers to the notion of comity which is discussed fully in Chapter 2.3 of this study.

accordance with South African law and not Mozambiquen law. In turn, the court in Mozambique will now have to recognise and enforce the South African court order.

The international community unanimously agree that better international co-operation is required when dealing with a cross-border insolvency matter.⁶² Westbrook points out that despite this agreement, no universal agreement has been reached as to how this reform should take place.⁶³ In the author's opinion, the reason why one should move away from the two extreme models is because countries cannot exist in isolation. First world countries, such as the United States of America and the United Kingdom, can dominate developing countries such as most African countries. Creditors from these developing countries are placed at a disadvantage because the legal system of the first world counties will be applied. That being said economic growth cannot be dependent upon international investments alone. The universality approach has its own unique set of disadvantages. Devlin rightly points out that one of the main disadvantages of this approach is that a creditor runs the risk of his claim being excluded from the insolvency proceedings if he fails to submit his claim.⁶⁴

Moving away from the two extremes will allow countries to provide preference to its own insolvency systems while maintaining the concept of equity and reasonableness.⁶⁵ In an effort to accomplish this reform most states have moved away from the territoriality approach towards a limited co-operational approach.⁶⁶ The limited co-operational approach can in turn be divided into two distinct categories. The first approach is known as secondary bankruptcy and the second as a modified universality approach.⁶⁷ The secondary bankruptcy approach is a modification of the territoriality approach, in that it provides the liquidator more access to courts of co-operation countries.⁶⁸ The second modification that has taken

⁶² Westbrook 1991 *Brooklyn JINT'L* L 516.

⁶³ Westbrook 1991 *Brooklyn JINT'L* L 516. Also see Stander 2015 *TSAR* 115-117.

⁶⁴ Devling 2001 *UMKC Law Review* 437.

⁶⁵ Stander 2015 *TSAR* 108.

⁶⁶ Westbrook 1991 *Brooklyn JINT'L* L 516. Also see Stander 2015 *TSAR* 115-117.

⁶⁷ Westbrook 1991 *Brooklyn JINT'L* L 516. Also see Stander 2015 *TSAR* 115-117.

⁶⁸ Westbrook 1991 *Brooklyn JINT'L* L 516. Also see Stander 2015 *TSAR* 115-117.

place is that some assets may be handed over to the country where the proceedings have been initiated after a priority distribution to local creditors has taken place.⁶⁹

The second category of limited co-operation is referred to as a modified universality or a qualified universality approach.⁷⁰ This model has been suggested to bridge the gap between the universality and territoriality approach.⁷¹ According to Nielsen, Sigal and Wagner this approach identifies the complications that exist in the development of a uniform approach.⁷² The complications referred to are for example the notion that a state wishes to maintain its sovereignty.⁷³ This approach is based on the idea of a singular central administrative forum.⁷⁴ The forum referred to is located in one country while it is supplemented by secondary proceedings located in the other countries.⁷⁵ The central proceedings are referred to as the main⁷⁶ proceeding.⁷⁷ The modified universality approach is a crossbreed of the advantages of both the universality and territoriality approaches and it limits the disadvantages of above mentioned approaches.⁷⁸

LoPucki⁷⁹ identified another theory known as the co-operative territoriality.⁸⁰ According to LoPucki a co-operative territoriality system occurs when each court manages the assets found in its jurisdiction.⁸¹ Authorised representatives from each jurisdiction will then co-operate with each other regarding the assets found in their

⁶⁹ Westbrook 1991 *Brooklyn JINT'L L* 516. Also see Stander 2015 *TSAR* 115-117.

⁷⁰ Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 534. Also see Story 2015 *Arizona Journal of International and Comparative Law* 434; Westbrook 1991 *Brooklyn JINT'L L* 517.

⁷¹ Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 534. Also see Story 2015 *Arizona Journal of International and Comparative Law* 434.

⁷² Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 534.

⁷³ Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 534.

⁷⁴ Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 534. Also see Story 2015 *Arizona Journal of International and Comparative Law* 434.

⁷⁵ Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 534; Story 2015 *Arizona Journal of International and Comparative Law* 434.

⁷⁶ The expression of main proceedings explained in paragraph 2.3 below.

⁷⁷ Story 2015 *Arizona Journal of International and Comparative Law* 434.

⁷⁸ Nielsen, Sigal and Wagner 1996 *American Bankruptcy Law Journal* 534. Also see Story 2015 *Arizona Journal of International and Comparative Law* 434.

⁷⁹ LoPucki 2005 *American Bankruptcy Law Journal* 79-104.

⁸⁰ LoPucki 2005 *American Bankruptcy Law Journal* 79-104. Also see Stander 2015 *TSAR* 114.

⁸¹ LoPucki 2005 *American Bankruptcy Law Journal* 96. Also see Stander 2015 *TSAR* 114-115

respective jurisdictions.⁸² For example, the South African court will determine how the assets found in South Africa should be dealt with. They do not concern themselves with assets located in another country. The respective representatives from each country will in turn communicate with each other regarding the assets found in their respective jurisdictions. The basis of this theory can be found in co-operation between jurisdictions.⁸³ Using this approach insolvency proceedings, would be opened in each jurisdiction and a representative from each country will be appointed.⁸⁴ The representatives will have specific discretionary powers. They can elect to join the shared sale effort or they can elect to participate in separate sale efforts.⁸⁵

The theories mentioned above are however not an exhaustive list. Other writers such as Fletcher⁸⁶ and Janger⁸⁷ have each developed their own theory. As it is not the main focus of this study and further in-depth analysis of the remaining theories will not be discussed.⁸⁸ It is however abundantly clear that no uniformity exists as to what theory is the most effective or fair. To the author's mind, academics and practitioners in developing jurisdictions follow the theory that is most beneficial to their own creditors, while academics and practitioners from developed jurisdictions consider those theories as inferior. What is evident is that all jurisdictions, regardless if they are a first or third world country, want to protect their own sovereignty.

2.2 The need for a uniform cross-border insolvency law

With the continuous globalization of businesses, the failure of these businesses has also become a global crisis.⁸⁹ As a result, insolvency law now plays a vital role in the

⁸² LoPucki 2005 *American Bankruptcy Law Journal* 96. Also see Stander 2015 *TSAR* 114-115.

⁸³ Stander 2015 *TSAR* 114.

⁸⁴ LoPucki 2005 *American Bankruptcy Law Journal* 96. Also see Stander 2015 *TSAR* 114-115.

⁸⁵ LoPucki 2005 *American Bankruptcy Law Journal* 96. Also see Stander 2015 *TSAR* 114-115.

⁸⁶ Fletcher 2011 *Texas International Law Journal* 489-512. In an attempt to eliminate the conflict of law problem Fletcher emphasises the justified expectations. Stander 2015 *TSAR* 117.

⁸⁷ Janger 2009 *Columbia Journal of transnational Law* 401-441. Janger refers to his theory as the reciprocal comity. Also see Stander 2015 *TSAR* 118.

⁸⁸ For an in-depth discussion on these theories see Fletcher 2011 *Texas International Law Journal* 489-512 and Janger 2009 *Columbia Journal of transnational Law* 401-441.

⁸⁹ Devling 2001 *UMKC Law Review* 435.

development of cross-border investment.⁹⁰ An economically profitable company or financial institution will be hesitant to open a business in a country with a poorly developed insolvency law. The reason for the hesitation lies in the fear that in the event of insolvency their creditors or investors would be greatly disadvantaged, or in some cases not receive recognition. The opposite also holds true: foreign investors are not likely to invest in a financial institution that is situated in a country with a poorly developed insolvency law. The lack of persistency in the handling of cross-border insolvency matters has significantly hampered global investment.⁹¹ An example of how this occurs is due to the limited communication and co-operation that exists between the courts and administrators from different states.⁹² This in turn creates the possibility that assets can be concealed, or even liquidated, without the consideration of a more profitable solution.⁹³ In light of the aforementioned it is clear that a need to establish an efficient and fair administrative system for cross-border insolvency matters is created.⁹⁴

Numerous attempts have been made in an effort to establish a uniform cross-border insolvency law. The use of protocols,⁹⁵ treaties,⁹⁶ conventions,⁹⁷ adoption of Model Law and the principles of Private International law are but a few examples.⁹⁸ Olivier and Boraine indicate that draft proposals have also been made by various international bodies, such as the International Bar Association, to attempt to bring about harmonisation to cross-border insolvency rules and procedures.⁹⁹ They proclaim that none of these attempts have however thus far been successful as most

⁹⁰ Devling 2001 *UMKC Law Review* 435. Also see Stander 2002 *Journal for Juridical Science* 72.

⁹¹ Stander 2002 *Journal for Juridical Science* 72.

⁹² Stander 2002 *Journal for Juridical Science* 73.

⁹³ Stander 2002 *Journal for Juridical Science* 73.

⁹⁴ Stander 2002 *Journal for Juridical Science* 72.

⁹⁵ A protocol is a legal arrangement between two or more courts; court to court communication, that governs the way in which assets located in different jurisdictions are dealt with. For example Protocols to the Geneva Convention. Stroebe *Protocols as a possible solution to jurisdiction problems in cross-border insolvencies* 27.

⁹⁶ A treaty is an international written agreement between states which operates within a field of international law. Also see Dugard *International law A South African Perspective* 28 and 406.

⁹⁷ A convention is an agreement between states for the regulation of matters that affect them. For example the convention on the Elimination of All forms of Discrimination against women. Webster 2017 <https://www.merriam-webster.com/dictionary/convention>

⁹⁸ Olivier and Boraine 2005 *CILSA* 377.

⁹⁹ Olivier and Boraine 2005 *CILSA* 377.

states still lean towards the use of the models based upon territoriality, universality or other models that are developed each day.¹⁰⁰ The author agrees that there are numerous problems with the handling of cross-border insolvency matters due to the fact that each jurisdiction follows a different theory. The consequences of this are that numerous cases were dealt with insufficiently. One case that can however be used as an example is the matter of *Maxwell Communication Corporation v Société Generale, Barclays Bank*.¹⁰¹ Even though this case is fairly old, it is preferred because the case made an admirable attempt to resolve some of these problems in that sovereign pride did not prevail.

2.3 *Maxwell Communication Corporation v Société Generale, Barclays Bank.*

In this matter Maxwell Communication Corporation, herein after referred to as the debtor, controlled a variety of broadcasting associated companies which were situated in different countries.¹⁰² Even though its principle place of business were located and managed in England, most of its assets were found in the United States of America.¹⁰³ The debtor had certain credit arrangements with three specific banks, namely Barclays, National Westminster and *Societe Generale*. All three of these banks were multinational entities in that they operated business in more than one country. Barclays and National Westminster's principle place of business were situated in London, with divisions located in New York.¹⁰⁴ *Societe Generale's* principle place of business was situated in *Paris* with divisions located in both London as well

¹⁰⁰ Olivier and Boraine 2005 *CILSA* 377.

¹⁰¹ *Maxwell Communication Corporation v Société General, Barclays bank* 93 F 3d, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁰² *Maxwell Communication Corporation v Société General, Barclays bank* par 4, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁰³ *Maxwell Communication Corporation v Société General, Barclays bank* par 4, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁰⁴ *Maxwell Communication Corporation v Société General, Barclays bank* par 5, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

as New York.¹⁰⁵ In order to satisfy the aforementioned credit arrangements the debtor, prior to the institution of Chapter 11 filings,¹⁰⁶ made certain payments (transfers) to these particular banks.¹⁰⁷ The debtor now intended to declare these transactions as voidable dispositions.¹⁰⁸ If these transactions were to be declared voidable dispositions then the aforesaid banks would have to repay the money to the debtor. The money could then in turn be used to settle the remainder of the debtor's debt.

The debtor continued to institute simultaneous insolvency proceedings in the United States of America (Chapter 11) as well as in England in terms of an administration order.¹⁰⁹ A dualistic approach to the insolvency proceedings was thus followed by the debtor. Under English law an administrator was appointed and in terms of the Chapter 11 procedure in the USA an examiner was appointed.¹¹⁰ The duty of the administrator as well as the examiner was to investigate debtor's financial position.¹¹¹ The purpose of the appointment of the examiner was to

(H)armonize for the benefit of all [Maxwell's] creditors and stockholders and other parties interest, [Maxwell's] United States Chapter 11 case and [Maxwell's] United

¹⁰⁵ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 5, (<http://www.allcourtdade.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁰⁶ Chapter 11 bankruptcy is the recognition of corporations under USA bankruptcy law. Chapter 11 is discussed in more detail in Chapter 2.4 of this study.

¹⁰⁷ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 5, (<http://www.allcourtdade.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁰⁸ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 5, (<http://www.allcourtdade.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁰⁹ A petition for reorganization under Chapter 11 was opened in the Southern District of New York-, and in London for the administration order. *Maxwell Communication Corporation v Soci   General, Barclays bank* par 10, (<http://www.allcourtdade.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹¹⁰ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 10, (<http://www.allcourtdade.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹¹¹ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 10, (<http://www.allcourtdade.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

Kingdom administration case so as to maximize [the] prospects for rehabilitation and reorganization.¹¹²

The administrator and examiner co-ordinated their various investigations and developed a reorganizational plan.¹¹³ This reorganizational plan which was accepted in both countries aimed at paying all secured and preferential claims.¹¹⁴ The payment would take place regardless if the particular creditor was afforded this right in terms of American law or English law. There was however a fatal flaw in this reorganizational plan. The dispute regarding the debtor's intention to have the aforementioned transactions set aside was never addressed by the examiner or the administrator.¹¹⁵

If the transactions were declared avoided by the administrator then the banks would have to repay the monies it received.¹¹⁶ In an effort to prevent this from happening Barclays applied for an anti-suit injunction barring the administrator from commencing litigation in order to recover the payment that Barclays received.¹¹⁷ Barclays' argument in favour of the order¹¹⁸ was based upon the difference between the avoidance rule¹¹⁹ under American law and the British law.¹²⁰ The application for

¹¹² *Maxwell Communication Corporation v Soci  t   General, Barclays bank* par 11, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹¹³ *Maxwell Communication Corporation v Soci  t   General, Barclays bank* par 14 - 16, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹¹⁴ *Maxwell Communication Corporation v Soci  t   General, Barclays bank* par 14 - 16, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹¹⁵ *Maxwell Communication Corporation v Soci  t   General, Barclays bank* par 14 - 16, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹¹⁶ *Maxwell Communication Corporation v Soci  t   General, Barclays bank* par 17, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹¹⁷ *Maxwell Communication Corporation v Soci  t   General, Barclays bank* par 17, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹¹⁸ The order was for an anti-suit injunction.

¹¹⁹ The avoidance of a transaction refers to (1) a judicial order requiring the return of the certain property transferred by a debtor (2) the cancelling of certain obligations incurred by a debtor (3) the award of a monetary judgment against the beneficiary of a transaction in the amount of the benefit received. Westbrook 1991 *Brooklyn J.INT'L L* 499. In South Africa this is known as the setting aside of impeachable transactions.

the anti-suit injunction was opposed by the administrator. They wanted to litigate in America because the conditions for avoidance under America law is less strict than British law and would therefore definitely favour their case.¹²¹ The injunction was denied which resulted in the administrator instituting an action in the Southern District bankruptcy court in New York against all three banks for the recovery of the transfers made by the defendant (Maxwell).¹²² As mentioned above the administrator wanted to use the money to settle the debtors remaining debts. The banks subsequently filed a motion¹²³ for dismissal of the application by the administrator which was granted.¹²⁴ The bankruptcy court based its decision on the grounds of "extra-territoriality" and comity, which emphasises the choice of law principles.¹²⁵ The USA court determined that in terms of the choice of law principle a determination has to be made as to which jurisdictional laws and procedures will be implicated to the highest extent.¹²⁶ The court established that in this instance it would be England.¹²⁷ The decision was based upon the fact that the court found the

¹²⁰ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 17, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹²¹ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 18, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹²² *Maxwell Communication Corporation v Soci   General, Barclays bank* par 22, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹²³ The motion was for dismissal under Fed.R.Cic.P. 12(b)(6) stating that when section 547 of the Bankruptcy Code is applied to the transactions would violate the presumption against extraterritoriality and that the dismissal was warranted on the grounds of international comity. *Maxwell Communication Corporation v Soci   General, Barclays bank* par 23, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹²⁴ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 22, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹²⁵ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 24, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹²⁶ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 24-25, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹²⁷ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 24-25, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

transactions to be "extra-territorial" and as such the *Bankruptcy Code* were not applicable to the transactions.¹²⁸

The decision was appealed by the debtor, now the defendant (Maxwell), and the administrator. The court of appeal found that the confirmation order¹²⁹ did not disqualify the banks from challenging the applicability of the avoidance rule.¹³⁰ In other words, they could still have challenged the applicability thereof. The court however determined that in this instance, where concurrent insolvency procedures were opened, the doctrine of international comity prohibits the application of the American avoidance rule to transfers which had predominantly English interests.¹³¹ The administrator should thus have instituted the action in England and not in America.

The doctrine of international comity¹³² and the choice of law principles were predominant factors that were considered when the above mentioned decision was reached. The US court stated that the use of the doctrine of international comity could be viewed as a discretionary act by a national court to enforce comity between nations.¹³³ This was achieved by declining to exercise or enforce their jurisdiction when they are of the opinion that the matter could be decided in a foreign nation.¹³⁴

¹²⁸ The Bankruptcy Court determined that the Bankruptcy Code does not apply to transactions whose centre of gravity lies outside the United States. *Maxwell Communication Corporation v Société General, Barclays bank* par 23-25, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>)

¹²⁹ The confirmation order was the reorganizational plan which was confirmed by Judge Brozman.

¹³⁰ *Maxwell Communication Corporation v Société General, Barclays bank* par 80, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹³¹ *Maxwell Communication Corporation v Société General, Barclays bank* par 80, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹³² See also the discussion in paragraph 2.3 below.

¹³³ *Maxwell Communication Corporation v Société General, Barclays bank* par 42, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹³⁴ *Maxwell Communication Corporation v Société General, Barclays bank* par 42, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

The court went further and stated that comity is implemented with reference to the doctrine of international law specifically the choice of law principles.¹³⁵

With reference to the matters of *Lauritzen v Larsen*¹³⁶ and *Romero v International Terminal Operating Co*¹³⁷ the US court stated that it should be reasonable for the court to enforce their jurisdiction.¹³⁸ Whether or not it can be considered to be reasonable is determined by factors such as the nexus between the state and the suit, as well as the importance of the suit to the particular nation.¹³⁹

In determining that the transfers had predominantly English interests, the US court considered the origins of each. The transfers originated from the National Westminster Bank in London and were credited to overdraft accounts which were maintained in England.¹⁴⁰ Secondly the court determined that because the debtor (Maxwell) was incorporated in terms of English law and most of the debt was incurred in England strongly suggest that the nexus between England and the suit was closer than that of the United States.¹⁴¹ The second factor that the court had to consider was if the suit had a particular importance to the US. In other words was there an adequate connection to the US. The court found that the only connection to

¹³⁵ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 43, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹³⁶ *Lauritzen v Larsen* 345 U.S. 571 1953 (<http://www.law.cornell.edu/supremecourt/text/345/571>)

¹³⁷ *Romero v International Terminal Operating Co.* 358 U.S. 354 1959 (<http://supreme.justia.com/cases/federal/us/358/354/case.html>).

¹³⁸ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 43 - 44, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹³⁹ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 44, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>). In the author's opinion the determination of the nexus between the state and the suit refers to the causal link that exists between the particular jurisdiction and the particular action brought. In this case the particular transactions that were the cause of the dispute originated in England. It is only logical to infer that if a dispute occurs, the English court would be best suited to resolve the matter and not the country that the transfers were received. With regard to the importance of the suit to the nation, in the author's opinion, this goes hand in hand with the first factor in that the closer the causal link the greater the importance will be to that particular nation.

