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Reciprocity Clause in Cross Border Insolvency: A Provision for Restriction or Expansion

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Abstract

The model law on Cross border Insolvency was adopted in 1997 by the United Nations Commission for establishing an efficient platform for transactions relating to cross border Insolvency. The regime of cross border insolvency was brought in after the financial crisis that occurred in the 1990's to resolve the disputes pertaining to cross border insolvency in an efficient manner. The model law provides direct access in the domestic proceedings in the matters of Insolvency, to the foreign professionals as well as the creditors. The framework allows for the recognition of the foreign proceedings and enables the courts to adjudicate accordingly. Since its inception, many countries have adopted the model law itself or have adopted the law with certain modifications as per the need of the country. Certain modifications dealt with the issue of inclusion of the reciprocity clause, which itself is a wrestling issue. The paper will elucidate on the concept of reciprocity and argues that the inclusion of the reciprocity clause will have a detrimental effect on the functioning of the model law and that India should avoid inculcating reciprocity provision in its version of model law.

The paper is divided into five sections, Section I reflects the Introduction of the research, Section II will provide a brief introduction on UNCITRAL model law on cross border Insolvency, the aim behind the enactment of such legislation and its objectives. Section III will discuss the various measures taken by India to espouse the cross-border Insolvency laws, and the provisions that are intended to be adopted by India and section IV will provide an analysis on the concept of reciprocity and its implications. Section V discusses the aspect of Legislative reciprocity and answers the questions pertaining to the adoption of the reciprocity clause, later followed by a conclusion.

Keywords: *Agreement, Cross-border Insolvency, Model law, International law, Reciprocity.*

Objectives

To examine the implications of adopting the legislative reciprocity clause in India's framework of cross border Insolvency

1. To analyze the reciprocity clause and its implications.
2. To understand the position of different countries in regards to the adoption of the reciprocity clause.
3. To give a rundown of hindrances that might come in a way after adopting the legislative reciprocity clause.

Literature review

Keith D. Yamauchi, in the paper titled "*Should Reciprocity Be a Part of the UNCITRAL Model Cross-Border Insolvency Law?"* (2017), reflected on the issue of inclusion of reciprocity provision or any of its versions. The paper enumerates the concept of reciprocity and detects that the reciprocity clause seems to create a negative curve in the operation of cross border insolvency law and has a detrimental effect on the parties in the cases where the country has adopted the reciprocity clause.

Sudhaker Shukla And Kokila Jayaram, in the paper titled *"Cross Border Insolvency – A Case to Cross the Border Beyond the UNCITRAL"* (2021), enumerates the alternatives and framework that could be adopted to move forward in order to fight back Insolvency in the background of a pandemic. The paper compels on the need of exploring the sense of maturity in terms of the legal system and establishing a framework that thinks beyond the model law

Cross-Border Insolvency: A Commentary On The UNCITRAL Model Law (3rd edition, 2012) highlights the grey areas of the model law, which requires further understanding as well as harmonization from the countries. The book addresses the issues pertaining to law that are prevailing across various jurisdictions and try to address them with the tool of a model law.

Irit Mevorach, in his book titled "The Future of CROSS-BORDER INSOLVENCY", gives a detailed framework on cross-border Insolvency. It takes into account the strength and weaknesses reflected in the subsisting methodology of cross border insolvency. It concludes by the applicability of the laws that the norms if followed in a bona fide manner, could lead to the path of efficiency.

Hypothesis

1. The insertion of reciprocity provision by the countries curtails the scope of a model law on cross border insolvency

2. The effectiveness and the purpose of model law will be diluted by the incorporation of the legislative reciprocity clause, which is proposed in draft Z of India's cross-border insolvency laws.

Research methodology

For the analysis of this study, the researcher has taken the doctrinal method and used the Harvard reference style as a Uniform method of Citation for acknowledging references. The information enumerated in this study is through secondary sources such as books, working papers, research articles and judicial pronouncements.

Introduction

Cross-border Insolvency aims to regulate the economic and financial torment of the debtors, who have their assets located in more than one country. The regime of cross border insolvency was brought in after the financial crisis that occurred in the 1990s, the international organization, namely United Nations Commission on International Trade Laws (hereinafter referred to as "**UNCITRAL"),** along with the World Bank, undertook the responsibility of establishing a framework along with creating, a set of rules that enables an efficient implementation in a unified and structured manner (Mevorach,2018). The framework established by the UNCITRAL was termed as a model law for cross border insolvency (hereinafter referred to as "**MLCBI**"). The model law provides legislative information on the matters of cross border insolvency mechanism of the multinational enterprises. The model law does not act as a guidance tool like the other conventions instead, it acts as preliminary legislation for the countries who have adopted the UNCITRAL model law for cross border insolvency regimes.

