

# Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts\*

by

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## INTRODUCTION

Global recessions, international hostilities, fluctuations in the world's financial markets, and poor business management have caused, and will continue to cause, the insolvency of many multinational companies. When a multinational company becomes insolvent, insolvency proceedings will often be commenced in every country in which it does business or has assets. In such cases, it would clearly be in the best interests of businesses and nations worldwide to make agreements that would promote the equitable treatment of creditors and debtors involved in cross-border insolvencies.

Nevertheless, one of the glaring omissions in private international law has been the failure of nations to reach accord about transnational insolvency.<sup>1</sup>

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<sup>1</sup>See LOUIS JACQUES BLOM-COOPER, *BANKRUPTCY IN PRIVATE INTERNATIONAL LAW* 3-4 (1954). However, many attempts have been made to reach an accord. For example, in 1963 the members of the European Economic Community started working on a bankruptcy convention whereby a bankruptcy adjudication in one member's country would be respected by all other members. Kurt H. Nadelmann, *Discrimination in Foreign Bankruptcy Laws Against Non-Domestic Claims*, 47 *AM. BANKR. L.J.* 147, 147-48 (1973) [hereinafter *Discrimination in Foreign Bankruptcy Laws*]; Kurt H. Nadelmann, *A Reflection on Bankruptcy Jurisdiction: News from the European Common Market, the United States, and Canada*, 27 *MCGILL L.J.* 541 (1982). More than a quarter century later an accord has not yet been reached. As one commentator puts it, interest in this convention "has quietly expired." PHILIP S. SMART, *CROSS-BORDER INSOLVENCY* 265 (1991). Other attempts to draft bankruptcy conventions for international application have also failed. Nadelmann, *Discrimination*

Historically, there has been little formal cooperation among bankruptcy courts worldwide. Most countries have long responded to the problem of what effect to give to foreign bankruptcies by protecting domestic interests and local creditors, and at times even discriminating against foreign creditors.<sup>2</sup> This nationalistic approach to bankruptcy laws has often resulted in full liquidation proceedings in every country in which the assets of a debtor are located. It has also caused duplication of expenses and litigation, inequitable distributions to creditors worldwide, and instability in the climate for international trade.

This article discusses U.S. law—and the inconsistent application of that law—regarding the recognition of foreign bankruptcy proceedings. Part I describes the historical development of that law prior to the enactment of the United States Bankruptcy Code (the “U.S. Bankruptcy Code”).<sup>3</sup> Part II examines the current statutory provisions (§§ 303(b)(4), 304, and 305)<sup>4</sup> and the case law regarding the recognition of foreign bankruptcies and the options available to a foreign representative for protecting the assets of a foreign debtor in the United States. This part of the article concentrates on § 304 (the section that provides for cases in the United States ancillary to foreign proceedings) and analyzes and critiques the important decisions that have applied and interpreted § 304. This critique highlights the inconsistent approaches taken by U.S. courts in determining whether to recognize and assist foreign bankruptcies and suggests criteria to guide the courts in making these decisions.

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in *Foreign Bankruptcy Laws*, *supra*, at 148.

At present there appears to be renewed interest in reaching agreement, and some attempts are currently progressing. See Council of Europe, European Convention on Certain International Aspects of Bankruptcy (Opened for Signature in Istanbul on 5 June 1990), Appendix II in CROSS-BORDER INSOLVENCY: COMPARATIVE DIMENSIONS 297–308 (Ian F. Fletcher ed. 1990); Section of Business Law (Committee J) of the International Bar Association, Proposal for Consultative Draft of Model International Insolvency Co-operation Act for Adoption by Domestic Legislation With or Without Modification, 17 INT’L BUS. LAW. 323–27 (1989). For an example of an accord that was established, see The Inter Nordic Insolvency Estate Convention (Den Nordiske Konkurskonvention), 1934, Denmark-Norway-Sweden-Finland-Iceland.

<sup>2</sup>Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary, 94th Cong., 2d Sess. 1442–43, 1445 (1976) [hereinafter *Hearings*] (statement of Prof. Kurt H. Nadelmann). See also Kurt H. Nadelmann, *Legal Treatment of Foreign and Domestic Creditors*, 11 LAW & CONTEMP. PROBS. 696 (1946).

<sup>3</sup>Bankruptcy Reform Act of 1978, Pub. L. No. 95–598, 92 Stat. 2549 (codified as amended in 11 U.S.C.A. (West 1991), in scattered sections of 28 U.S.C.A. (West 1991) and in scattered sections of other titles). Unless otherwise indicated, all references in this article to “section” will be to the applicable section of the U.S. Bankruptcy Code.

In this article the term “bankruptcy” is used as in the U.S. Bankruptcy Code and includes insolvency proceedings (both liquidations and reorganizations) of individual debtors, partnerships, and corporations.

<sup>4</sup>11 U.S.C.A. §§ 303(b)(4), 304, 305 (West 1991).

# I. U.S. Recognition of Foreign Bankruptcies Prior to the U.S. Bankruptcy Code<sup>5</sup>

A study of the historical development of U.S. case law regarding the recognition of foreign bankruptcies is helpful, if not necessary, in understanding § 304 of the U.S. Bankruptcy Code and other applicable provisions of U.S. bankruptcy law. First of all, many of the principles relied upon by U.S. courts for the past two centuries, often in the absence of statutory guidance, have been codified in the U.S. Bankruptcy Code. Secondly, bankruptcy courts frequently invoke and rely on these older cases when adjudicating disputes under current law.

Historically, there have been two different approaches used to resolve transnational bankruptcy problems: the "personalist," "unity," or "universality" approach (which I will refer to as the "universality" approach) and the "realist," "plurality," or "territoriality" approach (which I will refer to as the "territoriality" approach). The universality approach presumes "that bankruptcy attaches to the [bankrupt] person and follows the bankrupt . . . everywhere as his 'skin and bones.'"<sup>6</sup> Under this theory, a central bankruptcy proceeding

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<sup>5</sup>For a more detailed analysis of the historical development of the U.S. law regarding the recognition of foreign bankruptcies, see Charles D. Booth, *A History of the Transnational Aspects of United States Bankruptcy Law Prior to the Bankruptcy Reform Act of 1978*, 9 B.U. INT'L L.J. 1 (1991). For further, at times conflicting, interpretations of this history, see Douglass G. Boshkoff, *United States Judicial Assistance in Cross-Border Insolvencies*, 36 INT'L & COMP. L.Q. 729, 732-38 (1987) [hereinafter *U.S. Judicial Assistance*]; Michael S. Fischer, Note, *In the Matter of Toga Mfg. Ltd.: A Step in the Wrong Direction for International Bankruptcy*, 2 INT'L PROP. INVESTMENT J. 633, 639-41, 645-49 (1986); Brian J. Gallagher & John Hartje, *The Effectiveness of § 304 in Achieving Efficient and Economic Equity in Transnational Insolvency*, 1983 ANN. SURV. BANKR. L. 1, 10-11, 15-16 (1983); Richard A. Gitlin, Evan D. Flaschen & David M. Grimes, *American Reports—United States Treatment of Foreign Insolvency Proceedings*, chapter 4(b) in CROSS-BORDER INSOLVENCY: COMPARATIVE DIMENSIONS, *supra* note 1, at 69-71; John D. Honsberger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W. RES. L. REV. 631, 635-36, 663-64, 667-69 (1980); Stacy Allen Morales & Barbara Ann Deutch, *Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity*, 39 BUS. LAW. 1573, 1575-83 (1984); Kurt H. Nadelmann, *Codification of Conflicts Rules for Bankruptcy*, 30 ANN. SUISSE DR. INT. 57, 84-85 (1974) [hereinafter *Conflicts Rules For Bankruptcy*]; Kurt H. Nadelmann, *The Bankruptcy Reform Act and Conflict of Laws: Trial-and-Error*, 29 HARV. INT'L L.J. 27, 28-33, 35, 44, 45, 47 (1988) [hereinafter *The Bankruptcy Reform Act*]; Kurt H. Nadelmann, *The Lure in 'International Bankruptcies' of Assets Located Abroad*, 33 INT'L & COMP. L.Q. 431, 435-36 (1984); Kurt H. Nadelmann, *The National Bankruptcy Act and the Conflict of Laws*, 59 HARV. L. REV. 1025, 1035-39, 1043-45 (1946) [hereinafter *The National Bankruptcy Act*]; Anne Norby Nielsen, Note, *Section 304 of the Bankruptcy Code: Has It Fostered the Development of an 'International Bankruptcy System'?*, 22 COLUM. J. TRANSNAT'L L. 541, 544-49 (1984); Alexander L. Paskay, *Impact of the Bankruptcy Reform Act of 1978 on Foreign Debtors and Creditors*, 12 STETSON L. REV. 321, 322-36 (1983); Stefan A. Riesenfeld, *The Status of Foreign Administrators of Insolvent Estates: A Comparative Survey*, 24 AM. J. COMP. L. 288, 290-296 (1976); Barbara K. Unger, *United States Recognition of Foreign Bankruptcies*, 19 INT'L LAW. 1153, 1155-1167 (1985).

<sup>6</sup>L.J. BLOM-COOPER, *supra* note 1, at 11. In cases of intestacy, it has long been presumed that the intestate's movables, which "have no locality independent of his person, should be brought home, and distributed according to the law of his domicile." JOSEPH STORY, COMMENTARIES ON THE CONFLICT OF LAWS § 405 (8th. ed. 1883). In bankruptcy, movables have often been treated under the universality approach. *Id.* §§ 405-423(g); L.J. BLOM-COOPER, *supra* note 1, at 11.

occurs in the jurisdiction in which the debtor is domiciled or where the debtor's principal place of business is located. Since this central proceeding is intended to settle all the claims against the debtor's estate, a trustee is appointed to collect all assets of the debtor worldwide and to seek the turnover of all such assets to the central proceeding. All countries in which assets of the foreign debtor are located apply the substantive laws of the country in which the central proceeding occurs and then order the turnover of all local assets to the central proceeding. All creditors worldwide must submit claims in the central proceeding, and the final adjudication is to be respected by all other nations.<sup>7</sup>

The advantages of the universality approach are that all creditors will share equally, since their claims will be administered by the same court and under the same law; that distributions will be higher and the administration of claims more efficient (since duplicative proceedings and litigation will be avoided); and that increased cooperation among bankruptcy courts worldwide will result. The disadvantages of this approach are that local creditors might suffer inconvenience and hardship by being forced to participate in a foreign proceeding in which the applicable procedural and substantive laws may differ from those of their home jurisdiction. Moreover, the universal approach needs universal, or at least bilateral, acceptance to succeed over time.<sup>8</sup>

The contrasting territoriality approach presumes that a bankruptcy adjudication is limited to the *res* or property within the jurisdiction and does not have extraterritorial effect. Under this approach, each country sets forth bankruptcy laws to administer all property within its borders and will not recognize the extraterritorial effect of bankruptcies adjudicated elsewhere. This lack of cooperation leads to a full bankruptcy adjudication in every country in which the debtor's assets are located.<sup>9</sup>

Any advantages of this approach are generally limited to local creditors who benefit from local preferences and do not suffer the inconvenience and hardship of proving their claims abroad under foreign law. The primary disadvantage of the territoriality approach is that "it rejects, if not contravenes, the principle of creditor equality and encourages the race to the courthouse,"<sup>10</sup> and thus enables local creditors to benefit at the expense of other creditors worldwide. The resulting multiple administrations also lead to greater costs and inefficiency in the administration of assets, and create instability for companies engaging in international business transactions.

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<sup>7</sup>Unger, *supra* note 5, at 1154; L.J. BLOM-COOPER, *supra* note 1, at 11; Honsberger, *supra* note 5, at 633. See J. STORY, *supra* note 6, §§ 403-09.

<sup>8</sup>Honsberger, *supra* note 5, at 633-34; Unger, *supra* note 5, at 1154-55.

<sup>9</sup>Honsberger, *supra* note 5, at 634-35; Unger, *supra* note 5, at 1155. See also L.J. BLOM-COOPER, *supra* note 1, at 11; J. STORY, *supra* note 6, §§ 410-423(f). In bankruptcy, real property and other immovables historically were generally treated under the territoriality approach. L.J. BLOM-COOPER, *supra* note 1, at 11; J. STORY, *supra* note 6, §§ 424-463(a).

<sup>10</sup>Honsberger, *supra* note 5, at 635. See also Unger, *supra* note 5, at 1155.

Although no country adopts either approach in its pure form, these two approaches serve as a helpful starting point from which to begin an investigation of the transnational aspects of U.S. bankruptcy law. The battle between the territoriality and universality approaches, which is now being fought on the international front, has long been waged in the United States. Early on, U.S. courts rejected the universality approach in favor of the territoriality approach, and were generally hostile toward the claims of foreign representatives to local assets when they conflicted with the interests of local creditors.<sup>11</sup> For example, in *Harrison v. Sterry*<sup>12</sup> Chief Justice Marshall held that “the bankrupt[cy] law of a foreign country is incapable of operating a legal transfer of property in the United States”<sup>13</sup> and upheld the liens of attaching creditors over the subsequent claim of British assignees in bankruptcy. Other courts upheld the rights of local creditors against foreign representatives even when the local attachments were made after the foreign bankruptcy decree.<sup>14</sup>

Justice Joseph Story believed that U.S. courts deciding these early cases upheld local attachments against foreign representatives to protect the rights of U.S. citizens from the prejudice of foreign courts.<sup>15</sup> In his writings, Story tempered the harsh territoriality language of *Harrison* by urging that problems related to transnational insolvency would be better decided on principles of comity, but “only so far as may be done without impairing the remedies, or lessening the securities, which our laws have provided for our own citizens.”<sup>16</sup> Story was not abandoning the territoriality approach; rather, he was softening its effect by proposing that, if the interests of U.S. citizens are adequately protected, a U.S. court should recognize the title of foreign representatives to property in the United States.

Story’s territoriality-based view of comity as the basis for the recognition of foreign bankruptcy adjudications was followed in *In re Accounting of Waite*.<sup>17</sup> In this case, the New York Court of Appeals ordered that the funds of a partner

<sup>11</sup>See J. STORY, *supra* note 6, §§ 410–423(a); John Lowell, *Conflict of Laws as Applied to Assignments for Creditors*, 1 HARV. L. REV. 259, 260 (1888); Honsberger, *supra* note 5, at 635; Riesenfeld, *supra* note 5, at 290; Unger, *supra* note 5, at 1156. See, e.g., *Harrison v. Sterry*, 9 U.S. (5 Cranch) 289 (1809).

<sup>12</sup>9 U.S. (5 Cranch) 289 (1809).

<sup>13</sup>*Id.* at 302. See also *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827); Riesenfeld, *supra* note 5, at 292–94 (narrower reading of the nonrecognition principle in *Ogden*).

<sup>14</sup>Nadelmann, *Conflicts Rules for Bankruptcy*, *supra* note 5, at 84 n.161 (citing J. STORY, *supra* note 6, §§ 415 *et seq.* (2d. ed. 1841)); *Clark v. Williard*, 294 U.S. 211 (1935) (involving dispute arising at state, rather than international, level). *Contra* *Martyne v. American Union Fire Ins. Co.*, 216 N.Y. 183 (1915) (also involving dispute arising at state level; affirming an order to set aside a post-dissolution attachment by a local creditor against property claimed by an out-of-state statutory liquidator).