¹⁴⁰ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 60, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁴¹ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 59, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

the US was that of the proceeds of the transfers consisted from funds which were received from the sale of certain subsidiaries located in the US.¹⁴² As such the court ultimately determined that a substantial connection between the US and the dispute could not be found.¹⁴³ The court however determined that because these divisions were sold as a going concern the sale had little to no effect on the economy of the USA.¹⁴⁴

It is important to emphasise that this case is rather exceptional. It is exceptionally that the USA court with the consideration of comity referred that matter back to the UK. Normally states will elect to apply their own laws as it will protect their local creditors.

To summarise the key problem that occurred, was the question whether or not an administrator can decide to institute a certain action in a particular court if it is determined that that specific court would have a more favourable outcome. The administrator decided to enforce the avoidance principle under American law purely because the conditions thereof were less strict and would be more easily granted than if they applied under British law. The facts of this case clearly illustrate the following problems: Administrators choose the jurisdiction that will have the most favourable outcome for them.¹⁴⁵ If this is allowed, then what is stopping a creditor from doing the same?

¹⁴² *Maxwell Communication Corporation v Soci   General, Barclays bank* par 63, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁴³ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 63, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁴⁴ *Maxwell Communication Corporation v Soci   General, Barclays bank* par 63, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁴⁵ This refers to the notion of forum shopping. Forum shopping is defined by LoPucki as an attempt to choose a jurisdiction that will provide the most favourable outcome. LoPucki 2005 *American Bankruptcy Law Journal* 79-104. Also see Stroebel *Protocols as a possible solution to jurisdiction problems in cross-border insolvencies* 8. In the author's opinion this has the effect that a litigant will do his research and determine which jurisdictional laws will most likely provide him with the outcome he desires and only then will he proceed to institute a action in that particular court.

Leno forcefully argues that if a uniform cross-border insolvency law existed the number of court cases will drastically be reduced which will be more cost effective.¹⁴⁶ The current diverse approach is uneconomical as it prompts increased transactional cost.¹⁴⁷ It also creates ambiguity as to jurisdiction and the applicable law.¹⁴⁸

To the author's mind, it is clear that even if co-operation between nations exist, the problems regarding jurisdiction and the treatment of the creditors cannot easily be resolved. Currently, as a result of the lack of a uniform cross-border bank insolvency law, matters are obviously adjudicated on a case to case basis. The logical consequence is that in doing so the cost implications of such actions are enormous and the time spent on each individual matter is increased, all without the certainty that a decision will be reached. It is also reasonable to state that even courts and jurisdictions will fight to adjudicate the administration and liquidation of such cases, as it will be profitable for that specific district.

After examination of the above mentioned matter and in the author's opinion because no uniform insolvency law exists some of the following problems are evident: the judicial discretion regarding comity and extra-territoriality has created legal uncertainty; the law is not applied consistently; and finally no uniformity exists on how different claims, such as secured claims, should be treated.

2.4 The South African perspective on cross-border insolvency law

It is important to draw the distinction between the current position in terms of our common law and what the position will be after the *Cross-Border Act*¹⁴⁹ comes into operation.¹⁵⁰

The common law is regulated by the principles of private international law,¹⁵¹ which determines that the *lex domicilii* of the debtor is applicable to movable assets.¹⁵² Put

¹⁴⁶ Leno 2013 *Journal of African law* 2.

¹⁴⁷ Leno 2013 *Journal of African law* 2.

¹⁴⁸ Leno 2013 *Journal of African law* 2.

¹⁴⁹ *Cross-Border Act*.

¹⁵⁰ See the explanation below.

¹⁵¹ Franco 2003 *SA Merc LJ* 28; Olivier and Boraine 2005 *CILSA* 378.

¹⁵² Franco 2003 *SA Merc LJ* 28; Stander 1999 *THRHR* 512.

simply this means that if a debtor is domiciled in the jurisdiction of a South African court which grants the order at the time of sequestration, that order will automatically apply to his property situated in South Africa as well as movables elsewhere¹⁵³ – even in another state.¹⁵⁴ This entails that a South African trustee can deal with the assets without having to apply to a South African court for recognition.¹⁵⁵ However, when a sequestration or liquidation order is granted in another jurisdiction while the debtor is domiciled in South Africa¹⁵⁶ the trustee (that is the foreign representative) will have to apply for recognition to a South African court to deal with the movable assets in South Africa.¹⁵⁷ This recognition will only be granted if exceptional circumstances exist.¹⁵⁸

With immovable assets jurisdiction vests in accordance with the *lex situs*.¹⁵⁹ In other words with immovable assets the jurisdiction is determined by the law of the country where the immovable assets are locally situated.¹⁶⁰ In these situations the order made by the foreign court will have no effect on the locally situated immovable assets.¹⁶¹ If the foreign representative wants to lay claim to these assets (the immovable property) he should apply for recognition; which recognition is again in the discretion of the courts.¹⁶² The factors which the court will take into account are

¹⁵³ This has been emphasised in the matter of *Trustee of Howse, Sons & Co v Trustees of Howse, Sons & Co; Jocelyne v Shearer & Hine* 1887 3 SC 14 where liquidation was perused in London, the creditors then proceeded to institute an action for sequestration in the Cape Colony as that is where they were situated. Because only movable assets were found in the Cape the assets were allocated in terms of English Law. Also see *Ex Parte Palmer NO: In re Hahn* 1993 3 SA 359 (C) 362.

¹⁵⁴ Franco 2003 *SA Merc LJ* 28, Zulman 2009 *SA MERC LJ* 809.

¹⁵⁵ Franco 2003 *SA Merc LJ* 28, Zulman 2009 *SA MERC LJ* 809.

¹⁵⁶ For example a creditor applied for sequestration or liquidation in the jurisdiction where the debtor has immovable property.

¹⁵⁷ Franco 2003 *SA Merc LJ* 28; Stander 1999 THRHR 512.

¹⁵⁸ Franco 2003 *SA Merc LJ* 28; Stander 1999 THRHR 512.

¹⁵⁹ *Ex Parte Palmer NO: In re Hahn* 1993 3 SA 359 (C) 362. Also see Zulman 2009 *SA MERC LJ* 809; Stander 1999 THRHR 512-513.

¹⁶⁰ Stroebel *Protocols as a possible solution to jurisdiction problems in cross-border insolvencies* 20.

¹⁶¹ *Ex Parte Palmer NO: In re Hahn* 1993 3 SA 359 (C) 362. Also see *Ward and another v Smit and Others: In re Gurr v Zambia Airways Corporation Ltd* 1998 (3) SA 175 (SCA); Zulman 2009 *SA MERC LJ* 809; Franco 2003 *SA Merc LJ* 28.

¹⁶² *Westminster Bank Ltd NO v Zinn NO* 1938 AD 57. Also see *Ex Parte Palmer NO: In re Hahn* 1993 3 SA 359 (C); *Ward and another v Smit and Others: In re Gurr v Zambia Airways Corporation Ltd* 1998 (3) SA 175 (SCA); Franco 2003 *SA Merc LJ* 28; Zulman 2009 *SA MERC LJ* 809.

the following: comity of nations, convenience as well as equity.¹⁶³ At this stage, recognition is very difficult because the common law principles are basically territorial-, and to the author's mind the principles of comity and convenience do not make it easier. This is so because the application of these principles can in the author's opinion be very volatile and cause uncertainty. The situation will be similar when the debtor is sequestrated or liquidated in South Africa with immovable assets located in another country. Those assets (immovable in the other country) are subject to the laws of that country.¹⁶⁴

This viewpoint has the effect that in a majority of instances co-ordination of sequestration procedures between nations is required. The main problem with this, as seen in the *Maxwell-case*,¹⁶⁵ is that co-ordination between states is predominantly based upon the doctrine of comity.¹⁶⁶ Huber described the concept of comity as

(T)hose who exercise sovereign authority so act from comity, that the laws of each nation having been applied within its own boundaries should retain their effect everywhere, so far as they do not prejudice the power or right of another state or its subjects.¹⁶⁷

This statement offers an answer to the question as to how foreign law should be applied without breaching the local state's sovereignty.¹⁶⁸ The exact meaning of comity can however not be deduced from this statement. Therefore various Roman Dutch writers attempted to clarify what they believed Huber meant.¹⁶⁹ Professor Kahn determined that comity formed part of the *ius gentium*.¹⁷⁰ As such sovereign states had to apply foreign law in certain instances as they were bound by the rules of international law, which consists of both private and public international law.¹⁷¹

¹⁶³ *Moolman v Builders & Developers (Pty) Ltd (In provisional liquidation): Jooste Intervening* 1990 (1) SA 954 (A). Also see Zulman 2009 SA MERC LJ 809; Franco 2003 SA Merc LJ 28.

¹⁶⁴ Also see Stander 1999 THRHR 512-513.

¹⁶⁵ *Maxwell Communication Corporation v Soci   General, Barclays bank*, (<http://www.allcourtdate.com/law/in-re-maxwell-communication-corporation-plc-by-andrew-mark-homan-colin/cB1x4s6>).

¹⁶⁶ Stander 2002 *Journal for Juridical Science* 74.

¹⁶⁷ Forsyth *Private International Law* 42. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 178.

¹⁶⁸ Forsyth *Private International Law* 42.

¹⁶⁹ Forsyth *Private International Law* 42. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 177.

¹⁷⁰ Forsyth *Private International Law* 43.

¹⁷¹ Forsyth *Private International Law* 43.

The second and third writers that contributed to understanding the concept of comity were Paul and Johannes Voet. They differed from Kahn's understanding. They determined that comity does not form part of the *ius gentium* and as a result does not place any obligation on a state to enforce foreign law.¹⁷² Instead it places a discretion on a state to consider the inconvenience, injustice and confusion that may arise if recognition of the foreign law does not occur.¹⁷³

In 1985 the Supreme Court in American defined comity as

(C)omity, in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.¹⁷⁴

When the definition as set out in *Hilton v Guyot*¹⁷⁵ is considered it is clear that comity does not entail that a court cedes its authority,¹⁷⁶ nor can it be seen as a complete acceptance of the foreign law.¹⁷⁷ The concept merely requires that a local court consider the situation from an international perspective.¹⁷⁸

In terms of South African law the doctrine of comity has best been explained in the matter of *Ex Parte Palmer NO: In re Hahn*¹⁷⁹

(T)he Court having jurisdiction at the place where such landed property is situated is fully entitled to deal with that property according to the *lex rei sitae*, and to refuse in any way to recognise the order of the Judge of the debtor's domicile. But, on the other hand, the same Court, acting from motives of comity or convenience, is equally justified in allowing the order of the Judge of the domicile to operate within its jurisdiction, and in assisting the execution or enforcement of such order.¹⁸⁰

¹⁷² Forsyth *Private International Law* 43. Also see Pearce 1994 *Stanford Journal of International law* 526.

¹⁷³ Forsyth *Private International Law* 43. Also see Pearce 1994 *Stanford Journal of International law* 526; Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 177.

¹⁷⁴ *Hilton v Guyot*, 159 U.S. 113 1985 (<https://supreme.justia.com/cases/federal/us/159/113/>).

¹⁷⁵ *Hilton v Guyot*, 159 U.S. 113 1985 (<https://supreme.justia.com/cases/federal/us/159/113/>).

¹⁷⁶ Stroebe *Protocols as a possible solution to jurisdiction problems in cross-border insolvencies* 22.

¹⁷⁷ Devling 2001 *YMKC Law Review* 442.

¹⁷⁸ Devling 2001 *YMKC Law Review* 442.

¹⁷⁹ *Ex Parte Palmer NO: In re Hahn* 1993 3 SA 359 (C).

¹⁸⁰ *Ex Parte Palmer NO: In re Hahn* 1993 3 SA 359 (C) 363.

In this case the court determined that when a local court has to decide if an application for recognition of a foreign trustee should be granted, then the court has to exercise its discretion based on the grounds of comity.¹⁸¹ This discretion is absolute when it relates to immovable property.¹⁸²

Stroebe¹⁸³ states (and the author agrees with this view) that the doctrine of comity, when used as a consideration to grant recognition in a matter pertaining to cross-border insolvency, should be balanced against the interest of local creditors.¹⁸⁴ Fourie states that comity entails that local creditor's secured and preferential claims will be dealt in accordance with South African insolvency law as it is based on assets which are located locally.¹⁸⁵ The effect of recognising foreign proceedings in this matter is that the local assets will be dealt with as if the debtor is declared insolvent in terms of South African insolvency law.¹⁸⁶ It is however important to state that even though the assets are dealt with as if the debtor was declared insolvent in South Africa, the debtor himself will not be considered to be an insolvent.¹⁸⁷

Consequently, when all of the above mentioned is considered it can be argued that comity refer to the ability of courts to co-operate with different nations out of a sense of international understanding and respect rather than a blind obligation.

In an effort to eliminate some of the problems that arise out of cross-border insolvency matters,¹⁸⁸ for example as mentioned above, recognition is based on comity which is not always certain and the fact that the law is not applied consistently, South Africa developed the *Cross-Border Act*. The *Cross-Border Act* is an adaption of the *Model Law*,¹⁸⁹ which was designed to assist states to produce a harmonised cross-border insolvency procedure.¹⁹⁰ The aim of the act as set out in

¹⁸¹ *Ex Parte Palmer NO: In re Hahn* 1993 3 SA 359 (C) 362-363.

¹⁸² *Ex Parte Palmer NO: In re Hahn* 1993 3 SA 359 (C) 362-363.

¹⁸³ Stroebe *Protocols as a possible solution to jurisdiction problems in cross-border insolvencies* 22.

¹⁸⁴ See *Steinber v Cosmopolitan National Bank of Chicago* 1973 SA 564 (R). Also see Stroebe *Protocols as a possible solution to jurisdiction problems in cross-border insolvencies* 22.

¹⁸⁵ Fourie *Oorgrens-insolvensiewetgewing* 30.

¹⁸⁶ Fourie *Oorgrens-insolvensiewetgewing* 30.

¹⁸⁷ Olivier and Boraine 2005 *CILSA* 381. Also see Fourie *Oorgrens-insolvensiewetgewing* 30.

¹⁸⁸ Stander 2002 *Journal for Juridical Science* 73.

¹⁸⁹ Franco 2003 *SA Merc LJ* 27.

¹⁹⁰ Stander 2002 *Journal for Juridical Science* 73.

the preamble, is to supply tools to deal with cases pertaining to cross-border insolvency and in doing so strengthening co-operation between local and foreign courts.¹⁹¹ It also aims to provide legal certainty.¹⁹²

The application of the *Cross-Border Act* can be found in section 2.¹⁹³ This provision states that the model law is applicable in four specific situations. It is applicable in situations where assistance is required in the Republic by either a foreign court or representative in connection with foreign proceedings.¹⁹⁴ It is secondly applicable where assistance is required in a foreign state with regard to proceedings under South African law pertaining to insolvency.¹⁹⁵ It will be applicable when parallel insolvency proceedings are opened in South Africa and another state.¹⁹⁶ Finally it obtains applicability when foreign creditors take part in insolvency proceedings under South African law.¹⁹⁷ It is however important to keep in mind that the *Cross-Border Act* is not in force as of yet, because the minister has not designated any states.¹⁹⁸ The *Cross-Border Act* will thus only come into operation once designation has taken place.

The *Cross-Border Act* provides that the legislation is applicable to any state that is designated by the Minister by means of a notice in the government gazette.¹⁹⁹ The purpose hereof is to attempt to eliminate the problems associated with the principle of comity. This means that the Act will only be applicable to states that are designated by the Minister.²⁰⁰ Section 2(b)²⁰¹ determines that a state can only be

¹⁹¹ Olivier and Boraine 2005 *CILSA* 383.

¹⁹² Franco 2003 *SA Merc LJ* 27.

¹⁹³ Section 2 of the *Cross-Border Act*.

¹⁹⁴ Section 2(1)(a) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 73; Olivier and Boraine 2005 *CILSA* 383.

¹⁹⁵ Section 2(1)(b) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 73 and Olivier and Boraine 2005 *CILSA* 384.

¹⁹⁶ Section 2(1)(c) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 73 and Olivier and Boraine 2005 *CILSA* 384.

¹⁹⁷ Section 2(1)(d) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 73 and Olivier and Boraine 2005 *CILSA* 384.

¹⁹⁸ In terms of section 2 of the *Cross-Border Act* the act applies only in respect of states designed by the Minister.

¹⁹⁹ Stander 2002 *Journal for Juridical Science* 74. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 190.

²⁰⁰ Olivier and Boraine 2005 *CILSA* 383.

²⁰¹ Section 2(2)(b) of the *Cross-Border Act*.

designated by the Minister if he is satisfied that the recognition that is accorded by the laws of that state to the proceedings in terms of the South African insolvency law, justifies the application of the *Cross-Border Act* to foreign proceedings in that state.²⁰²

This section embodies the requirement of reciprocity. Reciprocity refers to the close relationship between South African insolvency law and the insolvency law of the foreign state, as well the ease with which recognition of South African insolvency proceedings can be accomplished.²⁰³ In other words if a country's insolvency law is closely related to that of South African insolvency law then designation will most likely take place. Designation will also take place if South African insolvency proceedings can easily be implemented in the foreign nation. This implies that an investigation should be carried out regarding the different legal systems of countries with which South Africa has trade ties. However, it appears that this study has not been done yet because designation has not taken place yet.

The requirement of reciprocity has been highly criticised in light of the fact that it brings about a dualistic approach when it comes to cross-border insolvency matters. Designated states will receive the full protection of the *Cross-Border Act* while states from non-designated states will have to rely on the principles of the common law (as discussed above).²⁰⁴ It can be argued that the limited restriction in terms of article

²⁰² Section 2(2)(b) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 74; Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 190.

²⁰³ Stander 2002 *Journal for Juridical Science* 75. Also see Botha and Stander 2011 *TRW* 11; Fourie *Oorgrens-insolvenswetgewing* 26; Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 190.

²⁰⁴ Botha and Stander 2011 *TRW* 21. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 191; Fourie *Oorgrens-insolvenswetgewing* 27.

1(2) of the *Model Law*²⁰⁵ is more favourable in that it excludes certain entities rather than complete legal systems.²⁰⁶ However, Stander has a different opinion. She asks

(W)as die Suid-Afrikaanse wetgewer werklik so verkeerd met die wederkerigheidsbeginsel in artikel 2 van die Wet op Insolvensie oor Landgrense? Beoog dit nie dieselfde as wederkerige hoflikheid nie; is dit nie gegrond op dieselfde beginsel as wederkerige hoflikheid nie?²⁰⁷

Another problem that currently exists is that the designation that is given by the Minister may by means of a notice in the government gazette be withdrawn.²⁰⁸ The state that is referred to in this withdrawal will then cease to be recognised as a foreign state.²⁰⁹ The implication thereof is that the state will no longer be considered a designated state and a representative from that particular state will have to rely on the common law principles for recognition.

There are several additional problems that exist with the concept and process of designation. These are not important for the purpose of this study. It is nevertheless important to discuss certain rules and principles set out in the *Cross-Border Act* with specific reference to the determination of jurisdiction and the treatment of creditors.

2.4.1 Access to court in terms of the Cross-Border Act

The access to courts by foreign representatives and creditors is determined in terms of the *Cross-Border Act*.²¹⁰ Section 9²¹¹ provides that a foreign representative may directly apply to a court in the Republic for relief; and in terms section 4 jurisdiction

²⁰⁵ Article 1(2) of the *Model Law* state that this law does not apply to a proceeding concerning [designate any type of entities, such as banks or insurance companies, that are subject to a special insolvency regime in this State and that this state wishes to exclude from law] In short this article entails that states may exclude certain types of entities for example the exclusion of banks. Fourie *Oorgrens-insolvensiewetgewing* 26.

²⁰⁶ Article 1(2) of the *Model Law*. Also see Stroebe *Protocols as a possible solution to jurisdiction problems in cross-border insolvencies* 26; Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 192; Fourie *Oorgrens-insolvensiewetgewing* 26.

²⁰⁷ Stander 2015 *TSAR* 124. Stander states that the reciprocity principle contained in section 2 of the *Cross-Border Act* is based on the same principle as the doctrine of comity.