When it comes to India, the adoption of a model law on cross border insolvency is still at a nascent stage. Various committees are formed to deal with the subject matter of cross-border Insolvency. Even after various recommendations and reports, the government has still not acted upon it. The recent report, which is termed the Insolvency law committee report, suggested the inclusion of the reciprocity clause. The clause, along with it, welcomes a series of predicaments, which may be in contrast with the aims of the model law. This paper will try to scrutinize the reciprocity clause and elucidate its impacts on the mechanism of Insolvency.

UNCITRAL model law on cross border insolvency

The preamble of the UNCITRAL model law reflects the notion of providing a constructive mechanism to facilitate cross border insolvency, with the aim of establishing cooperation among the courts of different

countries, to bring in a stance of legal certainty in the realm of trade and investment while dealing with foreign countries, to protect all the creditors and other involved parties who have a substantial interest in the subject matter, by providing them with the platform of efficient and equitable administration for resolving the disputes of cross border insolvency, and lastly, to show an exit door to the aspect of financial trouble in business thereby encouraging the investment as well as safeguarding the employment factor(United Nations Publications, 2014). The model law instrument dispenses a comprehensive structure and constructs a mechanism based on the bilateral framework, along with providing the feature of flexibility that could be enforced or legislated as per the need of the jurisdictions (Shukla, Jayaram,2020).

The aim behind the tool of model law is to prescribe an operationalization tool for the governance of cross border insolvency across the countries. Apart from the standardization of rules set for cross-border Insolvency, the framework provides a space for individual jurisdictions to formulate legislation depending on the nitty-gritty of the jurisdiction. The model law is adopted by 49 states in a cumulation of 53 jurisdictions. Several countries like Japan, the USA, Singapore, South Africa, Australia, New Zealand etc. (Shukla, Jayaram,2020). have adopted the model law for resolving cross-border insolvency issues.

Measures were taken by India to espouse the cross-border insolvency laws

The initiation of the cross-border insolvency regime in India can be traced back to 1908, through the case of Macfayden & Co., where the liquidation procedure of the Anglo- Indian Partnership was initiated after the demise of one of the partners. Later, the trustees of Madras and foreign countries came to a conclusion through the means of agreement wherein the claims and the surplus was decided, the agreement was affirmed by the court. The agreement was later challenged in the English court, to which the court stated that the concurrence of the parties in the agreement clearly indicates a formal and prudent business arrangement, and the arrangement seems to benefit the interested party and, therefore, in the eyes of the court, it was a just and fair agreement (Bob, Markell,2008). Since then, numerous instances of cross-border insolvency issues have come before the court, but in the absence of a detailed framework for dealing mainly with the issue of cross border, the judiciary was not able to deal with the disputes in an effective manner.

In order to understand the Indian approach in respect of cross border insolvency regime, the efforts taken by the government has to be taken into consideration, along with analyzing the existing framework of Indian laws to deal with cross border insolvency. This section will elucidate on the framework of Cross-border Insolvency in a twofold manner. The first segment will give an annotation on the statutory framework of India for dealing with cross-border Insolvency disputes, and the second segment will deal with the efforts taken by the government of India for adopting the UNCITRAL model law.

(A) Existing statutory framework for cross border insolvency

Section 234 & 235 are the only available section that directly addresses the issue of cross border insolvency. Section 234 enumerates that the Indian government can enter into bilateral agreements with the foreign countries to enforce the IBC provisions in respect of corporate debtors as well as the Individuals who may have personally guaranteed the recompensate for the loan. Section 235 states that the Indian courts can consult the competent courts of other countries, where the assets of the corporate debtor would be situated or where the individual who has personally guaranteed the payment of the loan resides. The proceeding under section 235 can be initiated through an application either through the liquidator or the administrator. The action can only be initiated under section 235 if there exists a reciprocal bilateral agreement between India and the country where the debtor's assets are located under section 234.

Apart from these two sections, there are no provisions that deal primarily with the cross-border insolvency issue. There exists other provision that could offer only supplemental help to this regime. The lack of provisions for cross-border Insolvency shows the dire need of bringing in and adopt the UNCITRAL model law.