<sup>15</sup>J. STORY, *supra* note 6, §§ 410, 414; Kurt H. Nadelmann, *Solomons v. Ross and International Bankruptcy Law*, 9 MOD. L. REV. 154, 164 (1946) (discussing Story).

<sup>16</sup>J. STORY, *supra* note 6, § 414. See also *id.* § 349; Honsberger, *supra* note 5, at 635; Paskay, *supra* note 5, at 324; Riesenfeld, *supra* note 5, at 293. For a discussion of Story’s interpretation of comity in the non-insolvency context, see Joel R. Paul, *Comity in International Law*, 32 HARV. INT’L L.J. 1, 19–24 (1991).

<sup>17</sup>99 N.Y. 433, 450 (1885).

of a firm adjudged bankrupt in England be turned over to an English trustee for distribution in England, but only after finding that all U.S. creditors had previously been paid out of other assets and thus did not have a stake in the outcome. In reaching its decision the court applied the rule that a foreign trustee's title should be recognized and enforced if it were "without injustice to our own citizens, and without prejudice to the rights of creditors pursuing their remedies here under our statutes," and if such title were "not in conflict with the laws or the public policy of [New York]."<sup>18</sup> The *Waite* decision was thus primarily based on a lack of harm to U.S. creditors under the territoriality approach.

The first major case espousing the application of comity in a transnational bankruptcy setting to the detriment of the interests of U.S. creditors was *Canada Southern Railway v. Gebhard*.<sup>19</sup> In this case New York bondholders brought actions in New York to recover on the bonds of a Canadian railroad corporation undergoing reorganization in Canada. The U.S. Supreme Court ruled against the bondholders, and held that they were bound by the Canadian reorganization even though they had never assented to the scheme ratified in the reorganization. Although the Canadian reorganization changed the contractual rights of the U.S. bondholders, the court rejected the territoriality contention that it would be unfair and inconvenient to force the bondholders to assert their claims in Canada. Rather, the court claimed "that every person who deals with a foreign corporation impliedly [sic] subjects himself to such laws of the foreign government, affecting the powers and obligations of the corporation with which he voluntarily contracts, as the known and established policy [as] that government authorizes."<sup>20</sup> In reaching its decision, the court also relied on principles of equality and on a more universality-based view of comity. By recognizing the validity of the Canadian reorganization scheme, the court assured that *all* creditors would be treated equally.<sup>21</sup>

The principle of equality of distribution was furthered by the writings of Judge John Lowell.<sup>22</sup> Lowell urged courts to apply the principle of equality of distribution, and one of his recommendations—to make presence of assets in the United States a basis for jurisdiction in bankruptcy cases<sup>23</sup>—was adopted

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<sup>18</sup>*Waite*, 99 N.Y. at 448. The court also noted that the partner, who was a U.S. citizen, had "invoked and submitted to the jurisdiction of the [English] Bankruptcy Court." *Id.* at 439, 449. See Unger, *supra* note 5, at 1157 n.17. The decision in *Waite* to allow a foreign representative to remove personal property not attached by local creditors was consistent with other cases dating from that time. See Lowell, *supra* note 11, at 261; Nadelmann, *Conflicts Rules for Bankruptcy*, *supra* note 5, at 84–85.

<sup>19</sup>109 U.S. 527 (1883).

<sup>20</sup>*Id.* at 537.

<sup>21</sup>*Id.* at 539.

<sup>22</sup>Nadelmann, *Conflicts Rules for Bankruptcy*, *supra* note 5, at 75–76, 84; *Hearings*, *supra* note 2, at 1503. See Lowell, *supra* note 11.

<sup>23</sup>Nadelmann, *The National Bankruptcy Act*, *supra* note 5, at 1036–37 (discussing § 106 of the Lowell Bill, S. 1382, 47th Cong., 2d Sess. (1882)).

in the United States Bankruptcy Act of 1898 (the "U.S. Bankruptcy Act").<sup>24</sup> This change enabled creditors or a foreign debtor itself (but not a foreign representative) to commence a bankruptcy case against a foreign debtor with assets in the United States, and thereby to secure equal distribution of those assets (which include, most importantly; voidable preferences that could not have been set aside under nonbankruptcy law).<sup>25</sup>

However, even as Lowell's reforms were being considered, the U.S. Supreme Court narrowed the principle of comity espoused in *Gebhard*. In 1895, in the renowned case of *Hilton v. Guyot*,<sup>26</sup> the Supreme Court refused to grant comity to a French judgment on the ground of "the want of reciprocity, on the part of France, as to the effect to be given to the judgments of this and other foreign countries."<sup>27</sup> The court noted that "[t]he extent to which the law of one nation . . . shall be allowed to operate within the dominion of another nation, depends upon what our greatest jurists have been content to call 'the comity of nations' "<sup>28</sup> and espoused the now famous definition of comity:

'Comity,' 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.<sup>29</sup>

Thirteen years after *Hilton*, the U.S. Supreme Court again interpreted comity quite narrowly, this time in a case, *Disconto Gesellschaft v. Umbreit*,<sup>30</sup> involving the garnishment by a local creditor. In this case the court upheld the Wisconsin Supreme Court's decision to satisfy the claims of its own

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<sup>24</sup>U.S. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898) [hereinafter the "U.S. Bankruptcy Act"] (repealed 1978). Section 2(a)(1) of the U.S. Bankruptcy Act vested U.S. bankruptcy courts with jurisdiction, *inter alia*, to "[a]djudge persons bankrupt . . . who do not have their principal place of business, reside, or have their domicile within the United States, but have property within their jurisdiction." 11 U.S.C. § 11(a)(1) (1970) (emphasis added).

<sup>25</sup>See *Hearings*, *supra* note 2, at 1443 (statement of Prof. Kurt H. Nadelmann). Earlier federal bankruptcy laws in force from 1800 to 1803, 1841 to 1843, and 1867 to 1878 did not provide for jurisdiction over non-resident foreign debtors. Act of April 4, 1800, ch. 19, § 1, 2 Stat. 19 (repealed 1803); Act of Aug. 19, 1841, ch. 9, § 1, 5 Stat. 440 (repealed 1843); Act of Mar. 2, 1867, ch. 176, §§ 11, 39, 14 Stat. 517, 521, 536 (repealed 1878). Kurt H. Nadelmann, *Rehabilitating International Bankruptcy Law: Lessons Taught by Herstatt and Company*, 52 N.Y.U.L. REV. 1, 11 (1977) [hereinafter *Lessons Taught by Herstatt*]; Paskay, *supra* note 5, at 322.

<sup>26</sup>159 U.S. 113 (1895).

<sup>27</sup>*Id.* at 210.

<sup>28</sup>*Id.* at 163.

<sup>29</sup>*Id.* at 163-64.

<sup>30</sup>208 U.S. 570 (1908).

citizens before turning over the remainder of the local assets to the foreign creditor, even though the Wisconsin creditor made its garnishment after the foreign creditor.<sup>31</sup>

In *In re Stoddard & Norske Lloyd Insurance Co. ("Norske Lloyd")*<sup>32</sup> the New York Court of Appeals continued to apply a territoriality-based definition of comity, but also injected some universality notions into its analysis. In this case the court ordered that the remaining assets of an insolvent foreign insurance company, which had not been attached by U.S. creditors, be turned over to the primary receiver from Norway to be administered in the foreign proceeding, rather than be paid to remaining local creditors.<sup>33</sup> In making its decision the *Norske Lloyd* court applied a territoriality-based notion of comity. Since the case did not involve a dispute between a foreign receiver and local lien holders, the court found that there was no "principle of equity, comity or public policy which authorizes the application of the funds in the hands of the Superintendent to payment in full of local creditors before transmission of any surplus to the primary or domiciliary receiver."<sup>34</sup> By basing its decision on the principle of equality of distribution among creditors of the same class and on the ancillary nature of the New York proceeding, the court also applied some elements of the universality approach.<sup>35</sup>

In *In re Aktiebolaget Kreuger & Toll ("Kreuger & Toll")*,<sup>36</sup> the Southern District of New York also applied universality notions of equality of distribution. However, unlike the court in *Norske Lloyd*, this court avoided the issue of what notion of comity it was applying. After Swedish liquidation proceedings had

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<sup>31</sup>Accord *Clark v. Williard*, 294 U.S. 211 (1935) (involving dispute arising at state, rather than international, level). *Contra* *Martyne v. American Union Fire Ins. Co.*, 216 N.Y. 183 (1915) (also involving dispute arising at state level; affirming an order to set aside a post-dissolution attachment by a local creditor against property claimed by an out-of-state statutory liquidator).

If bankruptcy proceedings have not been commenced, the *Disconto Gesellschaft* decision "leaves each state free to decide what, if any, type of co-operation will be forthcoming when a cross-border insolvency occurs." Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 733. Since the federal courts must apply state law and state choice of law rules where the court's jurisdiction is based on diversity of the parties' citizenship, the recognition of foreign bankruptcies and notions of comity are matters of state law in such cases. *Id.* See also EUGENE F. SCOLES & PETER HAY, *CONFLICT OF LAWS* § 24.35, at 964 (1982).

<sup>32</sup>242 N.Y. 148 (1926).

<sup>33</sup>But see *In re Estate of Delahanty*, 11 Ariz. 366 (1908) (assistance to foreign representative not extended to land).

<sup>34</sup>*Norske Lloyd*, 242 N.Y. at 163.

<sup>35</sup>*Id.* at 164-65. In structuring the turnover order, the *Norske Lloyd* court also considered the interests of local creditors. The court stated that the turnover of local assets would not be made "if there is any danger that the . . . distribution thereof will be made in a manner unfair to the domestic creditors." *Id.* at 167. Therefore, since many of the domestic claims were too small to justify incurring the expenses of presentation and proof abroad, the court conditioned the transmittal of the funds to Norway on the Norwegian court allowing local creditors the opportunity to prove and defend their claims in the United States. *Id.* at 167-68.

<sup>36</sup>20 F. Supp. 964 (S.D.N.Y. 1937), *aff'd*, 96 F.2d 768 (2d Cir. 1938).

been commenced against Aktiebolaget Kreuger & Toll ("Kreuger & Toll"), U.S. creditors commenced a full bankruptcy proceeding against Kreuger & Toll in the Southern District of New York. Operating on the premise that "*any action taken by this court will be taken with a view to the most earnest cooperation with the authorities in Sweden in the interest of all creditors*,"<sup>37</sup> the court recognized a Swedish judgment that negatively affected the rights of U.S. debenture holders. Among the factors noted by the court in its decision were that the Swedish proceedings had treated all creditors equally, fairly, and impartially; that the U.S. trustee for the debenture holders had invoked the jurisdiction of the Swedish court; and that ruling in favor of the U.S. debenture holders would prefer them at the expense of all other creditors of Kreuger & Toll.<sup>38</sup> Thus, universality principles, including equality of distribution and a more flexible application of comity, led the court to recognize the Swedish judgment.

Into the 1970's, although territoriality-based "interests of local creditors" terminology continued to appear in the decisions, many courts began to cooperate more willingly with foreign bankruptcies and to adopt a more universality-oriented, pro-recognition comity approach.<sup>39</sup> However, in the mid-1970's before most of these pro-recognition comity decisions had been decided, the rudimentary status and inconsistent approaches of U.S. law regarding the recognition of foreign insolvency proceedings became especially critical as U.S. courts attempted to grapple with the insolvency of three large multinational financial corporations<sup>40</sup>—Bankhaus I.D. Herstatt K.G.a.A. ("Herstatt"), Israel-British Bank (London) Ltd. ("IBB"), and Banque de Financement, S.A. ("Finabank").

The Herstatt case was unreported and settled out of court.<sup>41</sup> Herstatt, a major West German commercial bank, suffered large foreign exchange losses

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<sup>37</sup>Kreuger & Toll, 20 F. Supp. at 965 (emphasis in original) (quoting Judge Mack).

<sup>38</sup>Id. at 969-70. The *Norske Lloyd* and *Kreuger & Toll* approaches should be contrasted with the territoriality-oriented approach in *Waite* and early non-bankruptcy cases in which local creditors had not attached property sought by foreign representatives. See text accompanying *supra* notes 17 and 18; Lowell, *supra* note 11, at 261.

<sup>39</sup>See, e.g., *Waxman v. Kealoha*, 296 F. Supp. 1190 (D. Haw. 1969) (in recognizing right of Canadian trustee in bankruptcy to bring action to recover debts from stockholders of bankrupt corporation, court stated the test in terms of territoriality language but did not strictly apply the test); compare *Clarkson Co. v. Shaheen*, 544 F.2d 624 (2d Cir. 1976) (in recognizing right of Canadian trustee in bankruptcy to obtain records located in the New York offices of bankrupt corporations, the court noted that exceptions to granting comity "are construed especially narrowly when the alien jurisdiction is, like Canada, a sister common law jurisdiction, with procedures akin to [those of the United States]"; *id.* at 629-30, and that assertions of fraud "must be pleaded 'with particularity.'" *Id.* at 630). See also *Cornfeld v. Investors Overseas Services, Ltd.*, 471 F. Supp. 1255 (S.D.N.Y. 1979), *aff'd*, 614 F.2d 1286 (2d Cir. 1979), discussed in note 235 *infra*.

<sup>40</sup>See Unger, *supra* note 5, at 1163.

<sup>41</sup>For a description and analysis of the Herstatt case, see Joseph D. Becker, *International Insolvency: The Case of Herstatt*, 62 A.B.A. J. 1290 (1976) [hereinafter *The Case of Herstatt*]; Joseph D. Becker, *Transnational Insolvency Transformed*, 29 Am. J. Comp. L. 706, 707-10 (1981); Nadelmann, *Lessons Taught by Herstatt*, *supra* note 25, at 1-10, 12-14, 24.

in connection with currency fluctuations following the 1973 oil embargo. In June, 1974 the West German banking authorities ordered Herstatt to be liquidated. Herstatt did not do business in the United States, but had millions of dollars of its funds on deposit there with its correspondents, including approximately \$150 million with Chase Manhattan Bank. When Herstatt's correspondents refused to honor drafts presented against the Herstatt accounts, creditors in the United States began attaching the funds. These attachments, in turn, were placed in jeopardy when an involuntary bankruptcy petition was filed against Herstatt in the Southern District of New York. The attaching creditors immediately began challenging the right of the petitioners to maintain the involuntary proceeding on the ground that Herstatt was a banking corporation and that § 4(b) of the U.S. Bankruptcy Act excluded banking corporations from involuntary bankruptcy.<sup>42</sup> The issue that the district court had to decide was whether the exclusion of foreign banks from the jurisdiction of the U.S. Bankruptcy Act applied to foreign banks such as Herstatt that were not engaged in the banking business in the United States.<sup>43</sup> The uncertainty over the resolution of this issue and the anticipated lengthy delay led all of the involved parties to reach an agreement, and the bankruptcy case

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<sup>42</sup>Section 4(b) of the U.S. Bankruptcy Act provided that, "[a]ny natural person, except a wage earner or farmer, and any moneyed, business, or commercial corporation, except a building and loan association, a municipal, railroad, insurance, or banking corporation, owing debts to the amount of \$1,000 or over, may be adjudged an involuntary bankrupt." U.S. Bankruptcy Act, § 4(b), 11 U.S.C. § 22(b) (1970).