²⁰⁸ Section 2(3) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 74; Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 190.

²⁰⁹ Section 2(2)(b) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 74.

²¹⁰ *Cross-Border Act*.

²¹¹ Section 9 of the *Cross-Border Act*.

is vested in the High Court.²¹² No specification is given as to which High court will have jurisdiction-, and as such it should be determined in accordance with section 6(7) of the Superior Courts Act.²¹³ This section briefly provides that

(W)henever it appears to the Judge President of a Division that it is expedient or in the interest of justice to hold a sitting for the hearing of any matter at a place elsewhere than at the seat or a local seat of the division, he or she may, after consultation with the Minister, hold such sitting at that place.²¹⁴

The access of foreign representatives is limited in terms of section 10.²¹⁵ This section determines that even if an application by the foreign representative is done in accordance with the *Cross-Border Act*, the foreign representative, assets or affairs of the debtor is not subject to the jurisdiction of the court of the Republic for any purpose other than that of the application;²¹⁶ jurisdiction is therefore limited.

This statutory right is thus only afforded to foreign representatives from a designated state. Recognition for representatives from non-designated states is dependent upon the discretion of the local courts, which discretion is based upon comity.²¹⁷ The implication of this is that when a representative is from a designated state the court will have no discretion on whether or not recognition should be granted if the application is done in accordance with the *Cross-Border Act*. The foreign representative will then receive direct access to our courts. In contrast and as stated above, recognition of a representative from a non-designated state is determined in accordance with the common law, which is largely based on territoriality, comity and practice.²¹⁸

Now that it has been established that foreign creditors have access to local proceedings, it is important to ascertain what position they hold; in other words how

²¹² Section 4 of the *Cross-Border Act*. Also see Sharrock Smith and Van der Linde *Hochly se Insolvensiereg* 285; Stander 2002 *Journal for Juridical Science* 76; Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 192.

²¹³ Section 6(7) *Superior Courts Act* 10 of 2013, hereinafter referred to as the *Superior Courts Act*.

²¹⁴ Section 6(7) *Superior Courts Act*.

²¹⁵ Section 10 of the *Cross-Border Act*.

²¹⁶ Section 10 of the *Cross-Border Act*. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 192.

²¹⁷ Olivier and Boraine 2005 *CILSA* 385.

²¹⁸ Olivier and Boraine 2005 *CILSA* 387.

their claims are treated.²¹⁹ In terms of section 13(1) foreign creditors have the same rights concerning the commencement of-, and participation in, proceedings in terms of the our insolvency law.²²⁰ These rights are however subject to subsection 2, which determines that the ranking of claims in proceedings under the insolvency laws of the Republic are not affected except that their claims may not be ranked lower than concurrent claims.²²¹ Subsection 3 continues to state that the ranking of claims with regard to assets which are found locally are regulated by the law and practice on the ranking of claims by the Republic.²²² This entails that claims are ranked in accordance with South African insolvency law, the ranking of claims are therefore unaltered.²²³ For example all creditors, local and foreign, have to submit their respective claims. The claims are then divided into preferential, secured or concurrent claims. The creditors will receive the dividend which is due to them in accordance with this ranking. A possible problem with this approach is that a situation may arise where a foreign creditor has a secured claim according to the law in his country, but his security is not recognised in South Africa. Will the doctrine of comity be used in these situations? ²²⁴

Another example of the legislature's intention to treat local and foreign creditors equally can be found in section 14.²²⁵ This section provides that all known creditors should be notified under the South African insolvency law; this notification has to be done in the same manner regardless if they have a South African address.²²⁶ It

²¹⁹ For a discussion of the legal position of the creditors in the absence of legislation see the discussion of Stander 2015 *TSAR* 105-204.

²²⁰ Section 13(1) of the Cross-Border Insolvency Act 42 of 2002. Also see Sharrock Smith and Van der Linde *Hochly se Insolvensiereg* 285; Stander 2002 *Journal for Juridical Science* 78; Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 192.

²²¹ Section 13(2) of the *Cross-Border Act*. Also see Sharrock Smith and Van der Linde *Hochly se Insolvensiereg* 285; Stander 2002 *Journal for Juridical Science* 78; Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 192.

²²² Section 13(3) of the *Cross-Border Act*, also see Stander 2002 *Journal for Juridical Science* 78.

²²³ Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 193.

²²⁴ This question has not yet been answered-, and an attempt to answer this question had not been made in this study as it did not form part of the main focus or aim of this study.

²²⁵ Section 14 of the *Cross-Border Act*.

²²⁶ Section 14 of the *Cross-Border Act*. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 193.

nevertheless have to be kept in mind that this notification process is only applicable to creditors from designated states.²²⁷

Albeit local creditors are placed in a better position than foreign creditors,²²⁸ both are afforded certain protections. The court must prior to acting in accordance with sections 19²²⁹ or 21²³⁰ be satisfied that the interest of creditors as well as any interested parties, which includes the debtor, are protected sufficiently.²³¹ Section 19 states that a foreign representative may apply for provisional relief when an application for recognition has been done.²³² The application for relief may even be granted prior to the court granting recognition. In order for this to occur the representative has to demonstrate that the relief is needed on an urgent basis in order to protect the assets of the debtor or the interest of the creditors.²³³ The relief that may be granted include an order for the staying of executions against the debtor's assets.²³⁴

The recognition of foreign proceedings is also regulated in terms of the *Cross-Border Act*. When a foreign representative requires recognition of a foreign proceeding in which he has been appointed then that representative must approach the High Court for recognition.²³⁵ The application must be accompanied by certain documentation as required by section 15(2).²³⁶ Once this application have been made the court has to determine whether the foreign proceedings should be considered as a foreign main

²²⁷ Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 193.

²²⁸ Even though they are classified in groups as said above a situation may occur when a foreign creditors secured claim is not recognised in South Africa, in these circumstances it can be argued that local creditor still receive some advantage over foreign creditors.

²²⁹ Sections 19 of the *Cross-Border Act* provides that relief may be granted upon application for recognition of foreign proceedings.

²³⁰ Sections 21 of the *Cross-Border Act* provides that relief may be granted upon recognition of foreign proceedings.

²³¹ Section 22(1) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 82.

²³² Section 19 of the *Cross-Border Act*.

²³³ Section 19 of the *Cross-Border Act*. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 194.

²³⁴ Section 19(1)(a) of the *Cross-Border Act*.

²³⁵ Section 15 of the *Cross-Border Act*. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 194; Stander 2002 *Journal for Juridical Science* 79.

²³⁶ Section 15(2) of the *Cross-Border Act*. The documentation includes a certified copy of the decision to commence the foreign proceedings and appointing the foreign representative; a certificate from the foreign court in which the court confirms the existence of the foreign proceedings and the appointment of the foreign representative.

proceeding or as a foreign non-main proceeding.²³⁷ It will be classified as a foreign main proceeding if the debtor's centre of main interest is situated within the court's jurisdiction.²³⁸ The place where debtor's centre of main interest is located is considered to be either the registered address of the business or the habitual residence of the debtor.²³⁹ It will be classified as a foreign non-main proceeding when the debtor has an establishment as defined in section 1(c) in that state's jurisdiction.²⁴⁰

As seen above, in some instances parallel proceedings are opened in different states. The main concern with concurrent proceedings is that the courts can make contradicting orders; or they may even act in a manner that will be detrimental to creditors who are situated in a different state. In an endeavour to limit these concerns section 28 provides that when recognition of a foreign main proceeding has been given, proceedings in terms of the insolvency laws of the Republic may only be instituted if the debtor has assets located in the Republic.²⁴¹ If the debtor has assets located in the Republic then an action may be instituted. This action is however limited to the local assets to the extent that is required for the co-operation and co-ordination in terms of sections 25-27.²⁴² There are provisions for any relief that have already been granted in a foreign non-main proceeding in order to conform to the foreign main proceeding that is recognised at a later stage.²⁴³ As soon as the foreign main proceeding is acknowledged by the High Court, then the debtor is presumed to be an insolvent for the purpose of instituting a local proceeding.²⁴⁴ It is important to

²³⁷ Section 17 of the *Cross-Border Act*. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 195; Stander 2002 *Journal for Juridical Science* 78.

²³⁸ Section 17(2)(a) of the *Cross-Border Act*. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 195; Franco 2003 *SA Merc LJ* 35.

²³⁹ Section 16(3) of the *Cross-Border Act*. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 195; Franco 2003 *SA Merc LJ* 35.

²⁴⁰ Section 17(2)(b) of the *Cross-Border Act*. Also see Smith and Boraine 2002 *American Bankruptcy Institute Law Review* 195; Stander 2002 *Journal for Juridical Science* 78; Franco 2003 *SA Merc LJ* 35.

²⁴¹ Section 28 of the *Cross-Border Act*.

²⁴² Section 28(2) of the *Cross-Border Act*. Also see Stander 2002 *Journal for Juridical Science* 84-85.

²⁴³ Olivier and Boraine 2005 *CILSA* 386.

²⁴⁴ Section 31 of the *Cross-Border Act*. Also see Olivier and Boraine 2005 *CILSA* 386.

mention that the proceedings that take place in the Republic will be regarded as the non-main proceedings.²⁴⁵

In conclusion it is clear that once the *Cross-Border Act* comes into operation, the determination of jurisdiction will have a dual effect. Representatives and creditors from non-designated states still have to rely on common law principles, while representatives and creditors from designated states will receive the full benefits that are offered in the *Cross-Border Act*.²⁴⁶ The *Cross-Border Act* will bring about legal certainty but only in respect to representatives and creditors from designated states. They will have direct access to court and will receive the assurance that their claims are not ranked lower than concurrent claims. In complete contrast to this creditors and representatives from non-designated states will still have to rely on the doctrine of comity which as seen from above gives rise to uncertainty. It is because of this that it can be said that a uniform cross-border insolvency law is required, one which does not differentiate between states, but treats all representatives and creditors regardless of their country of origin equally.

2.4.2 *The Cross-Border Act and financial institutions*

It is however not clear if the same rules will apply to a financial institution, such as a bank.²⁴⁷ As mentioned above there is a vital difference in the treatment of various creditors according to different insolvency systems.²⁴⁸ For example, when a dividend is payable all claims against the debtor are first classified as secured, preferential or concurrent claims. Creditors afforded with personal rights will have to share the dividend with creditors that are grouped in the same category.²⁴⁹ In contrast to this a person with an *in rem* right is considered to be a third party to the insolvency

²⁴⁵ Stander 2002 *Journal for Juridical Science* 84.

²⁴⁶ Olivier and Boraine 2005 *CILSA* 387.

²⁴⁷ The reason for the uncertainty is because the term debtor is not defined in the *Cross-border Act* and section 20(4) states that the laws of the Republic is still applicable to insolvency. Thus if a bank could be liquidated then the *Cross-border Act* would be applicable. In the author's opinion however, specialised rules and regulations should be put in place because a bank's creditors, investors and debtors are treated differently. For a full discussion as to why banks should have specialised rules and regulations see Chapter 3 below.

²⁴⁸ Garrido 2010 *Unif L Rev* 780.

²⁴⁹ Garrido 2010 *Unif L Rev* 780.

proceedings, one who does not have to share any dividend with other creditors.²⁵⁰ In the past the classification of creditors into these categories occurred with relative ease. But when it comes to financial institutions the distinction between personal and *in rem* rights have proven to be much more difficult.²⁵¹ The reason for this is because nations have taken a very distinct position of what the nature of an investor's rights should be.²⁵²

Another reason why the same principles cannot be applied to banks is because each bank relies on a well-functioning inter-bank market.²⁵³ A bank with cross-border operations that goes insolvent will have a damaging effect on these inter-bank markets which in turn will create several liquidity problems for non-financial institutions.²⁵⁴ It is clear that different rules should be applied when a bank is declared insolvent as a well-functioning banking system is essential for economic stability.²⁵⁵

From the aforesaid it is clear to the author's mind that the common law principles as well as the principles contained in the *Cross-Border Act* are insufficient to properly adjudicate a matter pertaining to cross-border bank insolvency. As such it is important to investigate how other countries have attempted to resolve the aforesaid problems. In paragraph 2.4 below the American perspective on cross-border insolvency law will be examined in order to establish if the same principles should be adopted in South Africa.

2.5 The American perspective on cross-border insolvency law

Cross-border insolvency matters are governed in terms of *Chapter 15* under Title 11 of the *United States of America's*²⁵⁶ *Bankruptcy Code*.²⁵⁷ *Chapter 15* is also based on

²⁵⁰ Garrido 2010 *Unif L Rev* 780.

²⁵¹ Garrido 2010 *Unif L Rev* 780.

²⁵² Garrido 2010 *Unif L Rev* 780.

²⁵³ Sester 2010 *ECFR* 534.

²⁵⁴ Sester 2010 *ECFR* 534.

²⁵⁵ Sester 2010 *ECFR* 534.

²⁵⁶ United States of America, hereinafter referred to as the US.

²⁵⁷ Chapter 15 under Title 11 of the U.S Bankruptcy Code, hereinafter referred to as *Chapter 15*.

the *Model Law* on Cross-Border Insolvency.²⁵⁸ As in South Africa the purpose of *Chapter 15* is to incorporate the *Model Law* in order to provide an effective way of administering cross-border insolvency matters.²⁵⁹

According to Schrag and Heuer *Chapter 15* provides a statutory structure in terms of which a foreign representative who is involved in foreign insolvency proceedings can obtain assistance.²⁶⁰ This assistance is provided by a US court²⁶¹ and it relates to the handling of the foreign debtor's assets which are located in the US.²⁶² In terms of *Chapter 15* the courts should co-operate with a foreign court if that court has jurisdiction over the main bankruptcy proceeding.²⁶³ The recognition of foreign proceedings is regulated by section 1517.²⁶⁴ This section determines that the foreign proceeding should either be recognised as a foreign main or a foreign non-main proceeding.²⁶⁵ The distinction between a foreign main or a foreign non-main are similar to the distinction as provided for in the *Cross-Border Act*.²⁶⁶

It is therefore important to understand in which category the proceedings fall as it has an impact on the scope and nature of relief which is afforded to the foreign debtor by the US bankruptcy courts.²⁶⁷ If the proceedings are determined to be a foreign main proceeding then the debtor immediately and automatically receives the benefit of an automatic stay.²⁶⁸ It is important to mention that this automatic stay corresponds with section 20 of the *Cross-Border Act*.²⁶⁹ This enables the foreign

²⁵⁸ Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 1. Also see Coulson 2005 *Consumer Finance Law Quarterly Report* 84.

²⁵⁹ Section 1501(a). Also see Fourie *Oorgrens-insolvenswetgewing* 16.

²⁶⁰ Schrag and Heuer 2010 *International Law Practicum* 1.

²⁶¹ The US has separate bankruptcy courts that specifically deal with insolvency matters.

²⁶² Schrag and Heuer 2010 *International Law Practicum* 1.

²⁶³ This co-operation of courts is similar to section 25 of the *Cross-Border Act*. Story 2015 *Arizona Journal of International and Comparative Law* 444.

²⁶⁴ Section 1517 of Title 11 of the U.S Bankruptcy Code.

²⁶⁵ Story 2015 *Arizona Journal of International and Comparative Law* 444. Also see Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 5; Weideman and Stander 2012 *PER* 159.

²⁶⁶ It is thus clear that the legislature intended to draw a distinction between main and non-main proceedings.

²⁶⁷ Schrag and Heuer 2010 *International Law Practicum* 1. Also see Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 11.

²⁶⁸ Schrag and Heuer 2010 *International Law Practicum* 1.

²⁶⁹ Section 20 determines that upon recognition of a foreign proceeding as a foreign main proceeding then the commencement or continuation of individual legal actions or individual legal

representative to operate any of the debtors businesses which are situated in the US.²⁷⁰ If the proceedings are classified to be a foreign non-main proceeding, then a hearing at the court's discretion has to be held in order to establish if the same relief may be granted.²⁷¹ Relief is thus not automatically afforded to the foreign representative.²⁷²

The determination whether a foreign proceeding is classified as main or non-main proceeding is similar to section 17 of the *Cross Border Act*.²⁷³ A foreign main proceeding is determined by the centre of main interest of the debtor,²⁷⁴ and a foreign non-main proceeding is where the debtor merely has an establishment.²⁷⁵ The US thus follow the same distinction as in South Africa. The burden of proof is placed on the foreign representative to prove where the debtor's centre of main interest is located.²⁷⁶ The question as to when the centre of main interest should be determined was answered in the matter of *Lavie v Ran (In re Ran)*.²⁷⁷ In this matter the court of appeal held that the determination must be done at the time of instituting the *Chapter 15* proceedings.²⁷⁸

proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed. (b) execution against the debtor's assets is also stayed.

²⁷⁰ Schrag and Heuer 2010 *International Law Practicum* 1. Also see Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 7.

²⁷¹ Schrag and Heuer 2010 *International Law Practicum* 1. Also see Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 7.

²⁷² Schrag and Heuer 2010 *International Law Practicum* 1. Also see Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 7. It is most probable that a concurrent proceeding will then be opened in the US.

²⁷³ Section 17 of the *Cross-Border Act*.

²⁷⁴ Section 1502(4) states that a foreign main proceeding is a foreign proceeding pending in the country where the debtor has the centre of its main interest. Also see Schrag and Heuer 2010 *International Law Practicum* 1; Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 5; Weideman and Stander 2012 *PER* 160.

²⁷⁵ Section 1502(5) defines a foreign non-main proceeding as: "a foreign proceeding pending in a country where the debtor has an establishment". Section 1502(2) defines an establishment as any place of operations where the debtor carries out nontransitory economic activity. Also see Schrag and Heuer 2010 *International Law Practicum* 1; Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 5; Weideman and Stander 2012 *PER* 160.

²⁷⁶ See also Schrag and Heuer 2010 *International Law Practicum* 2.

²⁷⁷ *Lavie v Ran (In re Ran)* 607 F3d 1017 (5th Cir 2010).

²⁷⁸ *Lavie v Ran (In re Ran)* 607 F3d 1017 (5th Cir 2010). Also see Weideman and Stander 2012 *PER* 161; Schrag and Heuer 2010 *International Law Practicum* 2.

As in South Africa a court application by the foreign representative is required in order to obtain recognition under *Chapter 15*.²⁷⁹ Only a foreign representative who has been appointed or authorised to either control a debtor's assets or act as a foreign representative may launch the application for recognition.²⁸⁰ This appointment or authorisation must be granted in the foreign proceedings.²⁸¹ In other words, prior to recognition being granted, an appointed or authorised foreign representative must bring a court application in terms of which recognition is sought. The requirement for recognition under *Chapter 15* is similar to the requirements stated in the *Cross-Border Act*.²⁸² It is clear that just as in the case of section 9 of the *Cross-Border Act*, once recognition is granted, the foreign representative is granted with direct access to courts. Upon recognition the foreign representative may receive certain rights. These rights include the right to institute proceedings as well as the capacity to apply for relief in an appropriate court.²⁸³ Domestic and foreign creditors receive the same rights in respect to the participations and commencement of *Chapter 15* filings.²⁸⁴ As stated above the position is not yet clear in those situations where the creditor has a secured claim in South Africa that is not recognised in the US.

Another important aspect of the *Chapter 15* procedure is that it provides courts with a discretion to decide whether or not a foreign proceeding should be recognised.²⁸⁵ This discretion is aimed at protecting the interest of creditors or any other interested

²⁷⁹ Section 1504. Also see Story 2015 *Arizona Journal of International and Comparative Law* 452; and Weideman and Stander 2012 *PER* 159.

²⁸⁰ Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 5.

²⁸¹ Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 5.

²⁸² Section 15(2) of the *Cross-Border Act* states that an application for recognition must be accompanied by – (a) a certified copy of the decision commencing the foreign proceedings and appointing the foreign representative; or (b) a certificate from the foreign court affirming the existence of the foreign proceedings and of the appointment of the foreign representative. The minimum requirement for recognition under Chapter 15 is some type of documentation of certification from the foreign court confirming the existence of the foreign insolvency proceeding and the authority of the foreign representative to act.