(B)efforts are taken by India to build a framework cross border insolvency dispute

This section will put forth the key efforts taken by the experts through the formation of quasi-judicial committees to provide recommendations and suggestions on the MLCBI.

In 2000, Eradi committee under the chairmanship of Justice V. Balakirshna Eradi suggested the adoption of MLCBI due to the emergence of globalization in the trade and commerce sector. The emergence will lead to the opening of the Indian economy in terms of investments in the companies situated in different countries. Thereby, the committee recommended the need to adopt cross border insolvency framework to deal with the disputes that would come in the near future due to the interdependence of India on other countries.

In 2001, the Mitra committee under the chairmanship of Dr N.L. Mitra recapitulated the findings of the Eradi Committee and emphasized the need for adopting the model law due to the globalization in the Indian market of business and trade. The committee highlighted the issue in the choice of law while dealing with the transactions in the context of the cross-border regime, and it also stated that in order to deal with such transactions, the reliance placed on private international law would not be helpful in the long run for India. The committee noted that the extent of section 44 in the Civil procedure code is only limited to foreign

judgements and foreign proceedings. Lastly, it pointed out that the then-existing insolvency laws were not at par with the global standards and that there was no law to address the issue of cross border insolvency.

Even after the recommendations of the committee, India did not implement the Model law for cross border insolvency. In 2018, Insolvency Law Committee (hereinafter referred to as "ILC") was constituted to give its recommendation on this subject matter. The ILC not only reviewed the cross-border insolvency regime but took a step further and provided a framework of the model law that could be adopted by India. The paper also recommended the temporary inclusion of the legislative reciprocity requirement. Later, in 2019 the MCA included Dr. Krishnan led the committee to ensure the smooth implementation of the cross-border insolvency provisions, the committee will analyze the report of the ILC and provide a detailed framework consisting of rules and regulations for better execution of the provisions relating to the proposed cross border insolvency regime. The report given by Dr. Krishnan Committee is still not available in the public domain. However, the important aspect is the legal reciprocity which is relevant for the paper in the further analysis.

The key recommendation of ILC committee to adopt the legislative reciprocity clause is of primary importance, this clause has often been seen to be a deterrent factor that eliminates the effect of UNCITRAL model law. The ILC report suggested the inclusion of the clause for a temporary period. The timeline, though provided, is temporary in nature but could create a major drawback in resolving the cross-border disputes and hence, it becomes crucial to scrutinize the implication of the reciprocity clause in the context of India but before delving into its complication, the paper will analyze on the understanding of the reciprocity and what it implies.

Understanding the concept of reciprocity and its implications

The term reciprocity employs a simple concept, but when implied in association with a legal concept, it certainly seems to have a dynamic structure. Courts and legislators have used the term in an intricated manner, and so, it becomes very important to determine the position of the term reciprocity and understand its implications. In order to ascertain the meaning of the term 'reciprocity' has to be understood in the context of an arrangement wherein the foreign court will be recognized by the domestic courts only on the completion of specific requirements.

Through the years, the clause of reciprocity has developed through various cases and have been classified in different forms on a global platform. The clause of reciprocity has gained various interpretations, one of them being Jurisdictional reciprocity. The jurisdictional reciprocity indicates that the reciprocity will be

based on the element of jurisdiction. The jurisdictional reciprocity implies a situation where State 'x' will recognize the jurisdiction of State 'y', only if State 'y' would have recognized the jurisdiction of state 'x', if kept in the same parlance. The jurisdiction reciprocity does not necessarily imply reciprocity in regard to the judgements, but there definitely lies reciprocity in respect of the jurisdiction (Kennedy,1954). The second type of reciprocity can be termed as reciprocity in recognition, this reciprocity can be observed when the foreign judgement is recognized by the foreign court only on the ground that the foreign court will recognize the order or judgment of domestic court. This type of reciprocity can also be termed substance reciprocity.

Professor Westbrook, in his work titled "Theory and Pragmatism in Global Insolvencies: Choice of law and Choice of Forum", demarcates the concept of reciprocity in two compartments, namely positive reciprocity and negative reciprocity. Positive reciprocity is detected when it appears to the domestic court that in the past case law or legislation, the foreign court has recognized and enforced the domestic judgement, then the domestic court will enforce the order or judgement without any difficulty. In contrast to the above circumstance, if the domestic court has reasons to believe that the foreign court will decline to recognize the judgement or order of the domestic court, then the domestic court will retaliate by reciprocating and not enforcing orders of a foreign court. On the other hand, negative reciprocity implies that unless there appears clear evidence on the part of foreign courts in regard to the non-recognition of the domestic court, the domestic court cannot deny enforcing as well as recognize the orders or judgments of the foreign court (Westbrook, 1991).