<sup>43</sup>This issue has been resolved in the U.S. Bankruptcy Code. Section 109(b)(3) provides that "[a] person may be a debtor under chapter 7 of this title only if such person is not . . . (3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such business in the United States." 11 U.S.C.A. § 109(b)(3) (West 1991). Such banking institutions and insurance companies are also excluded from chapter 11 under section 109(d). *Id.* § 109(d). These banking institutions and insurance companies are excluded because there are alternative provisions for their liquidation under various state and federal regulatory laws. H.R. REP. NO. 595, 95th Cong., 1st Sess. 318-19, reprinted in 1978 U.S.C.C.A.N. 5963, 6275-76; S. REP. NO. 989, 95th Cong., 2d Sess. 31, reprinted in 1978 U.S.C.C.A.N. 5787, 5817. Conversely, foreign banks or insurance companies not engaged in such business in the United States are subject to the U.S. Bankruptcy Code, since there are not alternative procedures for their liquidation under state and federal regulatory laws. *Id.* Such institutions not engaged in such business in the United States may commence a voluntary case under chapter 7 or chapter 11, but involuntary proceedings may only be commenced against a foreign bank that is not engaged in such business in the United States only under chapter 7 and only if a foreign proceeding concerning such bank is pending. 11 U.S.C.A. §§ 301, 303(k) (West 1991). This special protection is necessary "to prevent creditors from effectively closing down a foreign bank by the commencement of an involuntary bankruptcy case in [the United States] unless that bank is involved in a proceeding under foreign law." H.R. REP. NO. 595, 95th Cong., 1st Sess. 324, reprinted in 1978 U.S.C.C.A.N. 5963, 6280; S. REP. NO. 989, 95th Cong., 2d Sess. 35, reprinted in 1978 U.S.C.C.A.N. 5787, 5821. One commentator correctly notes that an inconsistency that needs to be corrected is that § 303(k) provides that the special protection for involuntary cases applies only to "foreign banks" not engaged in such business in the United States, but that § 109(b)(3) provides that other banking and insurance entities not engaged in such business in the United States, in addition to foreign banks not engaged in the banking business, are eligible to be debtors. Unger, *supra* note 5, at 1168-69.

in the United States was dismissed.<sup>44</sup>

This issue of whether a foreign bank not doing business in the United States can be the subject of bankruptcy proceedings under the U.S. Bankruptcy Act was resolved, however, in the case involving the insolvency of IBB.<sup>45</sup> IBB was a British bank that voluntarily commenced winding-up proceedings in England, and soon thereafter filed a voluntary bankruptcy petition in the Southern District of New York to avoid preferential attachments and to "insure that its assets in the United States would become available for all general creditors and distributed amongst them equally."<sup>46</sup> The Second Circuit upheld the bankruptcy court's ruling that the exclusion of "banking corporations" from the U.S. Bankruptcy Act did not apply to foreign banks not doing business in the United States.<sup>47</sup> In reaching its decision, the Second Circuit followed a universality approach and stressed the theme of equality of distribution.<sup>48</sup>

Soon thereafter, the Second Circuit again followed the universality approach in the case involving Finabank, a Swiss bank which, like Herstatt and IBB, did not do business in the United States but did have assets on deposit there. Finabank, another victim of currency speculation, was forced to seek protection and filed a petition for relief under Swiss law. Finabank then filed a petition in the Southern District of New York for an arrangement under Chapter XI to avoid preferential attachments of U.S. creditors.<sup>49</sup> The U.S. bankruptcy court dismissed the case under § 2(a)(22)<sup>50</sup> and Bankruptcy Rule 119,<sup>51</sup> but the

<sup>44</sup>Becker, *Transnational Insolvency Transformed*, *supra* note 41, at 708-09; Nadelmann, *Lessons Taught by Herstatt*, *supra* note 25, at 8-11; Unger, *supra* note 5, at 1165.

<sup>45</sup>In re Israel-British Bank (London) Ltd. v. Federal Deposit Ins. Corp., 536 F.2d 509, 512-15 (2d Cir. 1976) [hereinafter IBB], *cert. denied*, 429 U.S. 978 (1976).

<sup>46</sup>In re Israel-British Bank (London) Ltd., No. 74-B-1322 (Bankr. S.D.N.Y. Jan. 5, 1978), Findings of Facts, ¶ 15 (Jan. 5, 1978), reprinted in Kurt H. Nadelmann, *Israel-British Bank (London) Ltd.: Yet Another Trans-Atlantic Crossing*, 52 AM. BANKR. L.J. 369, 375 (1978) [hereinafter *Israel-British Bank*].

<sup>47</sup>IBB, 536 F.2d at 512-15.

<sup>48</sup>*Id.* at 513.

<sup>49</sup>In re Banque de Financement, S.A., 568 F.2d 911, 917 (2d Cir. 1977) [hereinafter *Finabank*].

<sup>50</sup>Enacted under the 1962 Amendment to the U.S. Bankruptcy Act, former § 2(a)(22) authorized a bankruptcy court to "[e]xercise, withhold, or suspend the exercise of jurisdiction, having regard to the rights or convenience of local creditors and to all other relevant circumstances, where a bankrupt has been adjudged bankrupt by a court of competent jurisdiction without the United States." 11 U.S.C. § 11(a)(22) (1976).

<sup>51</sup>Adopted in 1973, former Bankruptcy Rule 119 provided:

When a proceeding for the purpose of the liquidation or rehabilitation of his estate has been commenced by or against a bankrupt in a court of competent jurisdiction without the United States, the court of bankruptcy may, after hearing on notice to the petitioner or petitioners and such other persons as it may direct, having regard to the rights and convenience of local creditors and other relevant circumstances, dismiss a case or suspend the proceedings therein under such terms as may be appropriate.

11 U.S.C. app. rule 119 (1976).

Second Circuit reversed that decision after reasoning that § 2(a)(1) of the U.S. Bankruptcy Act, "by providing a jurisdictional underpinning in property located in this country, fosters in international situations one of the basic purposes of the [U.S. Bankruptcy] Act, i.e. equal distribution among creditors."<sup>52</sup>

In the Second Circuit's universality approach analysis, equality of distribution outweighed parochial protection of U.S. creditors and justified the U.S. segment of an international proceeding functioning "essentially as an instrument to set aside preferences."<sup>53</sup> To foster that purpose, the court explicitly rejected the bankruptcy court's contention (and reliance on *Disconto Gesellschaft*) that the preferential attachments of U.S. creditors were "rights" to be protected by the U.S. courts.<sup>54</sup> Rather, the Second Circuit stressed that local creditors were only to be protected against being forced "to participate in foreign proceedings in which their claims [would] be treated in some manner inimical to this country's policy of equality."<sup>55</sup>

The bankruptcy judge in *IBB* (which was still an active case when the Second Circuit issued its decision in *Finabank*) relied heavily on the Second Circuit's opinion in *Finabank* in his decision to suspend the U.S. proceedings and order the transfer of assets in the United States to the English liquidators to be administered by them in the English proceedings for the benefit of all creditors of *IBB*. The primary legal justifications for the bankruptcy court's universality-based decision were to further equality of distribution, to cooperate with the English courts, and to avoid duplication of efforts.<sup>56</sup> The bankruptcy judge concluded that his decision "would have regard to the rights and convenience of local creditors."<sup>57</sup>

The bankruptcy court's turnover orders in *IBB*,<sup>58</sup> based on the Second Circuit's universality approach in both *IBB* and *Finabank*, epitomize the extent to which the territoriality approach set forth in *Harrison* had given way to greater cooperation among U.S. and foreign bankruptcy courts by the time that the U.S. Bankruptcy Code was enacted. Under the *IBB* and *Finabank* approach, the interests of U.S. creditors were still to be protected, but within the framework of ensuring equality of distribution.

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<sup>52</sup>*Finabank*, 568 F.2d at 918.

<sup>53</sup>*Id.* at 918-19.

<sup>54</sup>*Id.* at 921.

<sup>55</sup>*Id.* The court also stressed the importance of cooperation in the cross-border insolvency context, *id.* at 918-19, and the need to avoid duplication of efforts. *Id.* at 921.

<sup>56</sup>*In re Israel-British Bank (London) Ltd.*, No. 74-B-1322 (Bankr. S.D.N.Y. Jan. 5, 1978), *Conclusions of Law*, ¶¶ 2-5 (Jan. 5, 1978) [hereinafter *IBB, Conclusions*], reprinted in Nadelmann, *Israel-British Bank*, *supra* note 46, at 380-81.

<sup>57</sup>*IBB, Conclusions*, *supra* note 56, ¶ 6, reprinted in Nadelmann, *Israel-British Bank*, *supra* note 46, at 381.

<sup>58</sup>*IBB, Order* (Jan. 5, 1978); *IBB, Order Authorizing Trustee to Turn Over Funds to U.K. Liquidators and to Pay Administration Claims* (Dec. 19, 1978) [hereinafter "*IBB Turnover Orders*"].

But this is not to say that the universality approach had completely replaced the territoriality approach. As the following discussion of § 304 demonstrates, the debate continues.

## II. *Current Recognition of Foreign Bankruptcies and the Options Available to a Foreign Representative for Protecting the Assets of a Foreign Debtor in the United States*

Under the U.S. Bankruptcy Code a foreign representative<sup>59</sup> has three options available for protecting the assets of a foreign debtor that are located in the United States: (1) filing a petition under § 304 to commence a case ancillary to a foreign proceeding; (2) filing a petition under § 303(b)(4) to commence an involuntary case against the foreign debtor under chapter 7 (liquidation) or chapter 11 (reorganization);<sup>60</sup> or (3) seeking dismissal of a case or suspension of all proceedings under § 305(a)(2).<sup>61</sup>

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<sup>59</sup>Section 101(24) defines "foreign representative" as a "duly selected trustee, administrator, or other representative of an estate in a foreign proceeding." 11 U.S.C.A. § 101(24) (West 1991). Section 101(23), in turn, defines "foreign proceeding" as a "proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization." *Id.* § 101(23).

<sup>60</sup>A foreign debtor may also file a petition under § 301 to commence a voluntary case under chapter 7 or chapter 11. 11 U.S.C.A. § 301 (West 1991). See *In re Florida Peach Corp. of America, Int.*, 63 B.R. 833 (Bankr. M.D. Fla. 1986). Also, under § 303, creditors may commence an involuntary case against a foreign debtor under chapter 7 or chapter 11. 11 U.S.C.A. § 303 (West 1991) (restrictions are included in § 303(k). *Id.* § 303(k). See *supra* note 43). However, under the hotchpot rule in § 508, any distribution that a creditor receives in a U.S. bankruptcy case must take into account any payment received by that creditor in a foreign proceeding. 11 U.S.C.A. § 508(a) (West 1991).

In addition, a foreign trustee who is the exclusive representative of a foreign bankrupt debtor and its creditors is a "creditor" under § 101(10) entitled to file the sole proof of claim on behalf of the foreign debtor and its creditors in a bankruptcy proceeding under the U.S. Bankruptcy Code, and need not bring a § 304 ancillary proceeding to submit such a claim. *In re Enercons Virginia, Inc.*, 812 F.2d 1469 (4th Cir. 1987); 11 U.S.C.A. § 101(10) (West 1991). However, a foreign debtor's creditors might be able to act independently of the foreign representative if the foreign law "did not clearly confer a privileged status on the foreign representative" to act as the sole representative of the foreign debtor's estate. Douglass G. Boshkoff, *American Reports—The American Judicial System and Cross-Border Insolvencies*, chapter 4(a) in *CROSS-BORDER INSOLVENCY: COMPARATIVE DIMENSIONS*, *supra* note 1, at 66 [hereinafter *American Reports*].

<sup>61</sup>11 U.S.C.A. §§ 305(a)(2), (b) (West 1991). See *In re Axona International Credit & Commerce Ltd.*, 88 B.R. 597, 606 (Bankr. S.D.N.Y. 1988), *aff'd*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991) [hereinafter *Axona*].

Rather than seeking relief under § 304, the foreign representative may choose to vacate local attachments under state law and seek the granting of comity. See, e.g., *Cunard S.S. Co. v. Salen Reefer Servs. AB*, 773 F.2d 452 (2d Cir. 1985) [hereinafter *Salen I*]; *Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B.*, 825 F.2d 709 (2d Cir. 1987) [hereinafter *Salen II*].

A. SECTION 304 (CASES ANCILLARY TO FOREIGN PROCEEDINGS)<sup>62</sup>1. *Background*

The U.S. Bankruptcy Code § 304 provides as follows:

- (a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.
- (b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may—
  - (1) enjoin the commencement or continuation of—
    - (A) any action against—
      - (i) a debtor with respect to property involved in such foreign proceeding; or
      - (ii) such property; or
    - (B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
  - (2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
  - (3) order other appropriate relief.
- (c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—

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<sup>62</sup>For articles that discuss § 304 and related matters in some detail, see Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 739–50; Boshkoff, *American Reports*, *supra* note 60; Terri P. Finister, *1988 Developments and the Conflicts Arising Under Section 304*, 6 *BANKR. DEV. J.* 345 (1989); Fischer, *supra* note 5, at 640–51; Gallagher & Hartje, *supra* note 5, at 3–21; Richard A. Gitlin & Evan D. Flaschen, *The International Void in the Law of Multinational Bankruptcies*, 42 *BUS. LAW.* 307, 315–22 (1987); Gitlin, Flaschen, & Grimes, *supra* note 5, at 71–88; Thomas C. Given & Victor A. Vilaplana, *Comity Revisited: Multinational Bankruptcy Cases Under Section 304 of the Bankruptcy Code*, 1983 *ARIZ. ST. L.J.* 325, 329–40 (1983); Daniel M. Glosband & Christopher T. Katucki, *Current Developments in International Insolvency Law and Practice*, 45 *BUS. LAW.* 2273 (1990) [hereinafter *Current Developments*]; L.F.E. Goldie, *The Challenge of Transnational Expectations and the Recognition of Foreign Bankruptcy Decrees—The United States Adjustment*, 58 *BRIT. Y.B. INT'L L.* 303, 308–23, 329–39 (1987); Eric W. Lam, *Bankruptcy Code Section 304(b)(3): "Other Appropriate Relief" for Multinational Bankruptcy*, 16 *BROOKLYN J. INT'L L.* 479 (1990); Morales & Deutch, *supra* note 5, at 1583–97; Nadelmann, *The Bankruptcy Reform Act*, *supra* note 5, at 35–46; Nielsen, *supra* note 5, at 549–73; Timothy E. Powers & Rona R. Mears, *Protecting a U.S. Debtor's Assets in International Bankruptcy: A Survey and Proposal for Reciprocity*, 10 *N.C.J. INT'L L. & COM. REG.* 303, 341–46 (1985); Pauline M. Stevens, *The Interpenetration of Foreign Bankruptcy Laws in Domestic Proceedings Under H.R. 8200*, 52 *AM. BANKR. L.J.* 61 (1978); Donald T. Trautman, *Foreign Creditors in American Bankruptcy Proceedings*, 29 *HARV. INT'L L.J.* 49 (1988); Unger, *supra* note 5, at 1167–78.