²⁸³ Story 2015 *Arizona Journal of International and Comparative Law* 444. Also see Weideman and Stander 2012 *PER* 160.

²⁸⁴ Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 1.

²⁸⁵ While in South Africa it is based partially on designation. Thus the US does not follow the reciprocity rule.

parties who are situated in the United States.²⁸⁶ Thus they do not follow the reciprocity rule. Just as in the case in South African law this discretion is however limited. Foreign proceedings may not be recognised if those proceedings will be against public policy.²⁸⁷ Additionally the court should also be satisfied that those proceedings will be fair to the parties situated in the United States.²⁸⁸ According to Story the exception of public policy is very narrowly interpreted-, and is only used in exceptional circumstances.²⁸⁹

2.5.1 Chapter 15 and financial institutions

A very important aspect with regard to the focus of this research that should be mentioned is that section 109²⁹⁰ determines who qualifies as a debtor under the *Bankruptcy Code*. Section 109(b) determines that a bank does not qualify as a debtor under the *Bankruptcy Code*-, and as a result cannot file for bankruptcy in terms of *Chapter 15*.²⁹¹ A void is thus created with the inclusion of this section. In an attempt to rectify the void, the US developed the *Dodd-Frank Act*. The *Dodd-Frank Act* is specifically aimed at solving the problems relating to cross-border insolvency matters of financial institutions, such as banks. How this is accomplished with specific reference to the determination of jurisdiction and the treatment of creditors are discussed later in this study.

It is clear from the above mentioned that the provisions contained in *Chapter 15* and the *Cross-Border Act* is fairly similar. It is also clear that neither one of the two provides a clear answer to the question of how cross-border bank insolvency matters will be adjudicated. The final aspect of this chapter focuses on the European perspective on cross-border insolvency. The purpose thereof is to determine if they can provide principles that can be adopted in South Africa in order to adjudicate a matter pertaining to cross-border bank insolvency.

²⁸⁶ Story 2015 *Arizona Journal of International and Comparative Law* 445.

²⁸⁷ Story 2015 *Arizona Journal of International and Comparative Law* 445.

²⁸⁸ Story 2015 *Arizona Journal of International and Comparative Law* 445.

²⁸⁹ Story 2015 *Arizona Journal of International and Comparative Law* 445.

²⁹⁰ Section 109 of Title 11 of the U.S Bankruptcy Code.

²⁹¹ Section 109 of Title 11 of the U.S Bankruptcy Code, also see Story 2015 *Arizona Journal of International and Comparative Law* 449. Also see Elkin et al 2006 *Norton Annual Survey of Bankruptcy Law* 1.

2.6 The European Union perspective on cross-border insolvency law

The European Union Council Regulations²⁹² regulates all matters pertaining to cross-border insolvency within the EU, as it is directly applicable.²⁹³ This means that it has automatic legal effect and that it is the prevailing authority on all cross-border insolvency matters.²⁹⁴ According to Story the purpose of the *EU Regulations* is to provide co-operation for efficient and effective operations of all cross-border insolvencies matters.²⁹⁵ The goals in South Africa, the USA and the EU are therefore the same. This only shows the importance of a uniform cross-border insolvency system. One of the main goals of the *EU Regulations* is to provide specific choice of law provisions, which will eliminate forum shopping.²⁹⁶

In terms of the *EU Regulations* jurisdiction is determined by the main interest of the debtor.²⁹⁷ Article 3(1) of the *EU Regulations* refers to international jurisdiction and it states that

(T)he court of the Member State within the territory of which the centre of the debtor's main interest is situated shall have jurisdiction to open insolvency proceedings ('main insolvency proceedings'). The centre of main interest shall be the place where the debtor conducts the administration of its interest on a regular basis and which is ascertainable by third parties.²⁹⁸

From the aforementioned it is clear that the determination of the debtor's centre of main interest in terms of article 3(1) corresponds with the South African determination in the *Cross-Border Act* as well as with the US determination in *Chapter 15*. Dotevall emphasises that the *EU Regulations* do not provide a clear

²⁹² EU Council Regulations, herein after referred to as the *EU Regulations*.

²⁹³ Weideman and Stander 2012 *PER* 138. Also see Story 2015 *Arizona Journal of International and Comparative Law* 440.

²⁹⁴ Story 2015 *Arizona Journal of International and Comparative Law* 440.

²⁹⁵ Story 2015 *Arizona Journal of International and Comparative Law* 440. It is thus clear that the goals in South Africa the US and the EU are similar, this clearly emphasises the need for the development of a uniform cross-border insolvency law.

²⁹⁶ Story 2015 *Arizona Journal of International and Comparative Law* 441. For a discussion on forum shopping see paragraph 3.2 of this study.

²⁹⁷ Story 2015 *Arizona Journal of International and Comparative Law* 441. A debtor does not include a insurance undertaking, credit institutions or investment undertakings article 1 of the EU Regulations.

²⁹⁸ Article 3(1) of the EU regulations. Also see Story 2015 *Arizona Journal of International and Comparative Law* 441.

definition of centre of main interest.²⁹⁹ As such a factual determination has to be done in order to establish the debtor's centre of main interest.³⁰⁰ Various writers are of the opinion that courts interpret the meaning of centre of main interest by following the legal definition contained in Recital 13 the *EU Regulations*.³⁰¹

Where subsidiaries of multinational groups are however considered the determination can become more intricate. The one possibility is that all subsidiaries receive the same centre of main interest as the parent company.³⁰² The second possibility is that separate proceedings are opened for each subsidiary in the jurisdiction where that subsidiary has its centre of main interest.³⁰³ In terms of English case law (applying the *EU Regulations*) the centre of main interest of multinational groups are determined by the registered address of the main company.³⁰⁴ This determination is based on the presumption contained in article 3(1).³⁰⁵ This presumption is similar to the presumption contained in section 1516; a further parallel can thus be drawn between the *EU Regulations* and *Chapter 15*.³⁰⁶ In the matter of *Eurofoods IFCS Ltd-Bondi v Bank of America NA*³⁰⁷ the court in a rebuttal to the presumption contained in article 3(1) held that the centre of main

²⁹⁹ Chapter 15 also does not provide a definition of centre of main interest.

³⁰⁰ Weideman and Stander 2012 *PER* 138.

³⁰¹ Recital 13 states the following: The centre of main interest should correspond to the place where the debtor conducts the administration of his interest on a regular basis and is therefore ascertainable to third parties. These two elements are not specifically sated in either the *Cross-border Act* or in *Chapter 15* but to the author's mind the second element automatically follows on the first element. There were a debtor normally conducts this administration on a regular basis is the place most ascertainable by third parties.

³⁰² Dotevall 2012 *Scandinavian Stud* 66, The US has made an order that all of the insolvent's companies must fall under one procedure, resulting in the assets being pooled together and forming one group.

³⁰³ Dotevall 2012 *Scandinavian Stud* 66.

³⁰⁴ In *Re Daisytek-ISA LTD* 2003 BCC 562. Also see Dotevall 2012 *Scandinavian Stud* 66;

³⁰⁵ Article 3(1) states: In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interest in the absence of proof to the contrary.

³⁰⁶ Section 1516 states: The location of the debtor's registered office is the centre of its main interest.

³⁰⁷ *Eurofood IFCS Ltd – Bondi v Bank of America NA* (case C-341/04, OJ [2006] C 143/11). In this matter the court had to determine the centre of main interest of Eurofood which was a subsidiary of Parmalat. Parmalat's registered office was situated in Italy while Eurofood's was registered in Ireland.

interest of the company can only be the registered office when factors which are both objective and ascertainable to third parties are considered.³⁰⁸

It is not sufficient only to understand how the debtor's centre of main interest is determined, when that determination is made should also be understood. Currently two viewpoints exist. The first viewpoint is that the centre of main interest of the debtor should be determined at the time when the decision to open insolvency proceedings are considered.³⁰⁹ The second viewpoint that is followed corresponds with the American perspective. In terms thereof the centre of main interest should be determined at the time when insolvency proceedings are opened.³¹⁰ A practical example to explain the two different viewpoints are as follows: A multinational entity has its centre of main interest located in the United Kingdom.³¹¹ Prior to launching an application to open insolvency proceedings the entity moves its centre of main interest to Germany. In accordance with the first viewpoint UK would have jurisdiction as the entity's centre of main interest was located in its jurisdiction the moment the entity decided to apply for the opening of insolvency proceedings.³¹² In accordance with the second viewpoint, Germany would have jurisdiction as the centre of main interest was located in its jurisdiction at the moment that the insolvency proceedings were opened (the relevant order granted).³¹³

Insolvency proceedings which are opened in the jurisdiction where the centre of main interest is located are considered to be the main insolvency proceedings.³¹⁴ These proceedings will have a universal scope in that all of the debtor's assets

³⁰⁸ *Eurofood IFCS Ltd – Bondi v Bank of America NA* (case C-341/04, OJ [2006] C 143/11) par 35. Also see Dotevall 2012 *Scandinavion Stud* 67; Weideman and Stander 2012 *PER* 141.

³⁰⁹ *Genevan Trading Co Ltd v Kjell Tore Skjevesland* High Court, 11 Nov 2002 [2003] BCC 391. Also see Weideman and Stander 2012 *PER* 142. In South African terms this is when an application is made for a sequestration or liquidation order.

³¹⁰ Weideman and Stander 2012 *PER* 142. In South African terms this is when an application is made for a sequestration or liquidation order.

³¹¹ United Kingdom, herein after referred to as UK.

³¹² *Genevan Trading Co Ltd v Kjell Tore Skjevesland* High Court, 11 Nov 2002 [2003] BCC 391. Also see Weideman and Stander 2012 *PER* 142.

³¹³ Susanne Staubitz-Schreiber ECJ. 17 Jan 2006, C-1/04 (eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62004CJ0001&from=EN) Weideman and Stander 2012 *PER* 142.

³¹⁴ Weideman and Stander 2012 *PER* 137.

around the globe are included in the proceedings.³¹⁵ Recognition of foreign proceedings are also not left to the judiciary. In contrast the *EU Regulations* determine that once a main insolvency proceeding have been opened in a member state then that proceeding is automatically recognised by all the other member states.³¹⁶ Local creditors are protected in that the law of the state where the main proceedings are taking place will be applicable to those proceedings.³¹⁷

Because foreign creditors may be prejudiced, it will be to their advantage to open secondary proceedings. Secondary proceedings can also be instituted in a different jurisdiction if a debtor qualifies as an establishment.³¹⁸ Just as in the case of *Chapter 15* and the *Cross-Border Act* the *EU Regulations* provide an explicit definition of an establishment. Article 2(10) defines an establishment as any place of business where the debtor has carried out operations in the three months prior to the institution of the main insolvency proceedings.³¹⁹ It is clear that this definition is similar to those provided for in *Chapter 15* and the *Cross-Border Act*. The determination for recognition of a foreign non-main or secondary proceeding is thus a definitional matter.³²⁰ The requirements of an establishment are also similar.³²¹

The scope of the secondary proceedings are however limited to the assets located in that jurisdiction.³²² These secondary proceedings are similar to the non-main proceedings in terms of *Chapter 15* and the *Cross-Border Act*. The interests of local creditors are still afforded with certain protections, in that the national law of the member state will be applicable to the secondary proceedings.³²³

³¹⁵ Weideman and Stander 2012 *PER* 138. Also see Dotevall 2012 *Scandinavian Stud* 65.

³¹⁶ Story 2015 *Arizona Journal of International and Comparative Law* 442. Also see Weideman and Stander 2012 *PER* 145.

³¹⁷ Story 2015 *Arizona Journal of International and Comparative Law* 441.

³¹⁸ Article 3(2) and 3(3) of the EU Regulations. Also see Story 2015 *Arizona Journal of International and Comparative Law* 441.

³¹⁹ Article 2(10) of the EU Regulations.

³²⁰ Weideman and Stander 2012 *PER* 190.

³²¹ A objective test is used to determine if a establishment exists, it is a question of fact, also see Weideman and Stander 2012 *PER* 190.

³²² Article 3(2) and 3(3) of the EU regulations. Also see Story 2015 *Arizona Journal of International and Comparative Law* 441; Weideman and Stander 2012 *PER* 198.

³²³ Weideman and Stander 2012 *PER* 198.

2.6.1 The EU Regulations and financial institutions

Just as in the case with *Chapter 15* the *EU Regulations* does not specifically answer the question of cross-border bank insolvency.

2.7 Summary

It is clear throughout the entire Chapter 2 that South Africa, USA and the EU all have the same objective in regard to handling cross-border insolvency matters. This further emphasises the need for a uniform cross-border insolvency system. Even though the handling of cross-border insolvency matters has greatly improved through the development of the *Cross-Border Act, Chapter 15* and the *EU Regulations* it is clear that the same principles cannot be applied to cross-border bank insolvency matters. The reason being is that cross-border bank insolvency has its own unique set of problems. In an effort to explain why there is a need for a uniform cross-border bank insolvency system, the problems that are specific to cross-border banking activities are discussed. Only after the problems have been identified can it be attempted to derive at possible solutions.

3 Cross-border bank insolvency law

3.1 Introduction

From the above mentioned it is clear that South Africa, the United States of America as well as the European Union have attempted to eliminate the problems associated with cross-border insolvency. It is however important to point out that there is a noteworthy difference between traditional cross-border insolvency matters and cross-border insolvency of financial institutions. One of the differences that are worth pointing out is that with corporate insolvency, the law is generally aimed at treating all creditors fair, in order for this to be accomplished, the process is slow and time consuming.³²⁴ The insolvency of banks has to limit the disturbance to the day to day

³²⁴ Wolf *A global cross-border insolvency framework for financial institutions* 4.

functions of that bank in order to ensure that normal banking activity persists.³²⁵ If this is not achieved systemic³²⁶ instability will be inevitable.³²⁷ As stated above the principles contained in the *Cross-Border Act* is not sufficient to resolve a matter of cross-border bank insolvency. Furthermore, section 109³²⁸ of the US *Bankruptcy Code* specifically excludes banks and as a result *Chapter 15* will also not be applicable. The question thus remains is there a need for a uniform cross-border bank insolvency law?

In an effort to answer the aforementioned two additional questions present itself. The first question that comes to mind is: what makes a bank so special? And secondly, why do banks require a unique resolution process when insolvency intervenes? There are a number of reasons why banks are considered to be special and it will be impossible to mention all. In the author's opinion the reasons stated below are the most prominent aspects why banks are considered to be special. Firstly, banks are considered to be the principle type of financial institutions.³²⁹ This means that banks are, especially amongst ordinary citizens, the most popular type of financial institutions that exist. Secondly, bank deposits are mainly comprised of a vast percentage of the population,³³⁰ in other words most of a bank's money arises from the public, ranging from the wealthy upper class to the poorest lower class. The last reason that the author feels should be mentioned is that banks contain the largest share of the population's or businesses' liquid assets.³³¹ This means that most of the population's or small businesses' money is held by banks. It is therefore clear why banks largely depend upon public trust and support. When banks lose the public's trust and support its operations will come to a halt which in turn can lead to its economic failure.³³²

³²⁵ Wolf *A global cross-border insolvency framework for financial institutions* 4.

³²⁶ Systemic risk and instability are discussed in paragraph 4.2 below.

³²⁷ Wolf *A global cross-border insolvency framework for financial institutions* 4.

³²⁸ Section 109 of Title 11 of the US Bankruptcy Code.

³²⁹ Bliss and Kaufman 2011 *The banking law journal* 342.

³³⁰ Bliss and Kaufman 2011 *The banking law journal* 342.

³³¹ Bliss and Kaufman 2011 *The banking law journal* 342.

³³² Wolf *A global cross-border insolvency framework for financial institutions* 2.

Another important aspect that is worth mentioning is that banks in the modern ages have moved away from the traditional type of banking activity. Banks are no longer purely financial mediators; instead banks are now considered to be multinational corporations³³³ with their main focus on investment banking.³³⁴

Now turning to the second question at hand: why is there a need for a uniform cross-border bank insolvency framework? The main reason is because banks are closely interlinked with each other.³³⁵ The second reason is because banks operate across national boundaries because of international trade.³³⁶ This means that banks are subject to a variety of different jurisdictions and regulations.³³⁷ This can be very problematic as national regulations are developed and influenced by historical events, political agendas as well as social standards.³³⁸ The final aspect that should be mentioned is the ease with which banking assets can be transferred from one owner to another and even from one country to another.³³⁹ For example the ease with which an everyday consumer can purchase items from another country by means of an electronic funds transfer. There are numerous other reasons that can be mentioned but it still does not answer the question as to the importance thereof. Declaring insolvency is the last resort to attempt to repay all debtors and having a framework in place will allow the procedure to be fast and effective.³⁴⁰ Another advantage is that it would limit outside influence and the problems related to the different creditor's rights.³⁴¹ Because politics play a crucial role in the development of law, when a large bank fails it is easy to draw an inference that political pressure is

³³³ For a description of a multinational corporation see Chapter 2.1 above.

³³⁴ Wolf *A global cross-border insolvency framework for financial institutions* 3.

³³⁵ Bliss and Kaufman 2011 *The banking law journal* 342.

³³⁶ Because of the close link between insolvency and commercial law that is based upon different legal traditions has led to different insolvency rules. See Lastra 2008 *Journal of Banking Regulation* 175 and Bliss and Kaufman 2011 *The banking law journal* 342.

³³⁷ Because of the close link between insolvency and commercial law that is based upon different legal traditions has led to different insolvency rules. See Lastra 2008 *Journal of Banking Regulation* 175 and Bliss and Kaufman 2011 *The banking law journal* 342.

³³⁸ Wolf *A global cross-border insolvency framework for financial institutions* 4.

³³⁹ Bliss and Kaufman 2011 *The banking law journal* 342.

³⁴⁰ Wolf *A global cross-border insolvency framework for financial institutions* 4.

³⁴¹ Wolf *A global cross-border insolvency framework for financial institutions* 4.

the main consideration whether or not bail-out³⁴² money will be provided.³⁴³ This concern can be eliminated with the existence of a unified legal framework.

From the aforementioned it is clear why it is crucial during a financial crisis to have a clear legal framework that governs financial insolvency.³⁴⁴ The implementation of specific rules that govern insolvency of banks will prevent financial instability.³⁴⁵ As the position currently stands there are no international accepted standards for banking insolvency.³⁴⁶ With the absence of a uniform cross-border bank insolvency system, the liquidation of cross-border banks³⁴⁷ are determined in accordance with national legal systems.³⁴⁸ This is problematic as in some countries the law favours the creditors but in others it favours the debtors.³⁴⁹ As such the choice between the *lex generalis*³⁵⁰ and the *lex specialis*³⁵¹ have led to a range of approaches to bank insolvency.³⁵² The effectiveness thereof depends on voluntary co-operation between nations.³⁵³ Lastra correctly points out that this can be problematic because

(t)he division of responsibilities between home and host country authority remains a matter of controversy.³⁵⁴

Regulators across the globe are faced with a number of challenges with the increased growth of cross-border banking activities.³⁵⁵ According to Lastra³⁵⁶

³⁴² For the meaning of a bail out see Chapter 4 of this study.

³⁴³ Wolf *A global cross-border insolvency framework for financial institutions* 4.

³⁴⁴ Lastra 2008 *Journal of Banking Regulation* 175.

³⁴⁵ Lastra 2008 *Journal of Banking Regulation* 175.

³⁴⁶ Lastra 2008 *Journal of Banking Regulation* 175.

³⁴⁷ A cross-border bank refers to a bank that has branches and subsidiaries located in different jurisdictions.

³⁴⁸ Lastra 2008 *Journal of Banking Regulation* 175. Also see Lastra 2004 *Journal of International Banking Regulation* 202.

³⁴⁹ Lastra 2008 *Journal of Banking Regulation* 175.