Lastly, there comes "legislative reciprocity", this reciprocity implies that the foreign court's judgement or order will be recognized by the domestic court only on the pretext that the foreign court has adopted identical or same legislation as that of a domestic court (Yamuchi, 2007). All the kinds of reciprocity expounded in the above discussion seem to have an overlapping effect with each other. The effect of reciprocity is detrimental, as the reciprocity clause works in contrast with the aim of conventions that are specifically legislated to enhance cooperation between the countries in respect of solving disputes in the fields of arbitration, cross border insolvency etc.

Should the legislative reciprocity clause be inserted in India's version of model law?

The UNCITRAL working group, while formulating the model law for cross border, came across the question of reciprocity and drew an inference that the concept of reciprocity has varied definitions across

all the jurisdictions, and to reach a common conclusion in regard to the notion of reciprocity would be tedious,

and no solution could be ascertained. So, it came to the consensus that the state could subject its applicability on the basis of its requirements for reciprocity that they wish to adopt. Therefore, the discretion of adopting the model law with or without the reciprocity clause was left on the countries.

The requirement of reciprocity provision embarks an approach that, in its nature, is less conventional. The inclusion of reciprocity creates a restrictive space for solving the issues of cross border Insolvency. It also portrays a negative image in the eyes of a foreign jurisdiction or foreign investors due to the notion of legislative reciprocity, which inherits the idea of being less cooperative. The Model Law of UNCITRAL on cross border insolvency still seems to remain partly inactive, and one of the reasons for not becoming completely operative is due to the insertion of the reciprocity clause. The adoption of the reciprocity clause makes the application of the UNCITRAL model law limited in scope (Meskin, 2011). The requirement of reciprocity can end up attracting a troublesome outcome if seen from a practical point of view. It will captivate needless judicial proceedings and legislative outcomes when dealing with the jurisdictions that have not adopted the same or identical insolvency regime. So, for that circumstance, India will have to enter into arrangements where the parties will have to set foot in bilateral agreements or through any other course to resolve the cross-border insolvency issue between them. Thus, going back to the pole position in the race of Insolvency, where India was before the adoption of the UNCITRAL model law. On this note, the reciprocity clause occurs to be a distraction when analyzed in the realm of cooperation between the countries for solving the disputes of Cross border Insolvency.

Whether the legislative reciprocity clause in the Indian model should be inserted with the model law was a contested question for the committee. In the discussion regarding the reciprocity clause by the committee, the factors such as infrastructure of Indian Insolvency and its development, economic growth, India's position at a global level was considered, and the committee reached a conclusion that the model law should be adopted on the basis of reciprocity. The reciprocity clause could result in deadlock for the foreign countries and could possibly be counted as a step backwards for the country that adopted the model law. The effects foreseen runs in complete contrast with the aims and objectives enumerated for the implementation of the MLCBI. Incorporation of the clause will create a deterrent effect on the interested parties of different jurisdictions and could possibly yield a detrimental outcome.

The implications of the reciprocity can be understood from the real-time example of South Africa, it became one of the foremost countries to adopt the model law. The SA Act was elapsed in 2000 and commenced on 28th November 2003. South Africa adopted the model law with the reciprocity requirement in a varied form,

i.e., the domestic court will only recognize the foreign countries if its name is notified by the Government of that country in the list of the countries. This requirement was termed a designation clause. Till date, no

country has been designated by the minister of South Africa. So technically, South Africa's position before and after the adoption of the UNCITRAL model law is the same in the international sphere, and the SA Act remains at the dormant stage due to the inclusion of the designation clause (Yamuchi, 2007). The above circumstance indicates how the inclusion of the reciprocity principle reflected a completely contradictory effect to the aim of the cross-border Insolvency regime. The result of following such an arrangement will result in a dual system, where the countries that have their names in the list will follow the mechanism adopted by Model law, and the remaining countries will have to follow the route that was followed by the country previously (Smith, Boraine, 2021). The incorporation of the designation clause will have an effect on the operation of Model law in South Africa, it will ultimately affect the foreign countries who have adopted the model law but cannot really follow the mechanism of model law due to the limitation of the designation clause. The clause of designation implies a serious flaw in the regime of the cross-border insolvency regime. In a similar manner, India will also engage itself in a dual system if the model law is adopted with the reciprocity clause. Given that 49 countries have adopted the model law with amendments, India will be able to solve the disputes relating to Insolvency with these countries only, leaving the other countries behind who have not adopted the model law, thereby the disputes arising with those countries will be resolved through the system that India used to follow before the adoption of the model law. Then, the structure of the Insolvency regime will consist of twin systems, i.e., one system will be solving the disputes as per the adopted model law, and the other system will be solved through a traditional approach. This an arrangement can create havoc in the existing system. India being at the nascent stage of the Insolvency regime internationally as well as at the domestic level, cannot afford to deal with such a complicated and unregulated structure.