- (1) just treatment of all holders of claims against or interests in such estate;
- (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
- (3) prevention of preferential or fraudulent dispositions of property of such estate;
- (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
- (5) comity; and
- (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.<sup>63</sup>

Authorizing a foreign representative to commence a case ancillary to a foreign proceeding was an innovation of the Bankruptcy Reform Act of 1978 intended to address the problems caused by the insolvencies of Herstatt, Finabank, and IBB in the 1970's.<sup>64</sup> Section 304 attempts to facilitate the cooperation of bankruptcy courts worldwide by creating a mechanism that enables U.S. bankruptcy courts "to accommodate the special needs of [foreign] representatives . . . charged with the responsibility of securing the debtor's United States assets for the benefit of all creditors."<sup>65</sup> The drafters of this innovation believed that, "[r]ecognition accorded a foreign trustee or representative pursuant to subdivisions (b) and (c) [of § 4-103, a predecessor draft provision of §§ 304 and 305]<sup>66</sup> should enhance the likelihood that a trustee of an estate appointed

<sup>63</sup>11 U.S.C.A. § 304 (West 1991).

<sup>64</sup>Paskay, *supra* note 5, at 334-36; Unger, *supra* note 5, at 1167. See, also, Reisenfeld, *supra* note 5, at 288-89; Nielsen, *supra* note 5, at 547-48. See generally Becker, *The Case of Herstatt*, *supra* note 41; Becker, *Transnational Insolvency Transformed*, *supra* note 41; Nadelmann, *Lessons Taught by Herstatt*, *supra* note 25. See also 2 COLLIER ON BANKRUPTCY, ¶ 304.01 at 304-5 (Lawrence P. King ed. 15th ed. 1992); 2 COLLIER BANKRUPTCY PRACTICE GUIDE, ¶ 19.02 at 19-5 to -6 (Asa S. Herzog & Lawrence P. King eds. 1992). For a discussion of Herstatt, Finabank, and IBB, see text accompanying *supra* notes 40 to 58.

<sup>65</sup>2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 304.01 at 304-4.

<sup>66</sup>Section 4-103, entitled *Administration of Debtors' Estates Involving More Than One Country*, was a section of the draft bill completed in 1978 by the Commission on the Bankruptcy Laws of the United States. REPORT OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 137, 93d Cong., 1st Sess., pts. 1-2 (1973) [hereinafter "COMMISSION REPORT"]. Section 4-103 provided as follows:

- (a) *Complaint by Debtor or Creditor to Obtain Dismissal or Suspension of Case When a Foreign Proceeding is Pending.* When a proceeding for the purpose of the liquidation or rehabilitation of his estate has been commenced in a court of competent jurisdiction in another country by or against a debtor who is also a debtor in a case filed under this Act, the debtor or a creditor may file a complaint in the bankruptcy court seeking dismissal or suspension of the case commenced under this Act.
- (b) *Petition or Complaint by a Foreign Trustee or Administrator.* A trustee, administrator, or other representative of a debtor's estate appointed in a proceeding in a court

or elected in this country [would] be accorded respect when he sue[d] to recover property located abroad.”<sup>67</sup>

There was no provision comparable to § 304 in the U.S. Bankruptcy Act.<sup>68</sup> Under the U.S. Bankruptcy Act, a foreign representative could not commence a bankruptcy case in the United States.<sup>69</sup> However, as a matter of comity,

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of competent jurisdiction in another country for the purpose of its liquidation or rehabilitation may file any of the following pleadings in the bankruptcy court:

- (1) *a petition as a creditor* pursuant to section 4-205 of this Act if the debtor is subject to involuntary relief as provided in section 4-204;
- (2) *a complaint seeking dismissal* or suspension of a case commenced under this Act by or against the debtor;
- (3) *a complaint seeking an injunction* to stay the commencement or continuation of any action against the debtor, or the enforcement of any judgment against him, or of any act or the commencement or continuation of any court proceeding to create or enforce any lien against his property; or
- (4) *a complaint seeking delivery of the property* of the debtor's estate or its proceeds.

(c) *Power and Discretion of the Court.* After a hearing on notice issued pursuant to the filing of a complaint under subdivision (a) or clause (1) or (2) of subdivision (b), the bankruptcy court may dismiss, suspend, or continue the case commenced under this Act on such terms as may be appropriate. *In addition*, the court may issue injunctions, turnover orders, and other appropriate relief in a proceeding under this section, *whether or not a petition has been filed by or against the debtor under this Act.* In exercising its discretion under this section, the court shall be guided by a consideration of what will best assure an economical and expeditious administration of the debtor's estate consistent with the objectives of fair and equitable treatment for all creditors, the protection of local creditors against prejudice and inconvenience in the processing of their claims, the avoidance of preferential and fraudulent dispositions of the debtor's property, the distribution of proceeds substantially in accord with the order prescribed by this Act, and, where appropriate, the provision of an opportunity for a fresh start for the debtor.

*Id.*, § 4-103 (emphasis in original).

The provisions of § 4-103 of the COMMISSION REPORT remain in the U.S. Bankruptcy Code, but have been incorporated into different sections. All provisions relating to the dismissal or suspension of a case are now included in § 305, which governs abstention; § 4-103(b)(1), which permitted the foreign representative to commence an involuntary case, has been incorporated into § 303, which governs involuntary petitions; and all provisions regarding ancillary relief have been incorporated into § 304. 11 U.S.C.A. §§ 303, 304, 305 (West Supp. 1991).

<sup>67</sup>COMMISSION REPORT, *supra* note 66, § 4-103 n.2.

It should be noted that the U.S. Bankruptcy Code adopts the universality approach towards the foreign assets of a U.S. debtor. Under § 541(a), the estate is comprised of property “*wherever located and by whomever held*.” 11 U.S.C.A. § 541(a) (West Supp. 1991) (emphasis added). This continues the policy that was made explicit in the 1952 amendment to § 70 of the U.S. Bankruptcy Act. Pub. L. No. 82-456, 66 Stat. 420 (1952) (repealed 1978). See Kurt H. Nadelmann, *Revision of Conflicts Provisions in the American Bankruptcy Act*, 1 INT'L & COMP. L.Q. 484, 484-86 (1952); Honsberger, *supra* note 5, at 659-660.

<sup>68</sup>2 COLLIER BANKRUPTCY PRACTICE GUIDE, *supra* note 64, ¶ 19.06 at 19-11. See also *id.*, ¶ 19.02 at 19-6, ¶ 19.08 at 19-15. See 2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 304.01 at 304-4 to -5.

<sup>69</sup>2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 304.01 at 304-4 to -5. Under the U.S. Bankruptcy Act, only the debtor or its creditors could initiate insolvency proceedings in U.S. bankruptcy courts. *Hearings*, *supra* note 2, at 1443 (statement of Prof. Kurt H. Nadelmann).

U.S. courts often recognized claims asserted by foreign representatives and deferred to foreign insolvency administrations.<sup>70</sup> Congress enacted § 304 “to implement the long standing policy of this country in extending comity to foreign bankruptcy proceedings.”<sup>71</sup>

There is no full and conventional bankruptcy case under § 304.<sup>72</sup> Moreover, the foreign representative need not commence a full bankruptcy case under another section of the U.S. Bankruptcy Code to make use of § 304.<sup>73</sup> Rather, an ancillary case is commenced in the United States in aid of the principal insolvency proceeding abroad.<sup>74</sup> The more limited purposes of the ancillary case are “to administer assets located in this country, to prevent dismemberment by local creditors of assets located here, or for other appropriate relief.”<sup>75</sup>

## 2. Commencement of the § 304 Case and Threshold Requirements— Eligibility for Relief, Jurisdiction, and Venue

A foreign representative commences a case ancillary to a foreign proceeding under § 304 by filing a verified petition<sup>76</sup> with the bankruptcy court.<sup>77</sup>

<sup>70</sup>2 COLLER ON BANKRUPTCY, *supra* note 64, ¶ 304.01 at 304–5. See generally text in Part I *supra*.

<sup>71</sup>*In re Metzeler*, 78 B.R. 674, 676 (Bankr. S.D.N.Y. 1987); accord *Salen II*, 825 F.2d at 713–14. See H.R. REP. NO. 595, 95th Cong., 1st Sess. 325, reprinted in 1978 U.S.C.C.A.N. 5963, 6281; S. REP. NO. 989, 95th Cong., 2d Sess. 35, reprinted in 1978 U.S.C.C.A.N. 5787, 5821.

<sup>72</sup>In addition, a separate estate is not created under § 541, because that section omits any reference to § 304. Boshkoff, *American Reports*, *supra* note 60, at 77. Section 541(a) provides that “[t]he commencement of a case under section 301, 302, or 303 of this title creates an estate.” 11 U.S.C.A. § 541(a) (West Supp. 1991).

<sup>73</sup>See H.R. REP. NO. 595, 95th Cong., 1st Sess. 324, reprinted in 1978 U.S.C.C.A.N. 5963, 6281; S. REP. NO. 989, 95th Cong., 2d Sess. 35, reprinted in 1978 U.S.C.C.A.N. 5787, 5821.

<sup>74</sup>*Axona*, 88 B.R. at 606; *In re Koreag*, Controle et Revision S.A., 130 B.R. 705, 710 (Bankr. S.D.N.Y. 1991) [hereinafter *Koreag*].

<sup>75</sup>H.R. REP. NO. 595, 95th Cong., 1st Sess. 324, reprinted in 1978 U.S.C.C.A.N. 5963, 6281; S. REP. NO. 989, 95th Cong., 2d Sess. 35, reprinted in 1978 U.S.C.C.A.N. 5787, 5821.

<sup>76</sup>The Federal Rules of Bankruptcy Procedure require the verification by the debtor of all petitions and accompanying papers. Fed. R. Bankr. P. 1008 (West 1991). See also *id.* 9011. Section 1746 of title 28 of the United States Code [hereinafter “U.S.C.”] provides that:

[w]herever, under any law of the United States or under any rule . . . made pursuant to law, any matter is required or permitted to be . . . proved by the sworn . . . verification . . . in writing of the person making the same . . . such matter may, with like force and effect, be supported, evidenced, established, or proved by the unsworn declaration, certificate, verification, or statement, in writing of such person which is subscribed by him, as true under penalty of perjury.

28 U.S.C.A. § 1746 (West Supp. 1991).

<sup>77</sup>11 U.S.C.A. § 304(a) (West Supp. 1991).

Section 1334(a) of title 28 of the U.S.C. provides that “the district courts shall have original and exclusive jurisdiction of all cases under title 11.” 28 U.S.C.A. § 1334(a) (West 1991). Section 1334(b) provides that “the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.” *Id.* § 1334(b). Section 1410 places venue in the appropriate district court. *Id.* § 1410. Section 157(a) of title 28 permits district courts to refer “any or all cases under

The foreign representative should file the petition with the clerk,<sup>78</sup> and on filing, "the clerk shall forthwith issue a summons for service . . . on the parties against whom relief is sought pursuant to § 304(b) . . . and on such other parties as the court may direct."<sup>79</sup>

The filing of a petition under § 304 does not guarantee that relief will be ordered, and § 304(b) provides that a "party in interest" may controvert the petition.<sup>80</sup> Controverted "petitions are governed in general by the procedural

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title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 . . . to the bankruptcy judges for the district." *Id.* § 157(a). And § 151 of title 28 designates bankruptcy judges in regular active service as a unit of the district court to be known as the bankruptcy court and provides that each bankruptcy judge "may exercise the authority conferred under this chapter with respect to any action, suit, or proceeding." *Id.* § 151.

Sections 301, 302, 303, and 304 provide that cases under the respective section are commenced by filing the petition with the bankruptcy court, rather than with the district court. 11 U.S.C.A. §§ 301, 302, 303, 304 (West 1991).

When the foreign representative petitions for ancillary relief, the representative receives no substantive rights with respect to the foreign debtor's property located in the United States—the foreign representative is merely given standing to seek discretionary relief. *Hearings, supra* note 2, at 1510 (statement of Prof. Stefan A. Riesenfeld).

Section 306 provides that "[a]n appearance in a bankruptcy court by a foreign representative in connection with a petition or request under section 303, 304, or 305 . . . does not submit such foreign representative to the jurisdiction of any court in the United States for any other purpose." 11 U.S.C.A. § 306 (West 1991). However, the bankruptcy court is permitted under § 306 to "condition any order under section 303, 304, or 305 . . . on compliance by such foreign representative with the orders of such bankruptcy court." *Id.* This section was designed to enable the bankruptcy court to enforce its orders that are necessary under § 303, 304, or 305. H.R. REP. NO. 595, 95th Cong., 1st Sess. 325–26, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6282; S. REP. NO. 989, 95th Cong., 2d Sess. 36, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5822.

Although an appearance in a bankruptcy court by a foreign representative in connection with a § 304 petition does not submit the foreign representative to the court's jurisdiction for any other purpose, actions in furtherance of granted § 304 relief could subject the foreign representative to such jurisdiction. *See Seidman & Seidman v. Gee*, 1989 U.S. Dist. LEXIS 7503 (S.D.N.Y. July 6, 1989), where plaintiff, an accounting firm for a defunct Cayman Island's company, sued Gee (the liquidator of the company) for breach of contract and fraud. The liquidator, who had earlier petitioned for and received § 304 relief, argued *inter alia* that the court lacked jurisdiction over his person. The court rejected this argument, and reasoned as follows: "Putting aside activities arguably required by his appearance in the bankruptcy proceedings in New York which may be excluded from consideration under 11 U.S.C. [§] 306, Gee engaged in other New York activities which make him amenable to process in this case. These included his employment of New York attorneys in connection with his prospective suit against Seidman and his negotiation and execution of the April 21, 1986 tolling agreement." *Id.* at 4–5.

<sup>78</sup>Fed. R. Bankr. P. 1002 (West 1991).

<sup>79</sup>*Id.* 1010 (this rule also provides for the manner of service).

<sup>80</sup>11 U.S.C.A. § 304(b) (West 1991). "Party in interest" is not defined in the U.S. Bankruptcy Code. The legislative history, however, states that:

the phrase "on request of a party in interest" . . . is used in connection with an action that the court may take in various sections of the [U.S. Bankruptcy] Code. The phrase is intended to restrict the court from acting *sua sponte*. Rules of bankruptcy procedure or court decisions will determine who is a party in interest for the particular purposes of the provision in question.

124 CONG. REC. H11,090 (Sept. 28, 1978); *id.* S17,407 (Oct. 6, 1978). A party in interest includes the debtor. 2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 304.06 at 304–14.

procedural rules applicable to involuntary petitions, including the provisions for summary relief, notwithstanding the provision in § 304(b) for relief 'after trial.'<sup>81</sup> Acceptable grounds for such a challenge include matters related to the eligibility of the debtor for relief, jurisdiction, venue, or the failure of the foreign proceeding to satisfy the § 304(c) factors,<sup>82</sup> all of which are discussed below.