³⁵⁰ Merriam Webster 2017 <https://www.merriam-webster.com/dictionary/lex%20generalis> where it is stated that *lex generalis* is a term to describe a law of general application. For example in some jurisdictions general insolvency law is followed as banks are considered to be like other corporations. Also see Lastra 2008 *Journal of Banking Regulation* 175.

³⁵¹ Anon 2016 <https://definitions.uslegal.com/l/lex-specialis/> where it is stated that *lex specialis* is a Latin phrase which means law governing a specific subject matter. For example in some jurisdictions banks are subject to specialised insolvency regimes administered by bank supervisors. Also see Lastra 2008 *Journal of Banking Regulation* 175.

³⁵² Lastra 2008 *Journal of Banking Regulation* 175.

³⁵³ Lastra 2008 *Journal of Banking Regulation* 175.

³⁵⁴ Lastra 2008 *Journal of Banking Regulation* 175.

³⁵⁵ Lastra 2004 *Journal of International Banking Regulation* 202.

insolvency law have to accomplish two basic objectives: firstly creditors have to be treated fair and predictably and secondly the assets of the debtor have to be maximised to the benefit of the creditors.³⁵⁷ She continues to state that bank insolvency law needs to fulfil an additional objective

(T)he bank should be closed as soon as the market value of its net worth reaches zero, because at this moment, direct losses are only suffered by shareholders. If the bank is declared legally insolvent when the market value of its net worth is already negative, losses will accrue not only to shareholders, but also to uninsured creditors.³⁵⁸

The attempt to explain the importance of a uniform cross-border bank insolvency law was twofold. Initially, cross-border banking activities within the SADC region were used as a practical example. This was accomplished by providing a brief background of cross-border bank insolvency within the SADC region. Following this, the specific factors that complicate cross-border bank insolvency in the SADC region were explored. The second part of the discussion will focus specifically on the Lehman Brothers Bankruptcy.³⁵⁹ The purpose thereof is to illustrate the global consequences of a failing bank, there after a conclusion is provided on the importance of a uniform cross-border bank insolvency law.

3.2 Cross-border bank insolvency in the SADC region.

SADC is a treaty based organisation that aims to achieve development and economic growth³⁶⁰ by means of co-operation between member states in all areas which are necessary for regional development and integration.³⁶¹ The areas of co-operation include amongst others industry, trade, finances and investments.³⁶² In terms of

³⁵⁶ Lastra 2004 *Journal of International Banking Regulation* 202.

³⁵⁷ Lastra 2004 *Journal of International Banking Regulation* 202.

³⁵⁸ Lastra 2004 *Journal of International Banking Regulation* 202.

³⁵⁹ Lehman Brothers Holding Inc was one of the largest investment bank in the USA with over \$639 billion in assets.

³⁶⁰ Article 5 of the Treaty of the Southern African Development Community, hereinafter referred to as *SADC Treaty*. Also see Stander "The Coordination of group and financial Insolvencies in the SADC Region" 99

³⁶¹ Article 21 of the *SADC Treaty*.

³⁶² Article 21(3)(c) of the *SADC Treaty*.

article 9 certain institutions should be established to oversee the implementation of its objectives.³⁶³

The uniformity of trade laws is an important aspect of regional and economic integration.³⁶⁴ In order for economic integration to successfully take place a uniform legal framework with a uniform cross-border insolvency legislation that supports such integration is of paramount importance.³⁶⁵ The fundamental purpose of a uniform insolvency law is to prevent forum shopping.³⁶⁶ Pauwelyn³⁶⁷ defines forum shopping as

(A) litigant's attempt to have his action tried in a particular court or jurisdiction where he feels he will receive the most favourable judgment or verdict.³⁶⁸

When provisions with these specific objectives are endorsed, the doubt in regards to the degree to which national law is applicable will be eliminated.³⁶⁹ Widely accepted trade laws have been developed within the SADC region in an attempt to eliminate some of the problems that currently hamper intra-regional trade.³⁷⁰ But even with the accepted trade laws cross-border bank insolvency matters are still governed by means of several national insolvency laws.³⁷¹ It is common knowledge that each state within the SADC region has its own unique legal framework and that the insolvency procedures within SADC countries are very diverse. This aspect creates numerous problems. It is clear that cross-border insolvency law constitutes a very intricate process. The question however remain how will the insolvency of banks be co-ordinated within the SADC region?³⁷²

³⁶³ Article 9 of the *SADC Treaty*.

³⁶⁴ Saurombe 2009 *SA Merc LJ* 695.

³⁶⁵ Saurombe 2009 *SA Merc LJ* 695 – 709. Also see Stander "The Coordination of group and financial Insolvencies in the SADC Region" 99.

³⁶⁶ Leno 2013 *Journal of African law* 2.

³⁶⁷ Pauwelyn 2004 *Minnesota Journal of Global Trade* 246.

³⁶⁸ Pauwelyn 2004 *Minnesota Journal of Global Trade* 246. Also see Leno 2013 *Journal of African law* 2.

³⁶⁹ Leno 2013 *Journal of African law* 2.

³⁷⁰ Saurombe 2009 *SA Merc LJ* 695.

³⁷¹ Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101.

³⁷² Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100.

As stated above there is a significant difference between commercial and bank insolvency. The foundation for this difference can be found in the basic structure of financial institutions, such as banks. The banking sector is profoundly interlinked with each other, for example in some instances a highly developed financial system will have to co-exist with a poorly developed financial system.³⁷³ The integrated corporate structure of banks is but another example of the complexity of banking activities.³⁷⁴ Garrido³⁷⁵ explains that the problems connected with the insolvency of a financial institution (such as a bank) are increased by the globalisation of markets which are situated in different jurisdictions.³⁷⁶ He states that these problems are complicated by the difference in the treatment of investors and creditors.³⁷⁷ The fear of non-compliance of treaties is but another example.³⁷⁸

3.3 The problems associated with cross-border bank insolvency within SADC

Cabello and others³⁷⁹ identify certain factors that complicate cross-border bank insolvency law in the SADC region each of which are discussed below:

3.3.1 Extreme diversity in the SADC region

Notwithstanding the growth of banking activities within the SADC region, some countries remain highly underdeveloped.³⁸⁰ Because the rate of development and the availability of proper infrastructure vary vastly within the region, this has resulted

³⁷³ For example in the SADC region financial institutions situated in countries such as South Africa has to co-exist with financial institutions situated in countries such as Zimbabwe which is on the verge of economic collapse. See Cabello *et al Banking on the African Moment* 36.

³⁷⁴ Standard bank for example has a variety of different financial subsidiaries and structures each of which is governed by its own unique set of rules. Also see Cabello *et al Banking on the African Moment* 37.

³⁷⁵ Garrido 2010 *Unif L Rev* 780. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101.

³⁷⁶ Garrido 2010 *Unif L Rev* 780. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101.

³⁷⁷ Garrido 2010 *Unif L Rev* 780. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101.

³⁷⁸ Leno 2013 *Journal of African law* 21. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101.

³⁷⁹ Cabello *et al Banking on the African Moment* 36-39.

³⁸⁰ Salami 2016 roar.uel.ac.uk/5561/.

in banking activities within the region being extremely diverse.³⁸¹ The diversity is especially evident when one considers the number of banks situated in each country. Highly developed countries such as South Africa have more native banks than banks originating from the other African countries.³⁸² Poorly developed countries such as Mozambique barely have any native banks instead they are dominated by foreign banks from more developed countries.³⁸³ Because of the extreme diversity that exist between the nations it is easy to understand why Cabello has identified it as one of the primary obstacles to the development of a uniform cross-border insolvency law.³⁸⁴

It cannot be denied that, in order to improve banking regulations within the SADC region some form of consensus is required.³⁸⁵ Leno explains that consensus is however difficult to reach as states within the SADC region have very different legal traditions.³⁸⁶ According to Cabello consensus is thus determined in accordance with the "lowest common denominator" approach.³⁸⁷ This approach entails that the most primitive, basic level of development amongst the countries will be followed. In addition to this even though the implementation of the *Basal Core Principles for Effective Banking Supervision*³⁸⁸ has been accepted by all the countries in the SADC region, there is no conformity as to the compliance thereof.³⁸⁹

³⁸¹ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101 and Salami 2016 roar.uel.ac.uk/5561/.

³⁸² Salami 2016 roar.uel.ac.uk/5561/.

³⁸³ Beck *et al Making Cross-Border Banking Work for Africa* 30. Also see Salami 2016 roar.uel.ac.uk/5561/.

³⁸⁴ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 101.

³⁸⁵ Cabello *et al Banking on the African Moment* 36-39.

³⁸⁶ Leno 2013 *Journal of African law* 4. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100. Some countries have a Roman Dutch and English law origin and others a French or Portuguese framework or traditions.

³⁸⁷ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 102.

³⁸⁸ *Basal Core Principles*, hereinafter referred to as *BCP*

³⁸⁹ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 102.

3.3.2 Complex structure of banks

Another reason why it is difficult to create a uniform cross-border insolvency framework is, as stated above, the fact that banks now operate business in different sectors.³⁹⁰ They have, for example, divisions in investment banking, capital markets as well as insurance.³⁹¹ The effect of this is that banks nowadays have an exceptionally intricate corporate structure.³⁹² A consequence of the complex corporate organisation of banks is that each division in itself is subject to certain practices and regulations that are unique to that division. According to Salami another unintended consequence is that these divisions now expand across different banking systems.³⁹³ The effect of this is that banks involved in cross-border operations will have originated and developed from different regulatory backgrounds.³⁹⁴

Another factor that goes hand in hand with the complex structure of banks is the lack of information sharing that takes place between nations.³⁹⁵ The extent to which the exchange of accurate and reliable information takes place between nations differs considerably. This is especially true between home and host administrators. What this means is that it is understandable that a more developed country such as South Africa will not rely on information that is supplied to it by a poorly developed country such as Zimbabwe.³⁹⁶ Cabello points out that this is especially true when that particular country do not comply with the *BCP* or apply the *International Financial*

³⁹⁰ Wolf *A global cross-border insolvency framework for financial institutions* 3. Also see Salami 2016 roar.uel.ac.uk/5561/.

³⁹¹ Wolf *A global cross-border insolvency framework for financial institutions* 3. Also see Salami 2016 roar.uel.ac.uk/5561/.

³⁹² For example the First Rand Group which is comprised of numerous subsidiaries. Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 103. and Salami 2016 roar.uel.ac.uk/5561/.

³⁹³ Salami 2016 roar.uel.ac.uk/5561/.

³⁹⁴ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 103.

³⁹⁵ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101

³⁹⁶ Cabello *et al Banking on the African Moment* 36-39.

Reporting Standards.³⁹⁷ The contrary thus also holds true: how can a country that is not compliant with the *BCP* or who does not apply the *IFR* possibly understand the information that is supplied to them from a country that is compliant and that does apply the *IFR*?³⁹⁸ Why is sharing information so important? When information is shared, a learning experience is created between the parties involved.³⁹⁹ Wolf points out-, and the author agrees, that, when information is shared between banks it greatly influences how these banks organize and develop themselves in a corporate manner.⁴⁰⁰ She continues and states that the sharing of information can eventually lead to a uniform framework on banking activities.⁴⁰¹

3.3.3 Non-binding effect of regional guidelines.

In an effort to attend to the above mentioned problems the *Finance and Investment Protocol*⁴⁰² was signed by the regional financial authorities namely the *SADC committee of Central Bank Governors* and the *SADC Subcommittee of Banking Supervisors*.⁴⁰³ The purpose of the *FIP* is to create the harmonization of investment and financial policies in member states.⁴⁰⁴ The purpose of these protocols is to inspire SADC countries to establish a uniform set of rules and procedures.⁴⁰⁵ Another initiative of SADC is the *SADC Model Central bank law*.⁴⁰⁶

Even though progress have been made no harmonization have yet been reached.⁴⁰⁷ This can be attributed to the fact that the SADC countries as mentioned above are in different stages of development, as well as the fact that the adherence to the *BCP*

³⁹⁷ *International Financial Reporting Standards* herein after referred to as *IFR*. Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 103.

³⁹⁸ Cabello *et al Banking on the African Moment* 36-39.

³⁹⁹ Wolf *A global cross-border insolvency framework for financial institutions* 14.

⁴⁰⁰ Wolf *A global cross-border insolvency framework for financial institutions* 14.

⁴⁰¹ Wolf *A global cross-border insolvency framework for financial institutions* 14.

⁴⁰² *Finance and Investment Protocol*, herein after referred to as *FIP*.

⁴⁰³ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 103; Enoch, Mathieu and Mecagni 2015 *International Monetary Fund* 50.

⁴⁰⁴ Cabello *et al Banking on the African Moment* 36-39.

⁴⁰⁵ Enoch, Mathieu and Mecagni 2015 *International Monetary Fund* 50.

⁴⁰⁶ *SADC Model Central bank law*, herein after referred to as *Bank Law*.

⁴⁰⁷ Enoch, Mathieu and Mecagni 2015 *International Monetary Fund* 50.

and *IRF* varies immensely.⁴⁰⁸ The implementation of these guidelines are however being constrained due to the fact that regional agreement are not binding on member states.⁴⁰⁹

3.3.4 The viability of bilateral Memoranda of Understanding.

With the lack of official international insolvency systems, countries revert to bilateral agreements, in most instances these agreements take on the form of a memorandum of understanding.⁴¹⁰ When a MoUs⁴¹¹ are signed between countries it creates a type of an official framework in terms of which information sharing between financial supervisory authorities takes place.⁴¹² It is in essence a tool that is used between home and host administrators in order to abide by specific principles that aim at upholding the financial stability of the institutions.⁴¹³ The basis for these MoUs is the availability of information.⁴¹⁴ In order for a MoU to be effective, home and host supervisors should be willing to share information relating to the stability of the banking institution.⁴¹⁵ This will ensure that proper procedures are put in place to assist a financial institution that experiences financial instability.⁴¹⁶ As mentioned above this remains problematic as the extent that information is being shared between nations varies immensely. There are a variety of different MoUs that has been signed within the SADC region.⁴¹⁷ The problem is, however that none of these contain a resolution process that should be followed in the event of insolvency.⁴¹⁸

⁴⁰⁸ Enoch, Mathieu and Mecagni 2015 *International Monetary Fund* 50.

⁴⁰⁹ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 103.

⁴¹⁰ Memoranda of understanding herein after referred to as MoU. Also see Lastra 2008 *Journal of Banking Regulation* 179; Lastra 2004 *Journal of International Banking Regulation* 207.

⁴¹¹ A memoranda of understanding is a undertaking by both countries' financial authorities to co-operate with each other. An example of a MoU is the co-operation agreement between Central Bank and the Financila Ministries of the European Union.

⁴¹² Lastra 2008 *Journal of Banking Regulation* 179. Also see Cabello *et al Banking on the African Moment* 36-39.

⁴¹³ Salami 2016 roar.uel.ac.uk/5561/.

⁴¹⁴ Salami 2016 roar.uel.ac.uk/5561/.

⁴¹⁵ Salami 2016 roar.uel.ac.uk/5561/.

⁴¹⁶ Salami 2016 roar.uel.ac.uk/5561/.

⁴¹⁷ Salami 2016 roar.uel.ac.uk/5561/. Also see Cabello *et al Banking on the African Moment* 36-39; Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 103.

⁴¹⁸ Salami 2016 roar.uel.ac.uk/5561/.

The biggest problem with these MoUs is that they are voluntary and not legally binding.⁴¹⁹ In other words there is no legal obligation to co-operate in terms of the MoU.⁴²⁰ In order for these MoUs to be effective supervisors from different states need to want to share information. This is especially true since no authority exists that determines the regularity that information sharing should take place, or even establishes a method on how the sharing of information should take place.⁴²¹ In the author's mind, this can only be successful if good relationships between the different countries exist.⁴²²

3.4 Lehman Brothers Bankruptcy

3.4.1 Introduction

The bankruptcy of Lehman Brothers is a prime example of the interconnected nature of banks as well as the global effect that is created when a large financial institution declares bankruptcy.

3.4.2 Background

Prior to 2008 Lehman Brothers (herein after referred to as Lehman) was considered to be one of the largest global investment banks.⁴²³ Lehman operated business in the three main global economic sectors namely: investment banking, capital markets as well as investment management.⁴²⁴ In order to fulfil its vision to become the largest investment bank in the US Lehman decided to change direction and substantially alter its business strategy.⁴²⁵ It moved away from its brokerage service and started

⁴¹⁹ Lastra 2008 *Journal of Banking Regulation* 179. Also see Salami 2016 roar.uel.ac.uk/5561/.

⁴²⁰ Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 103.

⁴²¹ Salami 2016 roar.uel.ac.uk/5561/.

⁴²² Cabello *et al Banking on the African Moment* 36-39. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 103.

⁴²³ Estrada 2008 *University of Richmond Law Review* 1113. Also see Feng and Fredriksson 2010 citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.186.5564&rep1&type=pdf and Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.

⁴²⁴ Estrada 2008 *University of Richmond Law Review* 1114. Also see Hardee 2011 *North Carolina Banking Institute* 267.

⁴²⁵ The assets were tied up in immovable property from the loans it provided to consumers to purchase immovable property. There security for the loans was a mortgage over the property. See Estrada 2008 *University of Richmond Law Review* 1115-1116. Also see Feng and Fredriksson

to focus on the real estate market and leveraged loans.⁴²⁶ As a result of this most of Lehman's assets were then tied up.⁴²⁷ This meant they no longer had primarily liquid assets.⁴²⁸ To overcome this stumbling block and to sustain its high risk profile Lehman was forced to borrow billions on a daily basis from short-term financial markets.⁴²⁹ After the failure of Bear Stearns,⁴³⁰ Lehman was unable to secure the short-term finance it needed in order to survive.⁴³¹ Lehman was now in a precarious situation, as the company was experiencing quarterly losses. Attempting to avoid bankruptcy Lehman tried to negotiate a sale with Barclays, which ultimately fell through as the requirements⁴³² needed to conclude the sale was disallowed by UK regulators.⁴³³ One of the reasons that was stated why the sale was not finalised was because no bankruptcy order was in place.⁴³⁴

During 2008 Lehman (in an effort to escape liquidation) filed for *Chapter 11* protection.⁴³⁵ During the petition Lehman proclaimed to have \$613 billion in debt.⁴³⁶

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- 2010 citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.186.5564&rep1&type=pdf and Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.
- ⁴²⁶ Estrada 2008 *University of Richmond Law Review* 1115-1116. Also see Feng and Fredriksson 2010 citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.186.5564&rep1&type=pdf and Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.
- ⁴²⁷ Estrada 2008 *University of Richmond Law Review* 1116. Also see Feng and Fredriksson 2010 citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.186.5564&rep1&type=pdf and Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.
- ⁴²⁸ Estrada 2008 *University of Richmond Law Review* 1116. Also see Feng and Fredriksson 2010 citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.186.5564&rep1&type=pdf and Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.
- ⁴²⁹ Estrada 2008 *University of Richmond Law Review* 1116.
- ⁴³⁰ Bear Stearns was one of the largest US securities firms. During 2008 Bear Stearns was in financial crises and the Federal Reserve Bank participated in there bailout. See Hardee 2011 *North Carolina Banking Institute* 261-262.
- ⁴³¹ Estrada 2008 *University of Richmond Law Review* 1117. Also see Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.
- ⁴³² The shareholders were required to vote prior to the sale being approved, the vote could not be secured within the time frame and as a result the sale fell through. Also see Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.
- ⁴³³ Estrada 2008 *University of Richmond Law Review* 1117-1118.
- ⁴³⁴ Barclays did not want to proceed with the sale as they did not want to expose themselves to the possibility of fraudulent transfers or other claims. See Estrada 2008 *University of Richmond Law Review* 1118.
- ⁴³⁵ The application was made in the United States Bankruptcy Court for the Southern District of New York, see Estrada 2008 *University of Richmond Law Review* 1118. Also see Macey *American Society of International Law Proceedings* 34; Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>
- ⁴³⁶ Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>. Also see Estrada 2008 *University of Richmond Law Review* 1118.