The states in the majority, adopting model law are not inclined to adopt the reciprocity clause (Yamuchi, 2007). When Singapore was contemplating on the question of whether the reciprocity clause should also be inserted while adopting the model law. The discussion regarding the same highlighted certain key points that spilt as advantages from the adoption of the model law. The attributes such as efficiency in the mechanism of solving international Insolvency that could involve a local business from any jurisdiction, recovery of assets from the foreign country in a trouble-free manner and most importantly, the setting up of equal footing for all the creditors. While considering the above aspects, the committee analyzed that the insertion of the reciprocity clause would limit the scope of advantages in terms of its applicability, which

will be contrary to the aim of the model law, which was to enhance cooperation and eliminate barriers and thereby, they dropped the idea of adopting the legislative reciprocity clause.

Most of the states believe that the reciprocity clause is not needed as it put forth in the argument that the Model law contains the essential elements which are of utmost importance for any jurisdiction. The essential elements in relation to the protection of local creditors and significance given to the term "public policy" are included in the model law. The interpretation for the Implementation of the term "public policy" can be molded as per the respective jurisdiction. In the model law, the court could refuse to provide assistance to the foreign Insolvency court proceedings if it appears to the court that the act would result in contravention of public policy. The phrase "manifestly contrary to the public policy" is inserted, the use of the term 'manifestly' indicates the intention of the legislation to use the interpretation of the term public policy as an exception in a restrictive sense and only where the issue is of the fundamental importance of that country.

Retired judge Zulman of South Africa stated that the reciprocity principle is outdated and seems to be inconsistent with modern thinking as he believes that these clauses are always implicated with a political agenda. The inclusion brings in a lot of uncertainty while dealing with the issue of insolvencies across different borders of the world. To curb this uncertainty, the model law was enacted, and by bringing in the realm of uncertainty through the inclusion of the reciprocity principle, we will be back again to where we started.

The inclusion of the reciprocity clause can be seen only in a few jurisdictions such as South Africa, Mauritius etc., whereas the countries like the United States, Canada, Mexico, Poland, Japan etc., does not have the reciprocity requirement. This shows the minimal amount of reliance placed on the reciprocity clause by the countries while adopting the model law. The international weight still rests on being against the idea of reciprocity requirement. So, when the Indian position is considered in regard to the adoption of the legislative reciprocity clause, certain aspects need to be considered, such as the model law was implemented to reduce the procedural barriers and to ease the cross-border insolvency transaction across different counties. In this background, there lies a responsibility on the shoulders of India to enact legislation in a manner that could promote co-operation between different jurisdictions to harmonize with the objectives of the model law. The inclusion of reciprocity provisions as a protection measure to defeat the uncertainty that could come in the way of the country while dealing with the cross-border insolvency disputes can create a huge hindrance in enforcing the model law.

Conclusion

In this era of globalization, there is a substantial increase in the ratio of financial distress among the multinational corporates of different nations. This distress is a concerning issue in almost all jurisdictions and is becoming a major threat for all the economies. The financial distress arising through the companies having

their association in different jurisdictions implies the need for adopting the legal framework of cross border insolvency. The adoption of the model law seems to be the need of the hour, but the legislative reciprocity tied with the rope of model law which is adopted by our country, seems to be a major deterring factor. The reciprocity clause curtails the scope of the model law and can create unfairness as well as a lack of predictability, which is exactly contrary to the aim of the model law. Taking into consideration all the loops that comes forth with the inclusion of reciprocity as well as the impacts it creates on the insolvency mechanism, a dire need of eliminating the reciprocity clause is felt. Therefore, the move of inclusion of reciprocity clause in the model law on cross border insolvency should be avoided, and the practice adopted by the developed nations should be adopted to lubricate the insolvency proceedings across the globe.

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