The foreign representative must establish that a foreign proceeding involving the debtor has been commenced,<sup>83</sup> and that she has been duly appointed in the standard manner for the foreign proceeding.<sup>84</sup> The U.S. bankruptcy court should defer to the laws of the foreign country that determine the legitimacy of a foreign proceeding or the appointment of a foreign representative.<sup>85</sup>

The definition of "foreign proceeding" as a "proceeding, whether judicial or administrative,"<sup>86</sup> leaves in doubt the status of both the private appointment of a receiver under a floating charge and the private appointment of a trustee under a general assignment for the benefit of creditors. These issues have not been raised in any reported § 304 case.<sup>87</sup> The *Collier Bankruptcy Practice Guide* states that "[t]he definition of a 'foreign representative' would not appear to be broad enough to include the private appointment of a receiver and manager upon crystallization of a floating charge under Canadian or English law."<sup>88</sup> Another commentator, John D. Honsberger, agrees.<sup>89</sup>

However, a contrasting view is offered by Professor Douglass G. Boshkoff. He argues that a receiver privately appointed under a floating charge should be permitted to commence a § 304 proceeding: "No American bankruptcy policy will be advanced by refusing to do so. Once this type of receiver has been appointed, liquidation will take place and American courts, in one way or another, need to consider whether comity will be extended to the foreign activity."<sup>90</sup> Boshkoff's position is supported by the more persuasive policy argument. At the technical level, his argument is further bolstered by the fact that the word "or" in § 101(23) is not exclusive,<sup>91</sup> and therefore the absence of any reference in § 101(23) to the private appointment of a receiver

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<sup>81</sup>2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 304.06 at 304-14; *In re Culmer*, 25 B.R. 621, 624 (Bankr. S.D.N.Y. 1982). See Fed. R. Bankr. P. 1018 (West 1991).

<sup>82</sup>See Powers & Mears, *supra* note 62, at 343; Given & Vilaplana, *supra* note 62, at 331.

<sup>83</sup>See *supra* note 59.

<sup>84</sup>Honsberger, *supra* note 5, at 651. See *supra* note 59.

<sup>85</sup>2 COLLIER BANKRUPTCY PRACTICE GUIDE, *supra* note 64, ¶ 19.05[1] at 19-10; Gallagher & Hartje, *supra* note 5, at 3-4.

<sup>86</sup>11 U.S.C.A. § 101(23) (West 1991).

<sup>87</sup>Compare *In re Ernst & Young, Inc.*, 129 B.R. 147 (Bankr. S.D. Ohio 1991) (granting § 304 relief in a case ancillary to a court ordered receivership of a Canadian corporation).

<sup>88</sup>2 COLLIER BANKRUPTCY PRACTICE GUIDE, *supra* note 64, ¶ 19.04[1] at 19-9.

<sup>89</sup>Honsberger, *supra* note 5, at 652 (also noting that the private appointment of a trustee under a general assignment for the benefit of creditors would be excluded).

<sup>90</sup>Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 742-43.

<sup>91</sup>11 U.S.C.A. § 102(5) (West 1991) (rules of construction).

under a floating charge or the private appointment of a trustee under a general assignment for the benefit of creditors does not necessarily exclude such types of proceedings. In any case, an amendment to § 101(23), incorporating the private appointment of a receiver (or a receiver and manager) under a floating charge and the private appointment of a trustee under a general assignment for the benefit of creditors into the definition of "foreign proceeding" would correct the present uncertainty under the U.S. Bankruptcy Code. It would also explicitly signal to other jurisdictions that, to be recognized for purposes of a § 304 proceeding, a foreign proceeding need not be identical to a U.S. proceeding. However, even if this amendment is made, a privately appointed receiver or trustee would still have to comply with the criteria for obtaining relief under § 304(c). Since such a receiver often protects the interests of only one creditor, which conflict with the interests of other creditors, such a foreign proceeding may violate the just treatment of creditors requirement contained in § 304(c)(1). If so, this would likely cause the U.S. bankruptcy court to deny relief.<sup>92</sup>

The next issue that arises is what connection the foreign debtor must have with the foreign country. Section 101(23) requires that the foreign proceeding be "in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding."<sup>93</sup> Professor Donald T. Trautman approaches this section from a choice of law perspective and rightly argues as follows:

It makes sense that the foreign proceeding entitled to deference under section 304 should be the foreign proceeding which would have control under a universalist approach to bankruptcy. Under that approach, there would be a unique jurisdiction where all assets would be collected and to which all creditors would go for their distributions. It is almost universally agreed that the jurisdiction for a business enterprise is its principal place of business. All conventions use that choice-of-law test to determine the appropriate place for a single proceeding that is to adjudicate bankruptcy.<sup>94</sup>

Under current law (although such a case has not yet arisen), it is possible for two foreign representatives—one from the country in which the debtor's prin-

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<sup>92</sup>But see Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 742–43 n.64 (citing two non-§ 304 cases, *Clarkson Co. v. Rockwell Int'l Corp.*, 441 F. Supp. 792 (N.D. Cal. 1977) and *Hammond Screw Machinery Co. v. Sullivan*, 580 F. Supp. 24 (N.D. Ill. 1984), in which the respective U.S. courts recognized a receiver appointed under a floating charge).

<sup>93</sup>11 U.S.C.A. § 101(23) (West 1991).

<sup>94</sup>Trautman, *supra* note 62, at 55. But see the English approach. In England the primary test is the place of incorporation. P. SMART, *supra* note 1, at 110. Trautman correctly observes that the choice of law issue has received little attention in the cases and § 304 guidelines. See Trautman, *supra* note 62, at 51. See also Given & Vilaplana, *supra* note 62, at 338–39 (also raising the choice of law issue).

principal place of business is located, and another from the country in which the debtor's principal assets are located, to come to the United States and seek § 304 relief. To avoid this possible conflict, Professor Trautman recommends that the term "principal assets" be deleted from § 101(23)<sup>95</sup> "and that, for an incorporated debtor, the appropriate test [be] the principal place of business."<sup>96</sup> He also proposes that the appropriate location for an individual in bankruptcy be the individual's domicile.<sup>97</sup> These proposals for restricting the appropriate "foreign proceeding" would increase the likelihood that relief would be granted under § 304 to a foreign representative from the appropriate jurisdiction.

Although not expressly mandated, another eligibility requirement should be that the foreign law authorizes the foreign representative to come to the United States and attempt to protect and recover the foreign debtor's property.<sup>98</sup> Moreover, if the foreign representative seeks the application in the United States of the substantive law of the foreign jurisdiction, she should also prove that the foreign law is intended to have effect abroad.<sup>99</sup> Some § 304 cases have discussed these matters.<sup>100</sup>

One of the most important preliminary issues is whether in a case commenced under section 304 the foreign debtor must be a "debtor" as defined in the U.S. Bankruptcy Code or need only qualify for insolvency administra-

<sup>95</sup>Trautman, *supra* note 62, at 55 n.34.

<sup>96</sup>*Id.* at 57 n.43. Trautman notes that "[t]his statement presupposes that the enterprise has an obvious center of its activities in one country." *Id.* at 56 n.37. In cases where there is no obvious center, the court's choice, of course, would be more difficult. See *infra* note 244.

<sup>97</sup>Trautman, *supra* note 62, at 57 n.43.

<sup>98</sup>The authority of the foreign representative could be proved by reference to provisions under foreign law. This is the rule in England. See P. SMART, *supra* note 1, at 139. Such authority could also possibly be proved by reference to judicial authorization, such as a court order. See also Gitlin, Flaschen & Grimes, *supra* note 5, at 78.

<sup>99</sup>I am indebted to Philip Smart for stressing the importance of these two points. If a U.S. court applied the substantive law of a foreign country that was not intended to have effect abroad, this would lead to the incongruous universal application of a law intended to have only territorial effect.

<sup>100</sup>See, e.g., *In re Goerg*, 844 F.2d 1562, 1563 (11th Cir. 1988) (noting that the West German court had (1) held that the debtor's bankrupt estate included the debtor's property located abroad and (2) authorized the German bankruptcy trustee to take possession of that property), *cert. denied*, 488 U.S. 1034 (1989); *Koreag*, 130 B.R. at 711-12 (noting that under Swiss law the foreign debtor had property in the United States); *In re Lines*, 81 B.R. 267, 272-74 (Bankr. S.D.N.Y. 1988) (noting, in discussing whether the foreign representatives acting on behalf of a debtor being wound up in Bermuda had authority to deal with property located in the United States, that "section 174 [of the Bermuda Companies Act] provides for a liquidator to take custody of or control all property to which the company 'is or may be entitled.'" *Id.* at 272 (quoting § 174 (1) Bermuda Companies Act)); *In re A. Tarricone, Inc.*, 80 B.R. 21, 24 (Bankr. S.D.N.Y. 1987) (finding that "the foreign representative ha[d] not pleaded any substantive foreign law which would support his claim" for recovering a fraudulent transfer in the United States under German law); *Metzeler*, 78 B.R. at 677 (foreign representative from Germany was vested with avoidance powers under foreign law that were applicable abroad); *In re Toga Mfg.*, 28 B.R. 165, 167 (Bankr. E.D. Mich.) (under Canadian bankruptcy law money located in the United States was considered property of the Canadian debtor's estate).

tion under foreign law. *In re Goerg*<sup>101</sup> is the first case that directly addressed this important question. This case arose when a foreign representative filed a § 304 petition on behalf of the estate of an insolvent West German decedent. The foreign representative requested the U.S. bankruptcy court to order that the decedent's estate's assets located in Georgia be turned over to him for distribution in the West German bankruptcy proceeding. The bankruptcy court concluded that, although eligible for relief under West German law, an insolvent decedent's estate is not eligible for relief under the U.S. Bankruptcy Code. The district court affirmed. The Eleventh Circuit Court of Appeals reversed, however, and held that a foreign decedent's estate may qualify for administration under § 304.<sup>102</sup>

The Eleventh Circuit reasoned that, although the U.S. Bankruptcy Code's definition of "person," and therefore its definition of "debtor," excludes insolvent decedents' estates,<sup>103</sup> this exclusion did not apply in the context of a case ancillary to a foreign proceeding under § 304. The court viewed this conclusion as a sensible resolution of an anomaly in the definition of "foreign proceeding." On the one hand, the definition of "foreign proceeding" makes reference to "the debtor,"<sup>104</sup> thereby suggesting "that the subject of the foreign proceeding must qualify as a 'debtor' under United States bankruptcy law."<sup>105</sup> On the other hand, the definition of "foreign proceeding" states that "foreign proceeding" means "'proceeding . . . whether or not under bankruptcy law . . . for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization,'"<sup>106</sup> thereby providing "that the foreign proceeding need not even be a bankruptcy proceeding, either under

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<sup>101</sup>844 F.2d 1562 (11th Cir. 1988), *cert. denied*, 488 U.S. 1034 (1989).

<sup>102</sup>*Goerg*, 844 F.2d at 1568.

<sup>103</sup>More specifically, the court reasoned as follows—§ 101(13) defines "debtor" as a "person or municipality." 11 U.S.C.A. § 101(13) (West 1991). Under section 101(41) the term "person" "includes individual, partnership, and corporation, but does not include governmental unit." 11 U.S.C.A. § 101(41) (West 1991). However, the U.S. Bankruptcy Code did not exclude decedents' estates from the definition of "person"; the word "includes" in the definition of "person" is not limiting. *See* 11 U.S.C.A. § 102(3) (West 1991) (rules of construction). Nevertheless, Congress intended to exclude insolvent decedents' estates from the definition of "person." First, Congress listed "person" and "estate" separately in the definition of "entity." 11 U.S.C.A. § 101(15) (West 1991). Second, the legislative history states that "[t]he definition [of person] does not include an estate or trust." H.R. REP. NO. 595, 95th Cong., 1st Sess. 313, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6270; S. REP. NO. 989, 95th Cong., 2d Sess. 25, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5811. And lastly, U.S. courts have uniformly agreed that insolvent decedents' estates are ineligible for relief under the U.S. Bankruptcy Code. *Goerg*, 844 F.2d at 1565–66. The *Goerg* court failed to mention that under § 109(a) "only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under [title 11]." 11 U.S.C.A. § 109(a) (West 1991) (*emphasis added*).

<sup>104</sup>11 U.S.C.A. § 101(23) (West 1991). *See supra* note 59.

<sup>105</sup>*Goerg*, 844 F.2d at 1566.

<sup>106</sup>*Id.* (quoting 11 U.S.C. § 101(22) (Supp. IV 1986), now 11 U.S.C.A. § 101(23) (West 1991) (*emphasis added by court*)).

foreign or United States law.”<sup>107</sup> In addition, “‘foreign proceeding’ includes a proceeding ‘for the purpose of liquidating an estate,’” even though a decedent’s estate does not qualify as a “debtor” under the U.S. Bankruptcy Code.<sup>108</sup>

The court resolved this anomaly by examining the purposes behind § 304. The court reasoned that Congress enacted § 304 to improve the efficiency of foreign insolvency proceedings involving assets in the United States. Since § 304 was intended to make ancillary administrations available in aid of foreign proceedings and not to require the commencement of full bankruptcy administrations, “it would make little sense to require that the subject of the foreign proceeding qualify as a ‘debtor’ under United States bankruptcy law.”<sup>109</sup> Therefore, the court concluded that:

the debtor in a section 304 proceeding need not qualify as a ‘debtor’ under the [U.S. Bankruptcy] Code’s definition of that term. Rather, the debtor need only be properly subject, under applicable foreign law, to a proceeding commenced ‘for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization.’<sup>110</sup>

This conclusion rightly furthers the use of § 304 as a procedural device to assist primary foreign proceedings,<sup>111</sup> and increases the likelihood that U.S. courts will defer to foreign proceedings that are somewhat different from their U.S. counterparts (assuming, of course, that the other criteria for granting relief have been met).<sup>112</sup>

After it is determined that the foreign debtor need only qualify for insolvency administration under foreign law to proceed under § 304, the next issue that arises is whether a foreign debtor must fulfill the other eligibility requirements that a debtor must satisfy in a full case under chapter 7 or 11; in short, whether a foreign debtor need only comply with the requirements of § 109(a), or must also comply with the requirements of § 109(b) or (d), as the case may be. Section 109(a) provides that “[n]otwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property

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<sup>107</sup>*Id.* at 1566–67.

<sup>108</sup>*Id.* at 1567 (quoting 11 U.S.C. § 101(22) (Supp. IV 1986), now 11 U.S.C.A. § 101(23) (West 1991)).

<sup>109</sup>*Id.* at 1568.

<sup>110</sup>*Id.* Implicit in the court’s conclusion is that the foreign debtor also need not qualify as a “person” under the U.S. Bankruptcy Code’s definition of that term.

<sup>111</sup>Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 740–41. See also Gallagher & Hartje, *supra* note 5, at 4.

<sup>112</sup>See Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 740–43. The *Goerg* court asserted that “it would make eminent sense for Congress to define expansively the class of foreign insolvency proceedings for which ancillary assistance is available.” *Goerg*, 844 F.2d at 1568. Congressional action certainly could resolve the confusion in this area.