The idea behind *Chapter 11* protection was to provide Lehman the chance to dissolve some of its operations.⁴³⁷ However not all of Lehman's operations were subject to the bankruptcy proceedings such as the derivate contracts.⁴³⁸ After filling the petition⁴³⁹ Lehman again tried to negotiate a sale with Barclays to acquire its North American Businesses.⁴⁴⁰ The negotiations were re-opened because Lehman now had the protection of the bankruptcy procedure.⁴⁴¹ Because of the volatility of Lehman's assets Barclays placed a five day deadline for the sale to the confirmed by means of a court order.⁴⁴² During September the court confirmed the sale.⁴⁴³ The court order approved the sale for the North American investment banking business and capital markets as well as Lehman Brothers international.⁴⁴⁴ During the course of Lehman's demises an estimated nineteen of its subsidiaries continued to file for *Chapter 11* bankruptcy.⁴⁴⁵

The bankruptcy of Lehman had a detrimental effect on its creditors. Hardee states that over sixty thousand claims were filed by various debtors against Lehman.⁴⁴⁶ This in itself was problematic but what complicated the matter even more was the fact that most of the debtors were subject to different insolvency laws.⁴⁴⁷ Because of the

⁴³⁷ Prior to 2008 Lehman conducted business in investment banking, fixed income, equities and capital markets. See Feng and Fredriksson 2010 citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.186.5564&rep1&type=pdf and Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.

⁴³⁸ A derivative is a contract between two parties. The value of a derivate is determined by the underlying assets. See Anon date unknown <https://www.investopedia.com/terms/d/derivative.asp>. A fire sale is when the sale of assets occur at a price that is below market value in an attempt to avoid financial distress. See Anon date unknown <http://www.businessdictionary.com/definition/fire-sale.html>. The counterparties that did not receive the protection provided for by the Bankruptcy proceedings in an attempt to protect themselves started to sell assets. This resulted in a fire sale which accumulated billions of dollars in loss. See Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.

⁴³⁹ Chapter 11 A petition for protection with was filed in the Southern District of New York.

⁴⁴⁰ Estrada 2008 *University of Richmond Law Review* 1118. Also see Hardee 2011 *North Carolina Banking Institute* 268.

⁴⁴¹ Barclays did not want to proceed with the sale as they did not want to expose themselves to ther possibility of fraudulent transfers or other claims. See Estrada 2008 *University of Richmond Law Review* 1118.

⁴⁴² Estrada 2008 *University of Richmond Law Review* 1119.

⁴⁴³ Estrada 2008 *University of Richmond Law Review* 1119.

⁴⁴⁴ Estrada 2008 *University of Richmond Law Review* 1119.

⁴⁴⁵ Hardee 2011 *North Carolina Banking Institute* 268.

⁴⁴⁶ Hardee 2011 *North Carolina Banking Institute* 268.

⁴⁴⁷ Hardee 2011 *North Carolina Banking Institute* 268.

intricate nature of Lehman and the fact that different legal systems were in place, resulted in debtors fighting over the distribution of Lehman's assets.⁴⁴⁸ The delay in payments was yet another negative consequence of the bankruptcy procedure.⁴⁴⁹

3.4.3 The effect on the global financial markets

The moment Lehman filed for bankruptcy a shockwave spread across the global financial markets as this was the first time such a large financial institution had failed.⁴⁵⁰ The failure occurred during the sudden burst of the "housing bubble".⁴⁵¹ With the burst, the financial markets became concerned about the actual value of subprime mortgages and other related securities.⁴⁵² This concern quickly spread to other types of securities across the financial markets not only in the United States but also across the globe.⁴⁵³ In the end the downfall of Lehman created a "global contagion".⁴⁵⁴

The term "global contagion" is not very familiar in South Africa but it can best be described as

(a) situation where one firm or market experiences a sudden shock that leads to other firms and markets experiencing a similar impact that is not totally explained by a direct linkage.⁴⁵⁵

It has a ripple effect in the sense that the particular situation creates such a dire effect on a global scale that even markets and companies that has no direct link to the falling situation will experience financial difficulties. The term thus has three key elements, namely, there must be (1) a distress to a market that has (2) a major negative effect not only on that market but also on (3) a secondary market.⁴⁵⁶ In the case of Lehman the contagion was a result of two distinct phases⁴⁵⁷ but it was the

⁴⁴⁸ Hardee 2011 *North Carolina Banking Institute* 271.

⁴⁴⁹ Hardee 2011 *North Carolina Banking Institute* 268.

⁴⁵⁰ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵¹ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵² Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵³ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵⁴ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵⁵ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵⁶ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵⁷ The first phase was the subprime mortgage crisis which weakened the short-term credit markets. The second phase was considered to be the period after Lehman filed for bankruptcy. During this

connection between these two phases that resulted in the global economic destruction.⁴⁵⁸ The question however remain: how did these subprime mortgages⁴⁵⁹ devastate the global economy?

To sum up the course of events that lead to Lehman's collapse were considered to be the following: Firstly when Lehman's started to experience financial difficulties the question was raised what is the actual value of Lehman's real estate assets.⁴⁶⁰ The moment this question was raised, the sale of these assets were halted.⁴⁶¹ What followed next was that Lehman was now placed in a position that they had to borrow money on a daily basis in order sustain its business.⁴⁶² The lenders on the other hand no longer wanted to provide the financial assistance Lehman required as the estate assets provided as collateral were no longer accepted.⁴⁶³ In order to secure the financial assistance required Lehman had to deliver other assets as security.⁴⁶⁴ When Lehman was unable to secure funding and meet its demand the Lehman's US holding company filed for bankruptcy, this created widespread fear across the global markets.⁴⁶⁵ The moment bankruptcy was filed in the US Lehman's UK broker-dealer was placed under supervision by the UK Financial Services Authority.⁴⁶⁶ The effect of this was that the UK broker-dealer's assets were frozen and communication ties between the US broker-dealer subsidiary⁴⁶⁷ and the UK broker-dealers were

phase fear and uncertainty washed over the global markets and created a severe liquidity crisis. See Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵⁸ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁵⁹ Subprime mortgage is a type of mortgage that is issued to a lender with a higher risk of defaulting in the loan. The interest charged on these types of loans are higher than conventional mortgage loans. See Anon date unknown <https://www.investopedia.com/terms/s/subprimemortgage.asp>.

⁴⁶⁰ When Bear Stearns liquidated two of its chief subprime mortgage companies, a concern was raised about the actual value of real estate assets, see Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁶¹ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁶² Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁶³ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁶⁴ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁶⁵ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>. Also see Macey *American Society of International Law Proceedings* 34; Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>

⁴⁶⁶ This occurred on the same day that the US holding company filed for bankruptcy, see Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>. Also see Macey *American Society of International Law Proceedings* 34; Wiggings, Piontek and Metrick 2014 <http://som.yale.edu/ypfs>.

⁴⁶⁷ They were excluded from the bankruptcy proceedings.

severed.⁴⁶⁸ This was however not the end. In the months that followed, a number of Lehman's affiliates that were located across the globe entered into bankruptcy and had their accounts frozen.⁴⁶⁹ Global markets began to panic, as the restrictions on the short-term credit markets increased which led to companies stockpiling their liquid assets.⁴⁷⁰

From that point onwards the destructive implications escalated. During 2008 major banks situated in the Belgium,⁴⁷¹ Iceland,⁴⁷² UK⁴⁷³ and the Netherlands⁴⁷⁴ either received support by means of bail outs or taken over by their respective governments.⁴⁷⁵ Wiggings and Metrick mention that the situation got so dire in Ireland that the government took over the entire banking sector.⁴⁷⁶ The global panic and interconnected nature of banks was yet again confirmed when a joint press release was issued by among others the Federal Reserve and European Central Bank.⁴⁷⁷ In the press release these banks stated that they will jointly support liquidity in the short-term funding markets.⁴⁷⁸

The collapse of Lehman emphasized that in order for an effective cross-border bank resolution to exist; an orderly resolution plan is required.⁴⁷⁹ Secondly an effective understanding of banking activities and its corporate structures are required and finally an adequate understanding of both host and home countries insolvency procedures is required.⁴⁸⁰

⁴⁶⁸ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁶⁹ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁷⁰ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁷¹ Dexia Bank.

⁴⁷² Glitnir Bank.

⁴⁷³ Bingley Bank.

⁴⁷⁴ Fortis Bank.

⁴⁷⁵ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁷⁶ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁷⁷ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁷⁸ Wiggings and Metrick 2015 <http://som.yale.edu/ypfs>.

⁴⁷⁹ Enoch, Mathieu and Mecagni 2015 *International Monetary Fund* 48.

⁴⁸⁰ Enoch, Mathieu and Mecagni 2015 *International Monetary Fund* 48.

3.5 Summary

From the above exposition it is clear that within this era of globalization a uniform cross-border bank insolvency law is required.⁴⁸¹ Leno indicates that this can however only be achieved with state co-operation.⁴⁸² The level of co-operation relates not only to the willingness [of the parties] to co-operate but also the willingness of countries to share information.⁴⁸³ This aspect is so important to Schwarcz that he pleads that conditions should be put in place that determines that cross-border bank insolvency law receives precedence over any national law within the region.⁴⁸⁴ According to him, only then will the problems stated above be resolved.

In an effort to answer the aforesaid the United States of America has developed the *Dodd-Frank Act*. The purpose of this act is to eliminate the problems that are associated with cross-border bank insolvency matters. It is important to study the provisions contained in the *Dodd-Frank Act* as similar provisions can be used within the SADC region to reduce the aforesaid problems or in some instances even eliminate them in its entirety.

4 Critical analysis and application of the Dodd-Frank Wall Street Reform and Consumer Protection Act

4.1 Introduction and background

As illustrated above, the insolvency of a financial institution is far more complicated than the insolvency of a natural person or a corporation for the reasons stated above. Another concern that relates to the insolvency of multi-national banks is the fear of systemic risk. Systemic risk can be defined as

⁴⁸¹ Leno 2013 *Journal of African law* 17. Also see Stander "The Coordination of group and financial Insolvencies in the SADC Region" 99.

⁴⁸² Leno 2013 *Journal of African law* 17. Also see Stander "The Coordination of group and financial Insolvencies in the SADC Region" 104.

⁴⁸³ Stander "The Coordination of group and financial Insolvencies in the SADC Region" 103.

⁴⁸⁴ Leno 2013 *Journal of African law* 18. Also see Stander "The Coordination of group and financial Insolvencies in the SADC Region" 99.

(t)he probability that cumulative losses will occur from an event that ignites a series of successive losses along a chain of [financial] institutions or markets comprising..... a system.⁴⁸⁵

In other words systemic risk refers to the collapse of an entire system.⁴⁸⁶ The most prominent effect of systemic failure of banks is the heightened cost of capital or the reduction in the accessibility of capital.⁴⁸⁷ Why is systemic risk such a concern in the contexts of banks? When a bank is unable to satisfy a "withdrawal-demand"⁴⁸⁸ a chain reaction of bank failures will be created.⁴⁸⁹ The failure is caused due to the fact that banks only keep a small percentage of capital on hand.⁴⁹⁰ If a bank has insufficient funds available, it will result in the bank defaulting in its obligations.⁴⁹¹ The chain reaction is then created because banks, as stated above are closely interlinked with one another. This means that banks are able to transfer funds to one another, obtain loans from one another and in some cases even hold deposits on behalf of one another.⁴⁹² The moment one bank is unable to fulfil its financial obligation towards another bank this may in turn result in that bank being unable to fulfil its own obligations towards a third bank.⁴⁹³

In order to reduce systemic risk and the possibility that the insolvency of a multi-national bank can lead to a global economic crunch a harmonised system to resolve the aforesaid needs to be developed.⁴⁹⁴ In fact, according to Lastra it was the lack a proper systemic risk evaluation system that led to the most recent financial crises.⁴⁹⁵ In an endeavour to prevent another financial crisis various financial authorities

⁴⁸⁵ Schwarcz 2008 *The Georgetown Law Journal* 197.

⁴⁸⁶ Lastra 2011 *Capital Markets Law Journal Vol 6 no 2* 199. Also see Coffee 2011 *Columbia Law Review* 797.

⁴⁸⁷ Schwarcz 2008 *The Georgetown Law Journal* 198.

⁴⁸⁸ Schwarcz 2008 *The Georgetown Law Journal* 198.

⁴⁸⁹ Schwarcz 2008 *The Georgetown Law Journal* 198.

⁴⁹⁰ Schwarcz 2008 *The Georgetown Law Journal* 198.

⁴⁹¹ Schwarcz 2008 *The Georgetown Law Journal* 198.

⁴⁹² Lastra 2011 *Capital Markets Law Journal Vol 6 no 2* 202. Also see Schwarcz 2008 *The Georgetown Law Journal* 198.

⁴⁹³ Schwarcz 2008 *The Georgetown Law Journal* 198. Also see Lastra 2011 *Capital Markets Law Journal, Vol 6 no 2* 200.

⁴⁹⁴ Macey *American Society of International Law Proceedings* 33.

⁴⁹⁵ Lastra 2011 *Capital Markets Law Journal, Vol 6 no 2* 197.

started to explore the concepts of micro-⁴⁹⁶ and macro-prudential⁴⁹⁷ supervision.⁴⁹⁸ These concepts were clearly considered by the US when they initiated their legislative reform.⁴⁹⁹

The US developed the *Dodd-Frank Act* in an attempt to achieve the aforesaid harmonisation in the United States of America. The *Dodd-Frank Act* was ratified on 21 July 2010.⁵⁰⁰ The purpose of the *Dodd-Frank Act* is to

(p)romote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services, and for other purposes.⁵⁰¹

Regaining investor trust after 2008 and the creation of a safe financial industry is a clear goal of the *Dodd-Frank Act*.⁵⁰²

How the *Dodd-Frank Act* attempts to achieve this is discussed in three parts below. The first part of the chapter focuses on the extraterritorial scope of the *Dodd-Frank Act*. After it has been determined that the *Dodd-Frank Act* is applicable across borders, the specific provisions that are included in the *Dodd-Frank Act* to limit systemic risk and enhance financial stability are discussed. The final aspect of this chapter focuses on the specific provisions that relate the treatment of creditors and investors.

4.2 Extraterritorial jurisdiction

⁴⁹⁶ Micro-prudential supervision refers to the daily supervision of financial institutions and the focus thereof is the financial safety of these institutions as well as to financially protect the consumer. See Lastra 2011 *Capital Markets Law Journal* Vol 6 no 2 197.

⁴⁹⁷ Macro-prudential supervision is referred to as the analysis of financial trends and inadequacies in the financial system and the detection of systemic risk in order to determine if these trends and inadequacies pose a risk to financial stability. The focus thereof is the financial safety of the economy as a whole. See Lastra 2011 *Capital Markets Law Journal* Vol 6 no 2 197.

⁴⁹⁸ Lastra 2011 *Capital Markets Law Journal* Vol 6 no 2, 197 -198.

⁴⁹⁹ Lastra 2011 *Capital Markets Law Journal* Vol 6 no 2, 198.

⁵⁰⁰ Bliss and Kaufman 2011 *The banking law journal* 340. Also see Gao, Liao and Wang 2018 *Journal of Banking and Finance* 86 205.

⁵⁰¹ *Dodd-Frank Act*. Also see Gao, Liao and Wang 2018 *Journal of Banking and Finance* 86 207.

⁵⁰² Gao, Liao and Wang 2018 *Journal of Banking and Finance* 86 204.

With the aim of fully comprehending the specific sections contained in the *Dodd-Frank Act* that deals with extraterritorial jurisdiction, requires a better understanding of the concept itself. Given that the concept has according to Colangelo no official definition it is most commonly referred to as

(t)he exercise of jurisdiction, or legal power, outside territorial borders.⁵⁰³

Nonetheless, to the author's mind, this can be considered to be an accurate definition in light of the fact that the concept impacts on a variety of different fields of law.⁵⁰⁴ Colangelo states-, and the author is inclined to agree, that in order to develop a suitable description the concept should be divided into two separate expressions namely (1) extraterritorial and (2) jurisdiction. First we look at the expression extraterritorial. Colangelo expresses that in most instances the answer as to the meaning of the expression extraterritorial can be found in the constitution of the specific country.⁵⁰⁵ In the author's opinion, the concept refers to a matter that occurs outside of the country's borders.

The concept "jurisdiction" is more intricate. Colangelo correctly states that in order to discover a definition of the term it would be beneficial to rather refocus the study to determine the type of jurisdiction that is applicable.⁵⁰⁶ There are three types of jurisdictions as pointed out by Colangelo namely prescriptive, adjudicative and enforcement jurisdiction.⁵⁰⁷ Prescriptive jurisdiction refers to situations where the law is applied to either a person or a thing;⁵⁰⁸ adjudicative jurisdiction is when a person is subject to the legal process⁵⁰⁹ and lastly enforcement jurisdiction refers to the

⁵⁰³ Colangelo 2014 *Cornell Law Review* 1304.

⁵⁰⁴ For example whether regulatory laws of a specific nation may be applied across borders; or the extent a nation has power over a foreign defendant; or lastly if a nation can adjudicate a matter whose cause of action arose from a activity in a different jurisdiction. See Colangelo 2014 *Cornell Law Review* 1303 - 1304.

⁵⁰⁵ Colangelo 2014 *Cornell Law Review* 1304.

⁵⁰⁶ The reason being, as seen above, because it affects a variety of different aspects in the field of law. See Colangelo 2014 *Cornell Law Review* 1304.

⁵⁰⁷ Colangelo 2014 *Cornell Law Review* 1310.

⁵⁰⁸ Prescriptive jurisdiction is also known as legislative jurisdiction as it is most commonly associated with legislation. See Colangelo 2014 *Cornell Law Review* 1310.

⁵⁰⁹ This type of jurisdiction is generally associated with court, in the sense that the court has jurisdiction over the person or thing held before it. See Colangelo 2014 *Cornell Law Review* 1310.

court's power to enforce compliance of a court order regardless if the order was granted in its jurisdiction.⁵¹⁰ From the aforesaid it is clear that each type of jurisdiction is applied in a specific situation. When one is referring to a court's power of jurisdiction, it refers to the court's jurisdiction over either the person or the dispute that is placed in before that court; this is known as adjudicative jurisdiction.⁵¹¹ Enforcement jurisdiction means exactly that, the power to enforce. Prescriptive jurisdiction is applied in situations where legislation has in some manner enforced jurisdiction upon the person or thing. It is for that reason why prescriptive jurisdiction is of utmost importance for the purpose of this study as the *Dodd-Frank Act* has specifically included an extraterritorial jurisdiction provision. The focus is thus on prescriptive jurisdiction, with specific reference to the US court's recent decision regarding extraterritorial jurisdiction.

In the matter of *Morrison v National Australia Bank*⁵¹² two important questions were raised: firstly whether there is a presumption against extraterritorial jurisdiction and secondly if this presumption can be discarded if the claim substantially affects American interest.⁵¹³ This matter pertained to the purchase of certain stocks from National Australia Bank (NAB).⁵¹⁴ The plaintiffs⁵¹⁵ purchased shares in a US subsidiary of NAB that were listed on the Australia Stock Exchange⁵¹⁶ on information provided to them by NAB about its US subsidiary.⁵¹⁷ The plaintiffs wanted to sue NAB under section 10(b) of the *Securities Exchange Act of 1934*,⁵¹⁸ in the US district court.⁵¹⁹ The plaintiffs' argument was that Homeside Lending Inc (an American

⁵¹⁰ Colangelo 2014 *Cornell Law Review* 1310 - 1311.

⁵¹¹ Colangelo 2014 *Cornell Law Review* 1310.

⁵¹² *Robert Morrison et al, petitioners v National Australia Bank Ltd* 561 U.S 247 (2010) (<https://supreme.justia.com/cases/federal/us/561/247/>).

⁵¹³ Colangelo 2014 *Cornell Law Review* 1308.