After the foreign representative in *Goerg* filed an amended and restated § 304 petition, the bankruptcy court “entered an order abstaining from or, alternatively, dismissing jurisdiction pursuant to 11 U.S.C. § 305.” *In re Goerg*, 930 F.2d 1563, 1565 (11th Cir. 1991).

in the United States, or a municipality, may be a debtor under [title 11]."<sup>113</sup> Section 109(b)(3) provides that a person may be a debtor under chapter 7 (or under chapter 11, pursuant to § 109(d)<sup>114</sup>) only if such a person is not "a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in such business in the United States."<sup>115</sup> The courts in *In re Gee*<sup>116</sup> and *In re Lines*<sup>117</sup> held that the foreign debtor need only comply with § 109(a), since a § 304 case is not a case under chapter 7 or 11.<sup>118</sup> Two other courts, in *In re Culmer*<sup>119</sup> and *Angulo v. Kedzep Ltd.*,<sup>120</sup> however, have required that the foreign debtor also fulfill the requirements of § 109(b).<sup>121</sup> Of these two approaches, the *Gee* and *Lines* approach is the more sensible one, and is consistent with the approach taken by the *Goerg* court. By filing a petition under § 304, the foreign representative seeks the assistance of a U.S. bankruptcy court in aid of a primary proceeding abroad, and not the commencement of a full case under chapter 7 or 11 and the related protections of the U.S. Bankruptcy Code, and therefore the criteria contained in § 109(b) or (d) should not apply.<sup>122</sup> Also, for the purposes of satisfying § 109(a), some courts have held that the foreign debtor's assets may include assets allegedly fraudulently transferred to third parties.<sup>123</sup>

The courts in a number of § 304 cases have further required that to qualify for § 304 relief the foreign debtor must meet the jurisdictional requirement

<sup>113</sup>11 U.S.C.A. § 109(a) (West 1991).

<sup>114</sup>*Id.* § 109(d).

<sup>115</sup>*Id.* § 109(b)(3).

<sup>116</sup>53 B.R. 891 (Bankr. S.D.N.Y. 1985).

<sup>117</sup>81 B.R. 267 (Bankr. S.D.N.Y. 1988).

<sup>118</sup>*Gee*, 53 B.R. at 900 ("since a [section] 304 case is one which does not administer an estate as such but simply aids a foreign bankruptcy, there is little reason to exclude a debtor ineligible for chapter 11 relief from being the subject of a case under section 304"); *Lines*, 81 B.R. at 271 ("[a]n ancillary proceeding under § 304 is not a Chapter 7 proceeding or a Chapter 11 proceeding; nor is it a full scale bankruptcy proceeding. Thus, sections 109(b) and (d), by their terms, simply do not apply"). See also 2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 109.01 at 109-4; Gitlin & Flaschen, *supra* note 62, at 317, 319.

<sup>119</sup>25 B.R. 621 (Bankr. S.D.N.Y. 1982).

<sup>120</sup>29 B.R. 417 (S.D. Tex. 1983).

<sup>121</sup>*Culmer*, 25 B.R. at 624, where creditors filed a motion to dismiss the § 304 petition on the ground that the debtor did not comply with the requirements of § 109(b)(3). The court denied the motion on finding that the debtor complied with § 109(b)(3). In *Angulo*, 29 B.R. at 418, the court indicated that owning assets in the United States and qualifying as a debtor under Chapter 11 were necessary to meet the "threshold prerequisites for application of section 304".

<sup>122</sup>Gitlin & Flaschen, *supra* note 62, at 319; Gitlin, Flaschen & Grimes, *supra* note 5, at 87.

<sup>123</sup>See *Metzeler*, 78 B.R. at 678-80 (a foreign representative may bring a § 304 petition based on foreign substantive law to recover property located in the United States); *Tarricone*, 80 B.R. at 23 (the fact that the foreign debtor has no property in the United States other than "funds allegedly transferred to defendants here does not detract from the foreign representative's right to look to section 304 to recover these funds"); *In re Stuppel*, 17 B.R. 413, 415 (S.D. Fla. 1981) [hereinafter *Stuppel II*] (an allegation of a fraudulent transfer of property in the United States satisfies "the Section 304 requirement of property 'involved in' the foreign proceeding"). See 2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 304.02, at 304-6 to -7.

of having property within the appropriate judicial district in the United States.<sup>124</sup> Moreover, when conducting this "jurisdictional analysis, the laws in the foreign proceeding are determinative of whether the foreign bankrupt has assets located in the district in which the § 304 petition was filed."<sup>125</sup>

Because § 304 cases generally involve an *in rem* proceeding limited to the debtor's assets in the United States,<sup>126</sup> such a jurisdictional requirement will rarely create an obstacle for a foreign representative. However, such an obstacle arose in *Gee*—the foreign representative sought discovery of parties (including access to corporate books and records and the testimony of corporate officials) in the Southern District of New York, but the foreign debtor did not have any assets in the district.<sup>127</sup> In turning to § 109(a), the *Gee* court correctly read § 109(a)'s listing of "a place of business, or property" in the disjunctive.<sup>128</sup> Although the foreign debtor did not have assets in the United States, it did have a place of business in the United States and therefore satisfied the threshold requirements of § 109(a).<sup>129</sup> The *Gee* decision is a flexible response under § 304 that accommodates the interests of the foreign proceeding. In light of the holding in *Gee*, fulfilling any one of the alternatives in § 109(a) should satisfy the prerequisites of that section.<sup>130</sup>

In sum, to meet the threshold requirements for relief under § 304(a), the foreign representative must establish that: (1) a foreign proceeding has been commenced in the appropriate jurisdiction; (2) the petitioner has been duly appointed in the foreign proceeding; (3) the foreign debtor qualifies as a debtor under foreign law; (4) the foreign representative is authorized under foreign law to commence proceedings in the United States regarding the foreign debtor's property or the administration of the foreign debtor's estate and, if need be, the foreign substantive law has extra-territorial effect; (5) the foreign debtor has complied with at least one of the § 109(a) criteria; and (6) if need be, the debtor has assets in the relevant district.<sup>131</sup>

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<sup>124</sup>See *Goerg*, 844 F.2d at 1568, n.14; *Koreag*, 130 B.R. at 711; *In re Trakman*, 33 B.R. 780, 783 (Bankr. S.D.N.Y. 1983); *Toga*, 28 B.R. at 167; *Stuppel II*, 17 B.R. at 415.

<sup>125</sup>*Koreag*, 130 B.R. at 711 (citing *Toga*, 28 B.R. at 167).

<sup>126</sup>See 2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 304.05[1], at 304–12.

<sup>127</sup>No jurisdictional issue appears to have been raised in *Angulo*, an earlier case involving a § 304 petition requesting discovery. In that case, citing *Stuppel II*, the court stated that the debtor had assets in the United States and therefore met the threshold requirements for the application of § 304; but "[t]he court did not hold that the presence of assets was mandatory." *Gee*, 53 B.R. at 898 (citing *Angulo*, 29 B.R. at 418) (emphasis added).

<sup>128</sup>11 U.S.C.A. § 109(a) (West 1991). *Gee*, 53 B.R. at 899, 900. See Gitlin & Flaschen, *supra* note 62, at 319; Gitlin, Flaschen & Grimes, *supra* note 5, at 87.

<sup>129</sup>*Gee*, 53 B.R. at 899, 900.

<sup>130</sup>Gitlin & Flaschen *supra* note 62, at 319; Gitlin, Flaschen & Grimes, *supra* note 5, at 87.

<sup>131</sup>See Gitlin & Flaschen, *supra* note 62, at 319 (noting three of these factors); Gitlin, Flaschen & Grimes, *supra* note 5, at 87 (noting four of these factors).

In addition to satisfying these criteria, the foreign representative must commence the § 304 case in the proper district to satisfy the venue requirements contained in § 1410 of title 28 of the United States Code.<sup>132</sup> If the foreign representative seeks to enjoin the commencement or continuation of an action or proceeding, or the enforcement of a judgment, the case may be commenced only in the district in which the action or proceeding against which the injunction is sought is pending.<sup>133</sup> If the foreign representative seeks to enjoin the enforcement of a lien against the property of a foreign debtor, or to require the turnover of property of the foreign debtor's estate, the case may be commenced only in the district in which such property is found.<sup>134</sup> A case in which the foreign representative seeks any other relief may be commenced only in the district in which is located the foreign debtor's principal place of business or principal assets in the United States.<sup>135</sup>

It appears from § 1410 of title 28 that, if the foreign representative wants to protect the assets of the foreign debtor that are located in more than one district, then the foreign representative must commence a § 304 case in each district in which such property is located.<sup>136</sup> The foreign representative could then move "in the interest of justice or for the convenience of the parties" under § 1412 of title 28 to consolidate the cases in one district.<sup>137</sup>

### 3. Form of Relief

The venue requirements discussed above in effect require the foreign representative to specify in the petition the form of relief sought under

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<sup>132</sup>28 U.S.C.A. § 1410 (West 1991).

<sup>133</sup>*Id.* § 1410(a). See, e.g., *In re Officina Conti*, S.R.L., 118 B.R. 392, 394 (Bankr. D.S.C. 1989) (an active dispute between the debtor and one of its creditors about the enforcement and collection of the creditor's unsatisfied judgment constitutes a pending "action or proceeding" satisfying the requirements of § 1410(a)); *In re Banco de Descuento*, 78 B.R. 337, 338 (Bankr. S.D. Fla. 1987) ("28 U.S.C. § 1410(a) provides that an 11 U.S.C. § 304 petition may be heard in the District in which an action against which an injunction is sought is pending"); *Culmer*, 25 B.R. at 634.

<sup>134</sup>28 U.S.C.A. § 1410(b) (West 1991). See, e.g., *Officina Conti*, 118 B.R. at 394 (seeking the turnover of cash from a South Carolina creditor in South Carolina would support venue under 11 U.S.C. § 1410(b)); *Banco de Descuento*, 78 B.R. at 338; *Culmer*, 25 B.R. at 634.

<sup>135</sup>28 U.S.C.A. § 1410(c) (West 1991).

<sup>136</sup>1 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 3.02[3][b] at 3-151 to -152; Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 744. However, an argument could be made, consistent with the statement in *Culmer* that a "[c]ourt is free to broadly mold relief in near blank check fashion," *Culmer*, 25 B.R. at 624, that the court in a single § 304 case has the power to enjoin actions against the foreign debtor's property throughout the United States. See Gallagher & Hartje, *supra* note 5, at 5. In fact, some courts have ordered nationwide § 304 relief, although they did not directly address this issue. See *In re Banco Nacional de Obras y Servicios Publicos, S.N.C.*, 91 B.R. 661, 662 (Bankr. S.D.N.Y. 1988) [hereinafter *Banobras*]; *Lineas Aereas de Nicaragua S.A.*, 10 B.R. 790, 791 (Bankr. S.D. Fla. 1981) [hereinafter *Lineas I*]. If ordering such relief, the bankruptcy court, however, probably could not enjoin another court, and should "make recommendations to the district court under 28 U.S.C. § 157(c)(1)." 1 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 3.01[8][b] at 3-119.

<sup>137</sup>28 U.S.C.A. § 1412 (West 1991); Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 744.

§ 304.<sup>138</sup> Section 304(b) sets forth the types of relief, some procedural and some substantive, that a court may order under § 304. This section provides that the court may enter injunctions, order a turnover, or order other appropriate relief.<sup>139</sup> Since the connecting word “or” does not imply exclusivity as to choice,<sup>140</sup> the foreign representative, in her petition for ancillary relief, may request any combination of remedies under § 304(b).

Section 304(b)(1) authorizes the bankruptcy court to enter interim or permanent relief. In determining what relief, if any, is to be granted, “the court shall be guided by what will best assure an economical and expeditious administration of [the] estate, consistent with [the six factors enumerated in § 304(c)].”<sup>141</sup> If these criteria have been satisfied, the court may enjoin the commencement or continuation of the following: (1) any action against a foreign debtor with respect to property involved in the foreign proceeding;<sup>142</sup> (2) any action against such property itself;<sup>143</sup> (3) the enforcement of any judgment against the foreign debtor with respect to such property;<sup>144</sup> or (4) any act or any judicial proceeding to create or enforce a lien against property of the foreign debtor’s estate.<sup>145</sup> This wide range of injunctive relief enables the courts to resolve the problems caused by creditors attempting to seize assets of the foreign debtor located in the United States after insolvency proceedings against the foreign debtor have been commenced abroad.<sup>146</sup>

The automatic stay of § 362 does not apply to an ancillary proceeding under § 304, since such a proceeding does not commence a full bankruptcy case.<sup>147</sup> To prevent local creditors from dismembering the foreign debtor’s assets in the United States, the foreign representative should apply for injunctive relief (either for a temporary restraining order or a preliminary injunction)

<sup>138</sup>Powers & Mears, *supra* note 62, at 343; Given & Vilaplana, *supra* note 62, at 329–30. See 28 U.S.C.A. § 1410 (West 1991).

<sup>139</sup>11 U.S.C.A. § 304(b) (West 1991).

<sup>140</sup>*Id.* § 102(5) (rule of construction).

<sup>141</sup>*Id.* § 304(c). See text in Part II.A.4 *infra*.

<sup>142</sup>11 U.S.C.A. § 304(b)(1)(A)(i) (West 1991). See, e.g., *In re Gercke*, 122 B.R. 621, 625; (Bankr. D.D.C. 1991); *Lines*, 81 B.R. at 268, 274; *Banco de Descuento*, 78 B.R. at 340; *Culmer*, 25 B.R. at 634.

<sup>143</sup>11 U.S.C.A. § 304(b)(1)(A)(ii) (West 1991). See, e.g., *Lines*, 81 B.R. at 268, 274; *Banco de Descuento*, 78 B.R. at 340; *Culmer*, 25 B.R. at 634.

<sup>144</sup>11 U.S.C.A. § 304(b)(1)(B) (West 1991). See, e.g., *Lines*, 81 B.R. at 268, 274; *Culmer*, 25 B.R. at 634.

<sup>145</sup>11 U.S.C.A. § 304(b)(1)(B) (West 1991). See, e.g., *Lines*, 81 B.R. at 268, 274; *Culmer*, 25 B.R. at 634.

<sup>146</sup>*Salen I*, 773 F.2d at 455.