⁵¹⁴ National Australia Bank herein after referred to as NAB.

⁵¹⁵ It was a class action lawsuit brought by four Australians. Also see Greenberger 2012 *UMKC Law Review* 973 and Elgadeh 2011 *Fordham Journal of Corporate & Financial Law* 584.

⁵¹⁶ Australian Stock Exchange herein after referred to as ASX.

⁵¹⁷ Painter 2011 *Harvard Business Law Review* 196. Also see Painter, Dunham and Quackenbos 2011 *Minnesota Journal of International Law* 5.

⁵¹⁸ The Securities Exchange Act of 1934 of the United States of America, herein after referred to as the *Securities Act*.

⁵¹⁹ Painter 2011 *Harvard Business Law Review* 196. Also see Greenberger 2012 *UMKC Law Review* 974 and Elgadeh 2011 *Fordham Journal of Corporate & Financial Law* 583.

mortgage subsidiary which was owned by NAB) committed fraudulent actions that caused the decrease in NAB's share price.⁵²⁰ The main issue that had to be dealt with was the presumption against extraterritorial jurisdiction. The court determined that section 10(b) could not be applied extraterritorially and stated that

(t)he focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States.⁵²¹

The US Supreme Court continued to state that section 10(b) of the *Securities Act* does not apply to securities fraud matters, in other words, the representation of false information in Australia that originated outside of the US. Section 10(b)⁵²² is only applicable to securities listed on an American stock exchange.⁵²³ The court denied the plaintiffs' request⁵²⁴ stating that if congress intended for the statute to be applied extraterritorially they should have clearly confirmed their intention.⁵²⁵ They based their decision on the specific language used in the *Securities Act*.⁵²⁶ In support of their decision the court quoted the decision of *EEOC v Arabian American Oil Co*.⁵²⁷

⁵²⁰ The plaintiffs' arguments was that NAB bought Homeside Lending Inc (the co-defendant) in order to expand its operations. According to the business model of Homeside mortgages would not be prematurely terminated or prepaid. As a subsidiary this was also indicted in NAB's financial statements. During 2001 NAB announced a write down of Homeside's assests which in turn resulted in an increase in mortgage prepayments. See Elgadeh 2011 *Fordham Journal of Corporate & Financial Law* 583. Also see Greenberger 2012 *UMKC Law Review* 974 and Painter, Dunham and Quackenbos 2011 *Minnesota Journal of International Law* 5.

⁵²¹ Painter, Dunham and Quackenbos 2011 *Minnesota Journal of International Law* 5. Also see Painter 2011 *Harvard Business Law Review* 196.

⁵²² Section 10(b) of the Securities Exchange Act of 1934.

⁵²³ Painter 2011 *Harvard Business Law Review* 195. Also see Painter, Dunham and Quackenbos 2011 *Minnesota Journal of International Law* 1, 6.

⁵²⁴ The Plaintiffs request was to sue National Australia bank in a US district court; also see Greenberger 2012 *UMKC Law Review* 973-974.

⁵²⁵ *Robert Morrison et al, petitioners v National Australia Bank Ltd* 561 US 247 (2010) (<https://supreme.justia.com/cases/federal/us/561/247/>). Also see Greenberger 2012 *UMKC Law Review* 974.

⁵²⁶ *Robert Morrison et al, petitioners v National Australia Bank Ltd* 561 US 247 (2010) (<https://supreme.justia.com/cases/federal/us/561/247/>). Also see Greenberger 2012 *UMKC Law Review* 974.

⁵²⁷ *EEOC v Arabian American Oil Co* 499 US 244, 248 (1991) *Aramco*. Also see *Robert Morrison et al, petitioners v National Australia Bank Ltd* 561 US 247 (2010) (<https://supreme.justia.com/cases/federal/us/561/247/>); Elgadeh 2011 *Fordham Journal of Corporate & Financial Law* 583.

(T)he longstanding principle of American Law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.⁵²⁸

Thus justice Scalia writing for the majority unmistakably confirmed that the extraterritorial application was a question that should be answered by the statute.⁵²⁹ It is important to remember that this decision was reached prior to the *Dodd-Frank Act* coming into effect.⁵³⁰

In a response to the above mentioned decision section 929P was added to the *Dodd-Frank Act*.⁵³¹ This section states that

- (t)he district court of the United States and the United States court of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation involving –
- (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the violation is committed by a foreign adviser and involves only foreign investors; or
 - (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.⁵³²

It is clear that this section determines that the Securities and Exchange Commission⁵³³ as well as the Department of Justice⁵³⁴ may apply US securities law across jurisdictions.⁵³⁵ By adding this section congress intended to provide the *SEC* and *DOJ* with sufficient powers to investigate alleged fraudulent matters with similar circumstances than that of Morrison.⁵³⁶ The consequence of adding this section is

⁵²⁸ *EEOC v Arabian American Oil Co* 499 US 244, 248 (1991) *Aramco*. Also see *Robert Morrison et al, petitioners v National Australia Bank Ltd* 561 US 247 (2010) (<https://supreme.justia.com/cases/federal/us/561/247/>); Elgadeh 2011 *Fordham Journal of Corporate & Financial Law* 583.

⁵²⁹ *Robert Morrison et al, petitioners v National Australia Bank Ltd* 561 US 247 (2010) (<https://supreme.justia.com/cases/federal/us/561/247/>). Also see Colangelo 2014 *Cornell Law Review* 1337.

⁵³⁰ Greenberger 2012 *UMKC Law Review* 974.

⁵³¹ Section 929(P) of the *Dodd-Frank Act*. Also see Greenberger 2012 *UMKC Law Review* 974; Painter 2011 *Harvard Business Law Review* 195.

⁵³² Section 922(P) of the *Dodd-Frank Act*.

⁵³³ Securities and Exchange Commission, herein after referred to as *SEC*.

⁵³⁴ Department of Justice, herein after referred to as *DOJ*.

⁵³⁵ Greenberger 2012 *UMKC Law Review* 974.

⁵³⁶ They will have the powers to pursue allegations of fraud that was conducted inside of the U.S that affected transactions outside of the U.S. Also see Painter, Dunham and Quackenbos 2011 *Minnesota Journal of International Law* 2.

that the order granted in the Morrison matter⁵³⁷ would in effect be reversed.⁵³⁸ In the author's opinion, this is a good principle as it will ensure global compliance and prevent a situation that is similar to Morrison from occurring in future. Another advantage is that it can be seen as the first step in eliminating some of the extraterritorial jurisdictional questions that might arise.

As seen above it is clear that the purpose of *Dodd-Frank Act* is to create financial stability across a range of different sectors. In order to further promote financial stability especially in the contents of cross-border bank insolvency, section 722(d)⁵³⁹ was introduced into the act.

Section 722(d) further emphasises the extraterritorially intent of the *Dodd-Frank Act*.⁵⁴⁰ In terms of this section US regulators can apply the provisions contained in the *Dodd-Frank Act* to foreign banks, subsidiaries of US Banks or even to trades that was concluded outside of the United States *if those trades either directly involve US participants or might considerably influence the US economy*.⁵⁴¹ The purpose of this section is to protect the US taxpayers from having to bail out "Too Big to Fail"⁵⁴² banks.⁵⁴³ The extraterritorial scope of the *Dodd-Frank Act* acknowledges that financial institutions are extremely interlinked and as such these multinational financial institutions greatly threaten systemic stability.⁵⁴⁴ The dangers that exist because of the interconnectedness of these financial institutions became apparent as seen above during the Lehman Brothers collapse.⁵⁴⁵ At the time of Lehman's demise

⁵³⁷ The order that section 10(b) of the securities Exchange Act of 1934 is not applicable.

⁵³⁸ Painter, Dunham and Quackenbos 2011 *Minnesota Journal of International Law* 2.

⁵³⁹ Section 292(d) of the *Dodd-Frank Act*. Also See Greenberger 2012 *UMKC Law Review* 974.

⁵⁴⁰ Section 292(d) of the *Dodd-Frank Act*. Also See Greenberger 2012 *UMKC Law Review* 974.

⁵⁴¹ Greenberger 2012 *UMKC Law Review* 968-974.

⁵⁴² The too-big-to-fail policy refers to the responsibility of the government to support certain large interlinked financial institutions when they experience financial difficulty, because if these financial institutions were to fail it would cause the entire system to fail. When these institutions are bailed out it is the public and not the shareholders that are placed at a disadvantage as they bear the cost of the risks taken by the financial institution. See Gao, Liao and Wang 2018 *Journal of Banking and Finance* 86 205 and Moosa 2010 *Journal of Banking Regulation* Vol 11, 4 319.

⁵⁴³ Greenberger 2012 *UMKC Law Review* 975.

⁵⁴⁴ Greenberger 2012 *UMKC Law Review* 975.

⁵⁴⁵ Greenberger 2012 *UMKC Law Review* 976.

it was difficult to establish which assets and liabilities belonged to which of the different legal entities.⁵⁴⁶

Despite vigorous opposition against the extraterritorial scope of the *Dodd-Frank Act* and in particular section 722(d), congress determined that section 722(d) is in complete harmony with US constitutional values and practices, in that it satisfies the due process condition.⁵⁴⁷ Despite this determination "Too Big to Fail" banks still oppose the extraterritorial application of the *Dodd-Frank Act*.⁵⁴⁸ The chief executive of the Institute of International Bankers stated that the extraterritorial application of the *Dodd-Frank Act*

(w)ill reach far beyond the shores of the US and apply to all of the global activities of every foreign bank that maintains even so much as a small branch in the US⁵⁴⁹

Greenberger states that another concern about the extraterritorial reach in that it extends the sovereignty of the US borders.⁵⁵⁰ The concerns raised are not without merit. Sally makes a valid point when she states

(n)one of the foreign regulators has proposed applying its local restrictions to the internal activities of US banks operating within America. One could only image the response of US regulators were the situation reversed.⁵⁵¹

Even with the concerns raised above, it is the author's opinion that the intent of the extraterritorial provisions is not to extent the sovereignty of the US borders but to create harmonisation.⁵⁵² Without this provision we are placed in the exact same position as in the past where each jurisdiction has to rely on domestic provisions, even if those provisions are in conflict with each other. Thus notwithstanding the above mentioned opposition the *Dodd-Frank Act* is a step in the right direction in creating a uniform regulating system. It is important to mention that uniformity will only occur if a connection exists between the actions of the bank that has bearing on

⁵⁴⁶ Greenberger 2012 *UMKC Law Review* 976.

⁵⁴⁷ Greenberger 2012 *UMKC Law Review* 971.

⁵⁴⁸ Greenberger 2012 *UMKC Law Review* 969.

⁵⁴⁹ Miller *Financial Times* 1. Also see Greenberger 2012 *UMKC Law Review* 969.

⁵⁵⁰ Greenberger 2012 *UMKC Law Review* 969.

⁵⁵¹ Miller *Financial Times* 1. Also see Greenberger 2012 *UMKC Law Review* 969.

⁵⁵² It promises to enhance global financial regulations, while at the same time protecting not only American taxpayers but also taxpayers from across the globe from bailouts. It also ensures a level playing field. See Greenberger 2012 *UMKC Law Review* 965-979.

the US economy.⁵⁵³ But in doing so legal certainty is created which is important especially when business is concluded with a country which laws does not contain any such provision.

To improve international acceptance of the extraterritorial reach of the *Dodd-Frank Act* section 719(c)⁵⁵⁴ was introduced. In terms of this section international co-operation and co-ordination is required during the development of the different sections.⁵⁵⁵ Section 175⁵⁵⁶ states that co-ordination with similar international policies in regards to limiting the interconnectedness, scope and size of financial institutions in order to protect the global economic stability may be considered.⁵⁵⁷ Another provision that was introduced in order to ensure international acceptance and co-operation was section 217.⁵⁵⁸ This section determines that a study should be conducted to determine the international co-ordination applicable to the bankruptcy of financial institutions.⁵⁵⁹ This section determines that the following should be studied:

- (A) the extent to which international coordination currently exists;
- (B) Current mechanisms and structures for facilitating international cooperation;
- (C) barriers to effective international coordination; and
- (D) ways to increase and make more effective international coordination of the resolution of financial companies, as to minimize the impact on the financial system without creating moral hazard.⁵⁶⁰

In the author's opinion, the intention of confirming the extraterritorial reach of the *Dodd-Frank Act* was undoubtedly a mere effort to enhance financial stability. By limiting the extraterritorial scope of the *Dodd-Frank Act* would in fact be taking a step backwards. The effect thereof would be that each jurisdiction will develop and implement their own legal framework and as seen above this can be problematic.

⁵⁵³ Greenberger 2012 *UMKC Law Review* 968-974, 894.

⁵⁵⁴ Section 719(c) of the *Dodd-Frank Act*. Also see Greenberger 2012 *UMKC Law Review* 980.

⁵⁵⁵ Greenberger 2012 *UMKC Law Review* 980.

⁵⁵⁶ Section 175 of the *Dodd-Frank Act*.

⁵⁵⁷ Section 175 of the *Dodd-Frank Act*.

⁵⁵⁸ Section 217 of the *Dodd-Frank Act*.

⁵⁵⁹ Section 217 of the *Dodd-Frank Act*.

⁵⁶⁰ Section 217 of the *Dodd-Frank Act*.

4.3 Creating a harmonised procedure

Now that it has been determined that the *Dodd-Frank Act* is applicable across borders⁵⁶¹ it is important to examine what exactly the act proposes to do in order to limit systemic risk and in the process create a harmonised insolvency system. Firstly it is important to point out that the *Dodd-Frank Act* adopted a macro prudential approach in that the stability of the entire financial system is considered as opposed to merely considering individual financial institutions.⁵⁶²

In terms of the *Dodd-Frank Act* banks that risk systemic stability have to comply with strict regulations, the purpose thereof is to reduce systemic risk.⁵⁶³ The *Dodd-Frank Act* contains a range of original regulations and provisions⁵⁶⁴ which aims at creating a secure banking system.⁵⁶⁵ The Financial Stability Oversight Council⁵⁶⁶ is one provision that was created by the *Dodd-Frank Act* that is aimed at identifying and eliminating systemic risk.⁵⁶⁷ The main purpose of the *FSOC* is to recognize which financial institution risk systemic stability.⁵⁶⁸ The *FSOC* is also responsible for enhancing and recommending stricter standards for large banks.⁵⁶⁹ The *FSOC* requires the establishment of resolution plans for failing banks.⁵⁷⁰ Additionally the *FSOC* can also provide government organisations with the authority it needs to institute an orderly resolution system that falls outside of the normal bankruptcy procedures.⁵⁷¹

⁵⁶¹ When there is substantial American interest.

⁵⁶² Gao, Liao and Wang 2018 *Journal of Banking and Finance* 86 207.

⁵⁶³ Gao, Liao and Wang 2018 *Journal of Banking and Finance* 86 204.

⁵⁶⁴ Some of the provisions include the creation of the Bureau of Consumer Financial Protection as well as providing authority for regulator to increase capital requirements. See Wolf *A global cross-border insolvency framework for financial institutions* 7.

⁵⁶⁵ Barth, Prabha and Wilhlborg 2014 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=24900374 pg 2.

⁵⁶⁶ Financial Oversight Stability Council, herein after referred to as *FSOC*. See Vartanian and Miller 2010 *Bank Accounting & Finance CCH Journal* 3.

⁵⁶⁷ Section 111 of the *Dodd-Frank Act*. Also see of the Vartanian and Miller 2010 *Bank Accounting & Finance CCH Journal* 3 and Gao, Liao and Wang 2018 *Journal of Banking and Finance* 86 207.

⁵⁶⁸ Section 112(a) of the *Dodd-Frank Act*. Also see Morrison and Foerster 2010 <https://media.mofo.com/files/uploads/Images/SummaryDodd-FrankAct.pdf>; and Telpner 2010 *The Journal of Structured Finance* 17.

⁵⁶⁹ Section 112(a)(1) of the *Dodd-Frank Act*. Also see Hoffman 2012 <http://ssrn.com/abstract=2145210> 56.

⁵⁷⁰ Wolf *A global cross-border insolvency framework for financial institutions* 7.

⁵⁷¹ Wolf *A global cross-border insolvency framework for financial institutions* 7.

Another of these provisions is the new resolution procedure. The purpose of this resolution procedure is to limit the damage that will be caused by the failing bank.⁵⁷² In terms of the resolution procedure an Orderly Liquidation Authority⁵⁷³ is established in order to liquidate failing bank.⁵⁷⁴ The OLA is assigned to financial institutions that risks systemic stability.⁵⁷⁵ The OLA is assigned when the bank is either in default or is in danger of defaulting.⁵⁷⁶ In terms of section 204⁵⁷⁷ the purpose of the OLA is to provide the necessary authority to liquidate failing financial companies in a manner that insures that

- (1) creditors and shareholders will bear the losses of the financial company;
- (2) management responsible for the condition of the financial company will not be retained; and
- (3) the corporation and other appropriate agencies will take all necessary steps and appropriate to assure that all parties, including management, directors and third parties, having responsibility for the condition of the financial company bear losses consistent with their responsibility, including actions for damages, restitution and recoupment of compensation and other gains not compatible with such responsibility.⁵⁷⁸

Bankruptcy procedures in general are very lengthy processes. The moment that a financial institution commences bankruptcy procedures an automatic stay situation is created.⁵⁷⁹ This enables an administrator to collect and dispose of certain assets which in turn protects the status *quo* of the debtors.⁵⁸⁰ In order to combat this, the *Dodd-Frank Act* established that certain financial institutions are required to develop

⁵⁷² Gao, Liao and Wang 2018 *Journal of Banking and Finance* 86 204.

⁵⁷³ Orderly Liquidation Authority, herein after referred to as *OLA*.

⁵⁷⁴ Barth, Prabha and Wilhlborg 2014 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=24900374 pg 8. Also see Vartanian and Miller 2010 *Bank Accounting & Finance CCH Journal* 3.

⁵⁷⁵ Systemic stability is based upon the conclusion of the Secretary of the Treasury that should the specific bank fail then it would result in a negative effect of the financial stability of the US-, and that default cannot be prevented by any private remedy and that the actions under the Act would prevent this. See Bliss and Kaufman 2011 *The banking law journal* 354 and Barth, Prabha and Wilhlborg 2014 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=24900374 pg 8.

⁵⁷⁶ A bank is in default or is in danger of defaulting when the bank can no longer pay all of its obligations or when the banks' capital is draining. Also see Bliss and Kaufman 2011 *The banking law journal* 354.

⁵⁷⁷ Section 204 of the *Dodd-Frank Act*.

⁵⁷⁸ Section 204 of the *Dodd-Frank Act*.

⁵⁷⁹ Wolf *A global cross-border insolvency framework for financial institutions* 5.

⁵⁸⁰ Wolf *A global cross-border insolvency framework for financial institutions* 5.

a recovery and resolution plan.⁵⁸¹ In terms of this recovery and resolution plan certain banks⁵⁸² are required to present reports that set out their plans for resolution in case of financial hardship.⁵⁸³ The purpose of the resolution plan or "living will" is to set out in detail the plan for liquidation to take place in an orderly manner in the event that the bank may fail.⁵⁸⁴ The production of this plan will dramatically reduce the number of assets that can be disposed of by the administrators thus protecting the creditors and investors. The resolution plan will also help to highlight the interconnected structure of the financial institution,⁵⁸⁵ which in turn will drastically reduce the possibility of global financial crises.

How does this differ from the current bilateral MoU's? Currently there is no regulating authority that can force compliance with MoU's. But because of section 722(d) of the *Dodd-Frank Act* foreign banks are now compelled to comply with the provisions contained in the Act.