<sup>147</sup>*Interpool, Ltd. v. Certain Freight of the M/V S Venture Star*, 878 F.2d 111, 112 (3d Cir. 1989) (“[t]he filing of a section 304 petition by a foreign representative does not trigger the automatic stay; instead, the foreign representative must affirmatively request injunctive or other available relief.”); *Banobras*, 91 B.R. at 664; *Goerg*, 844 F.2d at 1568; *Gee*, 53 B.R. at 896. See also Given & Vilaplana, *supra* note 62, at 330; Gallagher & Hartje, *supra* note 5, at 6; Power & Mears, *supra* note 62, at 343. See 11 U.S.C.A. § 362 (West 1991).

under § 304(b)<sup>148</sup> or under § 105.<sup>149</sup> Once granted, such relief may later be modified.<sup>150</sup>

Under § 304(b)(2) the bankruptcy court may order the turnover of the assets of the foreign debtor's estate, or the proceeds of such assets, to the foreign representative to be administered in the foreign proceeding.<sup>151</sup> The court may also order the turnover of books and records for the purposes of discovery.<sup>152</sup> As a condition to the issuance of the turnover, the court may impose conditions to minimize possible prejudice or inconvenience to U.S. creditors. For instance, one court has required that the foreign representative compile and file with the court an inventory of all of the assets of the debtor located in the United States,<sup>153</sup> and another court has permitted two creditors to retain assets held by them in the United States pending determination of the creditors' rights under the foreign law by the foreign court.<sup>154</sup> Likewise, a court should be able to condition a turnover order on allowing creditors with small claims (who may be prejudiced by being forced to prove their claims abroad) to prove their claims in the United States instead.<sup>155</sup> However, although a court has held to the contrary,<sup>156</sup> a court should not be permitted to condition a turnover order on the foreign representative's representations that none of the assets will be removed from the United States and that the assets will "be applied primarily to satisfy the debts owing to the U.S. creditors."<sup>157</sup> The effect of the turnover

<sup>148</sup>See, e.g., *Banobras*, 91 B.R. at 664 (granting "broad injunctive relief, which is specifically permitted and so typically granted in a section 304 case, [and] is not unlike the injunction which is automatic in a chapter 7 or 11 case pursuant to section 362 of the [U.S. Bankruptcy] Code"); *Lines*, 81 B.R. at 268. See also 2 COLLIER ON BANKRUPTCY, *supra* note 64, ¶ 304.03[2] at 304-8; Gallagher & Hartje, *supra* note 5, at 7; Given & Vilaplana, *supra* note 62, at 331; Powers & Mears, *supra* note 62, at 343.

<sup>149</sup>See 2 COLLIER ON BANKRUPTCY, ¶ 105.02 at 105-5; Fed. R. Bankr. P. 7065 (West 1991); Given & Vilaplana, *supra* note 62, at 331; Powers & Mears, *supra* note 62, at 343.

Section 105 sets forth the equitable powers of the bankruptcy court. This section provides in part: "(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. . . . (b) Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title." 11 U.S.C.A. § 105 (West 1991).

<sup>150</sup>See *Banobras*, 91 B.R. at 664.

<sup>151</sup>11 U.S.C.A. § 304(b)(2) (West 1991). *Koreag*, 130 B.R. at 716; *Banco de Descuento*, 78 B.R. at 340; *Culmer*, 25 B.R. at 634. Compare *Lineas I*, 10 B.R. at 791 (turnover granted, upon the condition that none of the assets would be removed from the United States).

As noted by the Commission on the Bankruptcy Laws of the United States, "The authorization for a turnover order at the behest of a foreign trustee or other representative extends a rule developed in this country in cases involving the administration of decedents' estates and receiverships." COMMISSION REPORT, *supra* note 66, section 4-103 n.2.

<sup>152</sup>*Gee*, 53 B.R. at 905.

<sup>153</sup>*Lineas I*, 10 B.R. at 791.

<sup>154</sup>*Culmer*, 25 B.R. at 634. In non-section 304 cases, bankruptcy courts have conditioned such turnover orders on prepaying administrative expenses and priority claims and providing for the payment of reasonable disbursements to be incurred in the ancillary proceeding. See *IBB Turnover Orders*, *supra* note 58; *Axona*, 88 B.R. at 618.

<sup>155</sup>See the earlier non-§ 304 case, *Norske Lloyd*, 242 N.Y. at 167-68. See also *Lam*, *supra* note 62, at 490.

<sup>156</sup>*Lineas I*, 10 B.R. 790.

<sup>157</sup>*Id.* at 791.

order should be to enable the foreign jurisdiction to administer and distribute the assets under foreign law and to further the principle of equality of distribution, rather than to benefit local creditors under U.S. law.<sup>158</sup>

Section 304(b)(3) authorizes the bankruptcy court to "order other equitable relief."<sup>159</sup> This catchall provision is consistent with the congressional intent to provide bankruptcy courts with "maximum flexibility in handling ancillary cases."<sup>160</sup> One court has relied on these legislative comments to claim that a court in a § 304 case "is free to broadly mold appropriate relief in near blank check fashion."<sup>161</sup> Courts have ordered a variety of relief under this section. For instance, the court handling an ancillary case involving a Nicaraguan company<sup>162</sup> authorized the foreign representative to operate the debtor's business in the United States<sup>163</sup> (although a foreign representative does not have the status of a trustee or debtor in possession under § 304(b)(3)) and appointed a "co-trustee whose authority and responsibility [did] not extend beyond the debtor's assets and affairs in [the United States]."<sup>164</sup> Unfortunately, this court relied on the reference to "maximum flexibility" in the legislative history as authority for issuing these orders to protect the interests of U.S. creditors engaged in a dispute with the foreign representative, rather than to protect all creditors in general. However, the court did acknowledge some limitations on its authority under § 304 and noted that, since a foreign representative derives his authority from the foreign court, a U.S. bankruptcy court may not remove or replace a foreign representative in a § 304 case.<sup>165</sup>

In other applications of § 304(b)(3), courts have allowed foreign representatives to conduct discovery<sup>166</sup> or to seek relief from the automatic stay in a chapter 11 case;<sup>167</sup> enjoined an action in a U.S. court to reduce a claim to judgment and allowed a foreign court to decide when and where the claim of a U.S. creditor should be adjudicated (thereby refusing to enforce a choice of forum clause in a contract between the debtor and a U.S. creditor);<sup>168</sup> and allowed a foreign court to interpret a contract under U.S. law.<sup>169</sup> As one commen-

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<sup>158</sup>See *Koreag*, 130 B.R. at 713-14; *Culmer*, 25 B.R. at 632; *Gitlin, Flaschen & Grimes*, *supra* note 5, at 80.

<sup>159</sup>11 U.S.C.A. § 304(b)(3) (West 1991).

<sup>160</sup>See H.R. REP. NO. 595, 95th Cong., 1st Sess. 325, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6281; S. REP. NO. 989, 95th Cong., 2d Sess. 35, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5821.

<sup>161</sup>*Culmer*, 25 B.R. at 624.

<sup>162</sup>*Lineas I*, 10 B.R. 790; *In re Lineas Areas de Nicaragua, S.A.*, 13 B.R. 779, 780 (Bankr. S.D. Fla. 1981) [hereinafter *Lineas II*].

<sup>163</sup>*Lineas I*, 10 B.R. at 791.

<sup>164</sup>*Lineas II*, 13 B.R. at 780.

<sup>165</sup>*Id.* at 780.

<sup>166</sup>*Gee*, 53 B.R. at 899, 905; *Angulo*, 29 B.R. at 419. See also *Honsberger*, *supra* note 5, at 654; 2 COLLIER BANKRUPTCY PRACTICE GUIDE, *supra* note 64, ¶ 19.09[3] at 19-19.

<sup>167</sup>*Tarricone*, 80 B.R. 21.

<sup>168</sup>*Gercke*, 122 B.R. at 626, 632, 634.

<sup>169</sup>*Id.* at 632-33; *Lines*, 81 B.R. at 273.

tator has argued, § 304(b)(3) should also authorize a court to enjoin a debtor from interfering with the foreign representative's administration of a § 304 proceeding.<sup>170</sup>

One of the major conflicts under § 304(b)(3) is what, if any, avoidance powers are available to the foreign representative in an ancillary case. A minority view is that under § 304 the foreign representative may not exercise avoidance powers. This view derives some support from comments in the legislative history and by a few commentators.<sup>171</sup>

The case law on point, however, rejects this narrow view of section 304 and supports the proposition that an avoidance action may be brought in an ancillary proceeding.<sup>172</sup> For example, in *In re Culmer*<sup>173</sup> the court stated in dicta that "it has always been contemplated that United States ancillary proceedings might be used by foreign liquidators to avoid American preferences and protect assets for foreign administration."<sup>174</sup> Once a bankruptcy court has determined that an ancillary proceeding meets the statutory criteria in § 304(c):

Creditors who purport to obtain liens on the property of a foreign debtor prior to his representative's filing of an ancillary petition are no longer entitled to have those liens, which are inherently preferential, exist free of the claims of other creditors similarly situated merely because the domiciliary bankruptcy proceeding is foreign and they have been able to beat the 'foreign representatives' in a race to an American courthouse.<sup>175</sup>

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<sup>170</sup>Lam, *supra* note 62, at 490.

<sup>171</sup>Section 4-103(b) (a predecessor draft provision of § 304) "does not override the general American rule of conflict of laws that foreign trustees may not defeat rights acquired by local creditors through levy on local assets." COMMISSION REPORT, *supra* note 66, section 4-103 n.3; 2 COLLIER BANKRUPTCY PRACTICE GUIDE, *supra* note 64, ¶ 19.10[4] at 19-20 to -21 (citing *id.*).

<sup>172</sup>See *Tarricone*, 80 B.R. at 23-24; *Metzler*, 78 B.R. at 676-79; *In re Egeria Societa per Azioni de Navigazione*, 26 B.R. 494, 497 (Bankr. E.D. Va. 1983) [hereinafter *Egeria II*], *rev'd on other grounds sub nom.* Ciel y Cia. S.A. v. Nereide Societa di Navigazione per Azioni, 28 B.R. 378 (E.D. Va. 1983), *appeal dismissed sub nom.* Ciel y Cia. S.A. v. Commissioner of Egeria Societa di Navigazione per Azioni, 723 F.2d 900 (4th Cir. 1983); *Gee*, 53 B.R. at 898-99; *Culmer*, 25 B.R. at 633; *In re Comstat Consulting Servs. Ltd.*, 10 B.R. 134, 135 (Bankr. S.D. Fla. 1981) [hereinafter *Comstat*]. See also *Florida Peach Corp.*, 63 B.R. at 836 (in this chapter 11 case the court discussed an avoidance action brought in an earlier related ancillary case); *Axona*, 88 B.R. at 600-01 (foreign representatives' U.S. counsel believed that a foreign representative could not exercise a trustee's avoidance powers under U.S. law in a § 304 case, and therefore recommended that the foreign representatives commence a full case under § 303(b)(4)).

<sup>173</sup>25 B.R. 621 (Bankr. S.D.N.Y. 1982).

<sup>174</sup>*Id.* at 633 (citing *Finabank*, 568 F.2d 911). It should be noted, however, that neither *Culmer* nor *Finabank* involve the issue of whether §§ 547 and 548 of the U.S. Bankruptcy Code or their predecessor provisions of the U.S. Bankruptcy Act apply to ancillary bankruptcy proceedings under U.S. law. *Metzler*, 78 B.R. at 676-77 n.2.

<sup>175</sup>Gallagher & Hartje, *supra* note 5, at 14.

If § 304 is to be useful to foreign representatives it is imperative that foreign representatives be allowed to avoid preferences and fraudulent transfers in ancillary proceedings under § 304.

However, there is some disagreement about which avoidance powers the foreign representative should be allowed to exercise. Two early § 304 cases applied the avoidance powers provided in the U.S. Bankruptcy Code.<sup>176</sup> One court approved a consensual agreement to apply U.S. avoidance powers and claimed "that the 'petition' specified in § 547 is the petition filed in this court under § 304."<sup>177</sup> The other court applied § 547 in determining whether preferences existed, and relied on the reference to "preferential or fraudulent dispositions of property of such estate" in § 304(c)(3) as authority to do so.<sup>178</sup> This approach, which applies U.S. avoidance powers in § 304 cases, is misguided.

To treat creditors equally worldwide, foreign representatives in section 304 cases should exercise the avoidance powers under foreign law, and not the avoidance powers contained in the U.S. Bankruptcy Code:

With respect to the exercise of avoidance powers, the foreign representative should be limited to the powers available under the laws of the state where the foreign proceeding is pending. The section 304 court's task should be to assist implementation of the foreign court's decrees (when not contrary to fundamental domestic policies), not to provide the foreign representative with the benefit of American avoidance powers, which may be better (from a debtor's perspective) than those available in the foreign court.<sup>179</sup>

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<sup>176</sup>See 11 U.S.C.A. § 544(a) (West 1991) (strong arm powers as hypothetical lien creditor or bona fide purchaser); *id.* § 544(b) (trustee as successor to certain actual unsecured creditors); *id.* § 545 (statutory liens); *id.* § 546 (limitations on avoidance powers); *id.* § 547 (preferences); *id.* § 548 (fraudulent transfers); *id.* § 549 (postpetition transfers).

<sup>177</sup>*Comstat*, 10 B.R. at 135.

<sup>178</sup>*Egeria II*, 26 B.R. at 497. See 11 U.S.C.A. § 304(c)(3) (West 1991). See also *In re Papeleras Reunidas, S.A.*, 92 B.R. 584, 591-93 (Bankr. E.D.N.Y. 1988) [hereinafter *Papeleras*] (considering the possibility that fraudulent conveyances and preferences would result under U.S. law if the court deferred to foreign proceedings).

<sup>179</sup>Gitlin & Flaschen, *supra* note 62, at 319. However, by including the proviso "when not contrary to fundamental domestic policies," Gitlin and Flaschen leave open the possibility that a U.S. court should not apply foreign avoidance powers if such powers do not exist under U.S. law. *Id.* at 321. Such a proviso is inappropriate. Rather, the proviso should read "unless fundamentally unfair." See Trautman, *supra* note 62, at 56. The benchmark should not be whether the foreign avoidance powers are different from those in the United States, but rather whether such powers deviate from the principle of equality of treatment. See *id.* Other commentators agree:

The application of American preference rules to a foreign bankruptcy carries with it the inherent possibility of a transaction being a preference in one place and not another (similar transactions being treated differently by reason of the application of different law). Thus, there is an inherent inequality of distribution of the type that [section] 304 is designed to avoid.

Gallagher & Hartje, *supra* note 5, at 18.

The court in *In re Metzeler*<sup>180</sup> held that "a foreign representative may assert, under § 304, only those avoiding powers vested in him by the law applicable to the foreign estate."<sup>181</sup> (A related case also adopted this approach,<sup>182</sup> and two other cases implicitly support such an approach.<sup>183</sup>) In reaching its decision to allow a West German foreign representative to bring an avoidance action, as permitted under the West German Bankruptcy Act, the *Metzeler* court noted that "neither § 547 nor § 548 contains any indication that the avoidance powers contained therein are to be vested in a foreign representative."<sup>184</sup> Moreover, the assertion of such powers would be "inconsistent with the overall purpose of § 304: to afford comity through ancillary administration."<sup>185</sup> Next, the court ascertained that West German bankruptcy law had transnational effect and vested the West German liquidator with the power to avoid transactions abroad.<sup>186</sup>

The *Metzeler* approach is correct. Once a U.S. court ascertains that a foreign bankruptcy should be recognized and assisted by an ancillary administration in the United States, creditors worldwide will be treated most fairly if the avoidance law of the primary administration (if by its own terms it is applicable to the property in the United States) is applied in the ancillary administration.<sup>187</sup>

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<sup>180</sup>78 B.R. 674 (Bankr. S.D.N.Y. 1987).