4.4 The treatment of creditors and investors

The next question that requires an answer is what are the implications of the above mentioned on creditors and investors? Does the *Dodd-Frank Act* eliminate some of the problems that occur during bankruptcy or does it have a negative effect on creditors and investors. Section 204⁵⁸⁶ clearly identifies the purpose of orderly liquidation authority:

The purpose of this title to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard. The authority provided in this title shall be exercised in the manner that best fulfils such purpose, so that-

(1) creditors and shareholders will bear the losses of the financial company;

⁵⁸¹ Barth, Prabha and Wilhlborg 2014 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=24900374 pg 8.

⁵⁸² Banks with has assets worth more than \$50 Billion.

⁵⁸³ Barth, Prabha and Wilhlborg 2014 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=24900374 pg 9-10.

⁵⁸⁴ Section 204 of the *Dodd-Frank Act*.

⁵⁸⁵ Wolf *A global cross-border insolvency framework for financial institutions* 5.

⁵⁸⁶ Wolf *A global cross-border insolvency framework for financial institutions* 5.

- (2) management responsible for the condition of the financial company will not be retained; and
- (3) the corporation and other appropriate agencies will take all steps necessary and appropriate to assure that all parties, including management, directors and third parties, having responsibility for the condition of the financial company bear losses consistent with their responsibility, including actions for damages, restitution, and recoupment of compensation and other gains not compatible with such responsibility.

It is clear from section 204⁵⁸⁷ that the purpose of the OLA is to protect the taxpayers from bailouts⁵⁸⁸ in that the creditors and shareholders bear the losses.⁵⁸⁹ Hardee states that this is the complete opposite to the purpose of the current US bankruptcy law.⁵⁹⁰ This view makes it necessary to briefly explain the process under the current bankruptcy law⁵⁹¹ and how it differs from the OLA procedure.

The main concern of the current bankruptcy code is either to (1) distribute assets fairly amongst creditors⁵⁹² or (2) the restructure the financial institution.⁵⁹³ The bankruptcy procedure is initiated by either the creditors once the financial institution is in default or by the debtor (the financial institution) once they are in default or if the debtor anticipates default.⁵⁹⁴ Once the decision to file for bankruptcy is made (by the debtor or creditors) a petition has to be filed in order for the court⁵⁹⁵ to consider the merits of the application.⁵⁹⁶ The time frame of the bankruptcy procedure varies

⁵⁸⁷ Section 204 of the *Dodd-Frank Act*.

⁵⁸⁸ A bailout is the government decision to provide financial assistance to a failing bank in an effort to prevent bankruptcy. During a bailout funds are transferred from taxpayers to the failing bank, the effect of this is that the taxpayers pay the price for the risky investments that was taken by the bank. See Miron 2009 *Cato Journal* 11-14.

⁵⁸⁹ Hardee 2011 *North Carolina Banking Institute* 276.

⁵⁹⁰ The purpose of the bankruptcy law is to maximise the amount that is available to the creditors. It is not concerned with the systemic risk but rather it focusses on the providing the best outcome for the debtors and creditors. See Hardee 2011 *North Carolina Banking Institute* 276.

⁵⁹¹ As documented in Title II of the US *Bankruptcy Code*, 1978.

⁵⁹² The assets will be distributed if it is determined that liquidation should take place in terms of *Chapter 7 of the bankruptcy Code*. See Bliss and Kaufman 2007 *Virginia Law & Business Review* 153; Hardee 2011 *North Carolina Banking Institute* 276.

⁵⁹³ The financial institution will be restructured if it is determined that it is in the best interest of the creditors that liquidation does not take place. This restructuring takes place in accordance with *Chapter 11 of the bankruptcy Code*. See Bliss and Kaufman 2007 *Virginia Law & Business Review* 153 -154; Hardee 2011 *North Carolina Banking Institute* 276.

⁵⁹⁴ Bliss and Kaufman 2007 *Virginia Law & Business Review* 155. Also see Hardee 2011 *North Carolina Banking Institute* 277.

⁵⁹⁵ The federal bankruptcy court; see Bliss and Kaufman 2007 *Virginia Law & Business Review* 155.

⁵⁹⁶ Bliss and Kaufman 2007 *Virginia Law & Business Review* 155.

as the appointed receiver determines the speed of the proceedings.⁵⁹⁷ This can in some cases be detrimental to the creditors as there is no specified time frame in which their claims will be finalised.⁵⁹⁸ This was the case during the *Lehman Brothers* matter. Another difference that should be noted is that the *Bankruptcy Code* provides an automatic stay that is applied to all contractual agreements.⁵⁹⁹ During the automatic stay process creditors are afforded the opportunity to arrange their claims.⁶⁰⁰ The way in which claims are allowed and denied also differs. In terms of the *Bankruptcy Code* all claims are allowed unless a trustee in terms of *Chapter 7* objects to the claim being allowed.⁶⁰¹ In this instance the creditor is afforded to opportunity to argue in court why the claim should be allowed.⁶⁰² The court will only reject the claim if the creditor fails to appear in court or if after consideration of the facts makes a determination that the claim should be excluded.⁶⁰³ The final difference, in the opinion of the author; that should be emphasised is the manner in which claims are paid out. Bliss and Kaufman points out that

(l)egal priority,⁶⁰⁴ security interest,⁶⁰⁵ and rights of offset⁶⁰⁶ where protected, jointly determine what a creditor is entitled to under the law.⁶⁰⁷

This, put simply, means that the statute will determine what each creditor is entitled to.⁶⁰⁸

⁵⁹⁷ Bliss and Kaufman 2007 *Virginia Law & Business Review* 166-167. Also see Hardee 2011 *North Carolina Banking Institute* 278.

⁵⁹⁸ Hardee 2011 *North Carolina Banking Institute* 278.

⁵⁹⁹ Hardee 2011 *North Carolina Banking Institute* 279.

⁶⁰⁰ Hardee 2011 *North Carolina Banking Institute* 278.

⁶⁰¹ Hardee 2011 *North Carolina Banking Institute* 281.

⁶⁰² Hardee 2011 *North Carolina Banking Institute* 281.

⁶⁰³ Hardee 2011 *North Carolina Banking Institute* 281.

⁶⁰⁴ Priority means the order in which unsecured creditors will be paid. See Bliss and Kaufman 2007 *Virginia Law & Business Review* 160.

⁶⁰⁵ Security Interest refers to liens on property. See Bliss and Kaufman 2007 *Virginia Law & Business Review* 160.

⁶⁰⁶ Offset refers to the process combining more than one contract between the insolvent and the creditor in order to reduce that assets of the insolvent as well as the number of unsecured claims. See Bliss and Kaufman 2007 *Virginia Law & Business Review* 160-161.

⁶⁰⁷ Bliss and Kaufman 2007 *Virginia Law & Business Review* 160. Also see Hardee 2011 *North Carolina Banking Institute* 283.

⁶⁰⁸ Bliss and Kaufman 2007 *Virginia Law & Business Review* 160. Also see Hardee 2011 *North Carolina Banking Institute* 283.

As mentioned above, the OLA is in contrast to the current bankruptcy procedure. The process is started by the appointment of a receiver.⁶⁰⁹ It is the duty of the receiver to initiate liquidation proceedings.⁶¹⁰ The moment when liquidation proceedings are initiated by the receiver, creditors are immediately barred from instituting liquidation under *Title II* of the *Dodd-Frank Act*.⁶¹¹ The purpose for the appointment of the receiver is to ensure that liquidation proceedings are instituted timeously. According to Bliss and Kaufman the abrupt commencement of liquidation proceedings will limit the losses incurred by financial institution which will be beneficial to the creditors.⁶¹²

Another benefit of OLA is the time constraints that are put in place.⁶¹³ *Title II* determines that a receiver has to be appointed within a three year time period.⁶¹⁴ This ensures the speedy resolution of failing financial institutions.⁶¹⁵ The benefit of a timeously resolution process is that certain losses can be limited and creditor's claims will be paid out faster. This is especially beneficial to creditors whose claims are based upon short term investments.⁶¹⁶ As seen above in the *Lehman Brothers* case the moment that Lehman initiated bankruptcy proceedings their assets were

⁶⁰⁹ The liquidation proceedings can be initiated even prior to the financial institution being insolvent. See Hardee 2011 *North Carolina Banking Institute* 276 -277.

⁶¹⁰ The liquidation proceedings can be initiated even prior to the financial institution being insolvent. See Hardee 2011 *North Carolina Banking Institute* 276 -277.

⁶¹¹ Creditors are barred from institution proceedings in terms of *Title II* not because it is not applicable but in contrast to the *Bankruptcy Code* proceedings are initiated by the FDIC and not the creditors. Sections 201 – 217 of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 277.

⁶¹² Bliss and Kaufman 2007 *Virginia Law & Business Review* 166. Also see Hardee 2011 *North Carolina Banking Institute* 277.

⁶¹³ Hardee 2011 *North Carolina Banking Institute* 277.

⁶¹⁴ Section 202 of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 277.

⁶¹⁵ Section 202 of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 277.

⁶¹⁶ Hardee 2011 *North Carolina Banking Institute* 278.

frozen,⁶¹⁷ which resulted in their creditors being unable to access funds which in turn led to those creditors becoming insolvent.⁶¹⁸

The manner in which claims are accepted and rejected are also in the hands of the receiver. In terms of section 210(a)(2) of the *Dodd-Frank Act*⁶¹⁹ the receiver is empowered to determine all claims against the financial institution.⁶²⁰ If the receiver is satisfied that the claim was received timeously⁶²¹ and that sufficient proof thereof have been delivered then the claim will be accepted.⁶²² If a creditor whose claim was disallowed by the receiver is of the opinion that the receiver has made an error; the creditor can appeal the receiver's decision by institution an action in the US district court.⁶²³ Together with this authority to allow or disallow any claims, is the authority to determine if any share of a secured creditor's claim exceeds the reasonable market value of the particular assets.⁶²⁴ This portion or this excess will now be treated as an unsecured claim.⁶²⁵ In the author's opinion, this is a good provision as it will ensure that all creditors are treated fairly and it will prevent a situation where creditors raise their claims in an effort to receive a higher pay out.

⁶¹⁷ As stated above the timeframe under the *Bankruptcy Code* varies-, and in some cases it takes several years before the liquidation is finalised. This is exactly what happened in the *Lehman Brothers* case, when they filed for bankruptcy all their assets were frozen pending the outcome of the bankruptcy procedure. Creditors had to wait for their claims to be paid out which took several years. The impact on the creditors were detrimental as some creditors were facing financial difficulties themselves. See Hardee 2011 *North Carolina Banking Institute* 278.

⁶¹⁸ Hardee 2011 *North Carolina Banking Institute* 278.

⁶¹⁹ Section 210(a)(2) of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 280.

⁶²⁰ Section 210(a)(2)(A) of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 280.

⁶²¹ Section 210(a)(2)(B) of *Title II* of the *Dodd-Frank Act*. Notice will be published to the creditors informing them to present their claim, together with proof thereof on the specific date as specified in the notice. This date shall not be prior to a 90 day period has lapsed after the date of publication.

⁶²² Section 210(a)(2)(B) of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 280.

⁶²³ Section 210(a)(4) of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 280.

⁶²⁴ Section 210(a)(3)(D) of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 281.

⁶²⁵ Section 210(a)(3)(D) of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 281.

The manner in which claims are prioritised are also determined by *Title II*.⁶²⁶ Section 210(b)(1) provides the order in which unsecured claims should be paid.⁶²⁷ If it is determined that in order to maximise the financial institution's ability to continue its operations, creditors of the same priority may be treated differently.⁶²⁸

It is clear from the aforesaid that the idea behind the institution of the OLA is to protect the taxpayer and not necessarily the creditors and shareholders. In the author's opinion, the OLA holds certain advantages and disadvantages for prospective creditors and investors. The timeously institution of liquidation proceedings is one advantage. This will ensure that losses or costs are indeed limited. The most prominent disadvantage is that fact that in certain instances even creditors that hold the same status may be treated differently.

5 Recommendations for South African Law and conclusion

5.1 Recommendations for South African law

Even though South Africa has already attempted to develop a cross-border insolvency system⁶²⁹ it is the author's opinion that it is not sufficient to deal with problems that are associated with cross-border bank insolvency. It is the author's opinion that, similarly to the US we need to strive to create an insolvency regime that is specific to cross-border bank insolvency and that can be accepted and applied internationally. This can be accomplished by amongst other things implementing an extraterritorial provision that is similar to the one contained in the *Dodd-Frank Act*. This provision will ensure uniformity and will especially be beneficial within the SADC region. By implementing an extraterritorial provision will ensure that all banks situated in a jurisdiction other than that of South Africa would have to comply with

⁶²⁶ *Title II* of the *Dodd-Frank Act*.

⁶²⁷ Section 210(b)(1) of *Title II* of the *Dodd-Frank Act*. All administrative expenses will be paid first. The second unsecured claims to be paid are debt that is owed to the United States. The third and fourth category is for wages for employees and contributions to employee benefit plans. Creditors will then be paid. The final two claims that are reserved for the wages for senior executives and directors and then only will the shareholders receive payment. Also see Hardee 2011 *North Carolina Banking Institute* 282.

⁶²⁸ Section 210(b)(4) of *Title II* of the *Dodd-Frank Act*. Also see Hardee 2011 *North Carolina Banking Institute* 282.

⁶²⁹ See the *Cross-Border Act*.

the same provisions as if the bank was situated in South Africa. This would in effect eliminate some of the problems highlighted in Chapter 3 of this study.⁶³⁰ However it is important to mention that an act will only be applicable in the specific country. In order for uniformity to exist internationally accepted regulations should be put in place that makes certain provisions contained within the act applicable within the SADC region. The purpose hereof is to ensure that the provisions are applicable even when no connection exists.

Secondly the author believes that South Africa should strive to implement a similar authority as the OLA. By implementing an orderly liquidation authority within the SADC region will result in a uniform manner to resolve cross-border bank insolvency matters. The OLA should contain similar provisions as contained in the *Dodd-Frank Act* for example the ranking of claims and the authority to initiate liquidation proceedings if deemed necessary. By implementing a central authority will ensure that failing banks are administered in the same manner.

It is important to note that this will however not ensure international co-operation but merely be a stepping stone towards it. Stander points out another approach, she states that in order to achieve harmonisation insolvency provisions should be implemented either in a treaty or by means of regulations.⁶³¹ Leno agrees with Stander and argues that a treaty should be developed.⁶³² His argument in favour of a treaty is founded on the idea that member states would have an obligation to comply with the provisions contained within treaty.⁶³³ Even though no such treaty currently exists attempts have already been made to reach consensus on specific international rules.⁶³⁴ In the author's opinion, developing a treaty will not ensure

⁶³⁰ With the implementation of a extraterritorial provision would eliminate the fear of relying on information received from a less developed country. This means that if a bank has an South African interest, or has the potential to influence the financial stability of South Africa, the that bank would also have to comply with the same standards of care, responsibility and transparency as if it was located within the territorial borders of South Africa.

⁶³¹ Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101.

⁶³² Leno 2013 *Journal of African law* 20.

⁶³³ Leno 2013 *Journal of African law* 20. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101.

⁶³⁴ Lastra 2008 *Journal of Banking Regulation* 177.

international uniformity as it will only be applicable on states that are signatories to the treaty.

The second option that is introduced by Stander is the regulatory approach. In terms hereof a committee should be established that has the authority so speedily resolve failing banks by either restructuring or by the application of resolution tools.⁶³⁵ This approach is similar to the author's recommendation of the creation of an OLA. In the author's opinion, this approach is more feasible.

Another option that should be considered is the creation of specialised courts similar to the international criminal court. Leno states that

(i)nsolvency issues are a court driven process. It is essential to note that there is no specialized commercial or insolvency court from the settlement of both national and international insolvency disputes. Rather, there are general courts which vary.⁶³⁶

With the creation of an international specialised cross-border insolvency court would eliminate most of the problems that are currently associated with the orderly liquidation of failing banks. This approach in theory would be the best option, but in reality it is not feasible as the question will arise which country's insolvency law will be applicable. Will it be dependent on the location of the failing bank? The approach will not eliminate the problems highlighted in the previous chapters but will merely emphasise them.

The author therefore stands by her opinion that, in order to create uniformity South Africa should adopt similar provisions as contained in the *Dodd-Frank Act*. Compliance by other states will be achieved when a connection exist that will influence the South African economy.⁶³⁷

⁶³⁵ Sester 2010 *ECFR* 539 - 544. Also see Stander "The Coordination of Group and Financial Insolvencies in the SADC Region" 100-101.

⁶³⁶ Leno 2013 *Journal of African law* 19.

⁶³⁷ If more states start to implement the same provisions as contained within the *Dodd-Frank Act* will result in a domino effect, which will ultimately lead to international acceptance and uniformity. Other states have also started to strive toward uniformity by implementing similar provisions for example some of European Commission's Law is already aligning with the principles contained in the *Dodd-Frank Act*. Japan has also amended its Financial Instruments and Exchange Act in order

5.2 Conclusion

Throughout this thesis the importance of uniform cross-border bank insolvency law has clearly been emphasised. This can in short be attributed to the vast increase in international trade and development. Consequently this resulted in an increase in the threat to the stability of global financial markets. The legal uncertainty that is created with the absence of a uniform bank insolvency law have been emphasised throughout this study. This was especially evident during the Lehman brothers collapse.

As a result of the financial crises that began during 2008 (with the Lehman brothers being in the centre thereof) the United States of America in an attempt to limit not only systemic risk but also to strive towards a uniform insolvency law enacted the *Dodd-Frank Act*. The extraterritorial range of the *Dodd-Frank Act* promises to achieve a uniform financial regulatory system.⁶³⁸ It is important to remember that the uniformity will only be achieved in so far as a connection exists if the actions of the specific bank (foreign or local) substantially influence the US economy.⁶³⁹ If the actions taken by the bank have a substantial impact in the US economy then the extraterritorial provision will be applicable to that bank. It is for this specific reason that the author believes that a similar provision will be beneficial to the SADC region. It will not only create legal certainty within the SADC region but will also increase trade within the region.

Great strides have already been achieved by the *Dodd-Frank Act* in that other countries are starting to implement the basic principles contained within the *Dodd-Frank Act* into their own national legislation.⁶⁴⁰ In addition the extraterritorial range

to adopt similar principles as contained in the *Dodd-Frank Act*. See Greenberger 2012 *UMKC Law Review* 980.

⁶³⁸ See paragraph 4.2 of this study.

⁶³⁹ See paragraph 4.2 of this study.

⁶⁴⁰ See paragraph 5.1 of this study.

of the *Dodd-Frank Act* ensures financial institutions even when located in different jurisdictions can compete on equal ground with each other.⁶⁴¹

Since the *Dodd-Frank Act* is a fairly new legislation it is impossible to fully understand the consequences of all the provisions. Nonetheless it is a step in the right direction to manage the current global interconnected banking system. The orderly liquidation of cross-border banking activities would best be achieved if an internationally accepted convention can be created.⁶⁴² The convention should contain specific provisions to liquidate or re-structure failing banks, based upon the current provisions contained not only in the *Dodd-Frank Act* but also in the *EU Regulations*.⁶⁴³

⁶⁴¹ See paragraph 4.2 of this study.

⁶⁴² See paragraph 3 of this study.

⁶⁴³ See paragraph 3 of this study.

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Higher Degree Administration

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I, ANEI MELANI SCHUTTE

hereby declare that the thesis/dissertation/article entitled

THE CO-ORDINATION OF CROSS-BORDER BANK INSOLVENCY

which I herewith submit to the North-West University, Potchefstroom campus, in compliance/partial compliance with the requirements set for the LLM qualification, is my own work and has been language edited and has not been submitted to any other university.

I understand and accept that the copies submitted for examination are the property of the North-West University.

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Declared before me on this 29 day of

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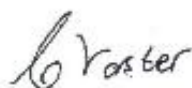
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I, C Vorster (ID: 710924 0034 084), Language editor and Translator and member of the South African Translators' Institute (SATI member number 1003172), herewith declare that I did the language editing of a mini-dissertation written by Ms AM Schutte from the North-West University (Potchefstroom campus), student number 20558530.

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28 August 2018

C Vorster

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