<sup>181</sup>*Id.* at 677.

<sup>182</sup>*Tarricone*, 80 B.R. at 23-24.

<sup>183</sup>*Gee*, 53 B.R. at 898-99. The *Gee* court rejected the notion that a foreign representative could exercise the avoidance powers under the U.S. Bankruptcy Code in a § 304 case, *id.* at 896, and there is some language in the decision that indicates that the court rejected the application of all avoidance powers in the § 304 context. *Id.* However, elsewhere in the decision the court noted that one of the reasons why the foreign representative wanted to conduct discovery was to ascertain whether certain "assets may be in New York or may have been fraudulently transferred out of New York." *Id.* at 894. It is doubtful that the court would have permitted discovery to ascertain whether fraudulent transfers had occurred, if it was not also willing to allow the foreign representative to avoid such transfers. See *Metzeler*, 78 B.R. at 678. The application of avoidance powers under foreign law would therefore be consistent with the *Gee* decision, given that the court rejected the application of such powers under U.S. law. Compare *Angulo*, 29 B.R. at 419 (this case, in which discovery was also granted, would be consistent with the application of avoidance powers under either U.S. or foreign law).

Lastly, although the *Culmer* court did not address the issue of which avoidance law to apply, by ordering that the foreign debtor's property in the United States be turned over to the foreign liquidators and be administered in the foreign courts under foreign law, *Culmer* supports an approach in which the law of the foreign jurisdiction is applied. Thus, Gallagher and Hartje (who represented the foreign representative in that case) claim that *Culmer* "negated the idea that an American creditor was entitled to have his claim resolved by American law." Gallagher & Hartje, *supra* note 5, at 14.

<sup>184</sup>*Metzeler*, 78 B.R. at 677.

<sup>185</sup>*Id.*

<sup>186</sup>Among the provisions cited by the court were sections 36 and 37(1) of the *Konkursordnung* [the "West German Bankruptcy Act"]. Section 36 provides that "authority to exercise the right of avoidance lies with the Trustee" and section 37 "provides that 'everything alienated, given away or surrendered by the avoidable act from the property of the bankruptcy estate shall be restored to the bankrupt's estate.'" *Id.* at 677 (citing §§ 36, 37(1) West German Bankruptcy Act).

<sup>187</sup>See text accompanying *infra* note 303. See also *Tarricone*, 80 B.R. at 23-24, where the court stated that "[a] foreign representative may bring a section 304 petition based on foreign substantive law to recover property located in this country," but the court went on to find that "the foreign representative ha[d] not pleaded any substantive foreign law which would [have] support[ed] his claim." *Id.* at 24.

Moreover, the *Metzeler* approach to avoidance actions should be extended to the applications of other substantive laws under § 304(b)(3). A few commentators are correct in proposing that *all* substantive law to be applied—including the rules relating to the distribution of the debtor's assets, to priorities among creditors, and to the effects of an adjudication of bankruptcy—should be governed by the law of the primary proceeding.<sup>188</sup> This proposition, which furthers the equal treatment of creditors, flows naturally from the idea that an ancillary proceeding under § 304 is intended to assist the primary proceeding abroad.

#### 4. Criteria for Granting Relief under § 304

Before issuing an injunction, turnover order, or other relief under § 304(b), the bankruptcy court must consider the factors listed in § 304(c). Section 304(c) mandates that the court “shall be guided by what will best assure an economical and expeditious administration” of the foreign debtor's estate consistent with six factors:

- (1) just treatment of all holders of claims against or interests in such estate;<sup>189</sup>
- (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
- (3) prevention of preferential or fraudulent dispositions of property of such estate;
- (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
- (5) comity; and
- (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.<sup>190</sup>

The legislative history openly states:

These guidelines are designed to give the court the maximum flexibility in handling ancillary cases. Principles of international comity and respect for the judgments and laws of other nations suggest that the court be permitted to make the appropriate

<sup>188</sup>Trautman, *supra* note 62, at 58, 56–57; Gallagher & Hartje, *supra* note 5, at 15, 19. Of course, application of the foreign substantive law would first have to satisfy the § 304(c) criteria. See *infra* note 303 and accompanying text.

<sup>189</sup>Many commentators have emphasized this factor. See, e.g., Lowell, *supra* note 11, at 264. Professor Kurt H. Nadelmann, one of the twentieth century's primary advocates for equality of distribution in transnational bankruptcies, repeats throughout his writings the themes of equal treatment for all creditors worldwide and the need to prevent discrimination against foreign creditors *vis-a-vis* local creditors. See, e.g., Nadelmann, *Discrimination in Foreign Bankruptcy Laws*, *supra* note 1; Nadelmann, *Legal Treatment of Foreign and Domestic Creditors*, *supra* note 2. See also Culmer, 25 B.R. at 628.

<sup>190</sup>11 U.S.C.A. § 304(c) (West 1991).

orders under all of the circumstances of each case, rather than being provided with inflexible rules.<sup>191</sup>

The factors listed in § 304(c) are an attempt to balance territoriality concerns against universality concerns. They enable a U.S. court to recognize the extraterritorial effect of foreign bankruptcy laws and proceedings, but only after ensuring that U.S. creditors have received certain minimum protection. These six factors are also historically rooted and build on the principles elucidated by U.S. courts in transnational insolvency cases over the past two centuries.<sup>192</sup>

Factors (1) and (3) are universality factors since they envision a single distribution of the debtor's assets that would benefit *all* creditors worldwide. Factors (2), (4), and (6), on the other hand, are territoriality factors. Factor (2) requires protection of U.S. creditors, and factors (4) and (6) require that the foreign law satisfies certain requirements that exist under U.S. law.<sup>193</sup> Comity, the fifth factor, might be either a universality or a territoriality factor, depending on the interpretation given by the court.<sup>194</sup> Thus, even a court following a universality approach to § 304 would have to consider the

<sup>191</sup>H.R. REP. NO. 595, 95th Cong., 1st Sess. 325, reprinted in 1978 U.S.C.C.A.N. 5963, 6281; S. REP. NO. 989, 95th Cong., 2d Sess. 35, reprinted in 1978 U.S.C.C.A.N. 5787, 5821.

<sup>192</sup>See text accompanying *supra* notes 11 to 58.

<sup>193</sup>But see Unger, *supra* note 5, at 1172 (the "fourth factor . . . reflect[s] the universalist approach").

<sup>194</sup>But see *id.* at 1173 (comity is "more consistent with the territorial notions of bankruptcy jurisdiction"). The starting point for the definition of comity is in *Hilton v. Guyot*, 159 U.S. 113 (1895), which is discussed in the text accompanying *supra* notes 26 to 29. Comity, in the insolvency context, involves balancing the advantages of a single bankruptcy proceeding against protection of local creditors. The *Culmer* court asserted that "[a]ll of the factors listed in [s]ection 304(c) have historically been considered within a court's determination whether to afford comity to a proceeding in a foreign nation." *Culmer*, 25 B.R. at 629. But see *Morales & Deutch*, *supra* note 5, at 1593, where the court stated; "[t]he *Culmer* court misapprehended the role of comity in the interplay between factors to be considered under section 304(c). The decision goes so far as to equate section 304(c) with the comity doctrine itself, to render comity the *only* controlling criterion." Accord *Gitlin & Flaschen*, *supra* note 62, at 321 ("'[c]omity' is only one of the six criteria listed in section 304(c) to guide the court in determining whether to grant the requested relief; to promote principles of comity above the remaining five criteria would be to ignore the literal terms of the statute").

Federal notions of comity apply under §§ 304 and 305. See Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 733; Boshkoff, *American Reports*, *supra* note 60, at 63; Goldie, *supra* note 62, at 330-31. However, there is confusion as to what these notions are, and as will be seen in the discussion *infra*, the courts adjudicating matters under §§ 304 and 305 have interpreted comity inconsistently (compare, e.g., *Culmer*, 25 B.R. at 631, and *Toga*, 28 B.R. at 167). As one commentator has noted, perhaps the "interpretation of comity in *Hilton v. Guyot*, the individual states' interpretations, or some combination of the two, is to be applied [under section 304(c)(5)]. On the other hand, the provision could also be read as an invitation to the bankruptcy courts to mould a uniform federal common or decisional law." Goldie, *supra* note 62, at 330-31. The latter interpretation is surely preferable. See *id.* at 631; Boshkoff, *American Reports*, *supra* note 60, at 63; E. SCOLLES & P. HAY, *supra* note 31, § 24.35 n.5. Applying a uniform federal rule of comity that was universality-based would give the courts "maximum flexibility" in deciding § 304 issues and lead to greater consistency in results. Such an approach would also be preferable in non-§ 304 cases. See Goldie, *supra* note 62, at 346-47; Boshkoff, *American Reports*, *supra* note 60, at 63. But see *supra* note 31 for a discussion of the rule at present.

territoriality factors. Likewise, a court following a territoriality approach would have to consider the universality factors.

Commentators have recommended other factors to assist the courts in § 304 cases. For instance, John D. Honsberger suggests that the following factors should favor granting a foreign representative's petition:

- (1) where the failure to grant an order in an ancillary proceeding will require a local bankruptcy to protect local assets, necessitating concurrent bankruptcies and higher administrative costs;
- (2) where the foreign bankruptcy law is similar to that of the United States;
- (3) where the relative ease of access to the foreign country and relative ease of communication with the foreign creditors facilitates a convenient proceeding . . . ; [and]
- (4) where more creditors and a greater part of the estate of the debtor are located in the foreign country.<sup>195</sup>

Also, Timothy E. Powers and Rona R. Mears have suggested that a reciprocity requirement be added to § 304.<sup>196</sup> They conclude that “[a] demand for reciprocity by U.S. bankruptcy courts in section 304 proceedings may be necessary to provide the catalyst to initiate legislation instituting ancillary bankruptcy procedures in foreign jurisdictions.”<sup>197</sup> However, including a reciprocity requirement, “while encouraging the use of similar procedures, may exacerbate existing differences and lead to increased tensions and political stalemate rather than increased international cooperation.”<sup>198</sup> For example, given that the United States and Canada, sister common law jurisdictions, have not been able to finalize a bankruptcy treaty, a reciprocity requirement would likely further detract from, rather than improve creditor equality.<sup>199</sup> Introducing a reciprocity requirement into § 304 would also openly reject the growing tendency by U.S.

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<sup>195</sup>Honsberger, *supra* note 5, at 656.

<sup>196</sup>Powers & Mears, *supra* note 62, at 346–51. Important commentators made similar proposals when Congress debated changing the U.S. Bankruptcy Act. *Id.* at 350 n.285 (citing *Hearings*, *supra* note 2, at 1516 (statement of Prof. Stefan A. Riesenfeld); *id.* at 1445[–46] (statement of Prof. Kurt H. Nadelmann, supporting a provision giving the executive branch the power to demand reciprocity and objecting to Prof. Riesenfeld's proposal for a reciprocity provision that provided for automatic retaliation); Nadelmann, *Lessons Taught by Herstatt*, *supra* note 25, at 34). See also Nadelmann, *The Bankruptcy Reform Act*, *supra* note 5, at 38–39.

<sup>197</sup>Powers & Mears, *supra* note 62, at 351.

<sup>198</sup>Nielsen, *supra* note 5, at 556. See also Trautman, *supra* note 62, at 52 (“While comity at times connotes reciprocity, there is wide agreement that the section [304] applies without regard to the existence of similar provisions in the foreign law. Nor would reciprocity be appropriate here.”)

<sup>199</sup>See Nielsen, *supra* note 5, at 557.

courts to cooperate in cross-border insolvencies.<sup>200</sup> Congress should consider including a reciprocity requirement in § 304(c) only as a means of last resort after all other attempts by the United States to convince other countries to enact ancillary bankruptcy procedures and to recognize U.S. bankruptcy procedures have failed. Given the relative youth of § 304, that moment has not yet arrived.

The following section discusses in detail and critiques the different approaches that the courts have been following in interpreting and applying the criteria for granting relief under § 304(c).

### 5. Section 304 and Related Cases

Since the enactment of the U.S. Bankruptcy Code in 1978, the number of reported § 304 cases has been steadily increasing,<sup>201</sup> although most of

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<sup>200</sup>The debate about reciprocity has a long history. A few early cases interpreted *Hilton* as meaning "that the principle of comity is extended by the courts of [the United States] to the judgments of the courts of a foreign country to the same extent that courts in the foreign country extend the principle to judgments of the courts of [the United States]." *Kreuger & Toll*, 20 F. Supp. 964, 969 (S.D.N.Y. 1937), *aff'd on other grounds*, 96 F.2d 768. However, the *Kreuger & Toll* court, in extending comity to the judgment of a Swedish court, observed that in a later case Judge Learned Hand stated that the Supreme Court in *Hilton* "certainly did not mean to hold that an American court was to recognize no obligations or duties arising elsewhere until it appeared that the sovereign of the locus reciprocally recognized similar obligations existing here. That doctrine I am happy to say is not a part of American jurisprudence." *Kreuger & Toll*, 20 F. Supp. at 969 (emphasis added by court) (quoting *Direction der Disconto-Gesellschaft v. U.S. Steel Corp.*, 300 F. 741, 747 (S.D.N.Y. 1924), *aff'd*, 267 U.S. 22 (1925)). Modern courts generally follow Hand's interpretation of *Hilton* and recognize that "while reciprocity may in some circumstances be considered a relevant factor, proof of reciprocity is not essential for the granting of comity." *Salen I*, 773 F.2d at 460; *accord Cornfeld v. Investors Overseas Servs.*, 471 F. Supp. 1255, 1259 n.5 (S.D.N.Y. 1979), *aff'd*, 614 F.2d 1286 (2d Cir. 1979) (extending comity to a Canadian liquidation proceeding). *Compare Remington Rand Corp.-Del. v. Business Sys.*, 830 F.2d 1260, 1273 (3d Cir. 1987) (directing the district court not to recognize the order of a Dutch bankruptcy court unless the Dutch court recognized a related U.S. judgment in its proceedings: "Although reciprocity is no longer an absolute condition precedent to comity, it is always a permissible consideration, and here we believe it to be a consideration of extreme importance.") (citations omitted).

<sup>201</sup>See *Koreag*, 130 B.R. 705 (Bankr. S.D.N.Y. 1991); *In re Ernst & Young, Inc.*, 129 B.R. 147 (Bankr. S.D. Ohio 1991); *In re Gercke*, 122 B.R. 621 (Bankr. D.D.C. 1991); *In re Officina Conti, S.R.L.*, 118 B.R. 392 (Bankr. D.S.C. 1989); *Papeleras*, 92 B.R. 584 (Bankr. E.D.N.Y. 1988); *Interpool, Ltd. v. Certain Freights of M/V Venture Star*, 102 B.R. 373 (D.N.J. 1988), *appeal dismissed*, 878 F.2d 111 (3d Cir. 1989); *Banobras*, 91 B.R. 661 (Bankr. S.D.N.Y. 1988); *Goerg*, 844 F.2d 1562 (11th Cir. 1988), *cert. denied*, 488 U.S. 1034 (1989); *Lines*, 81 B.R. 267 (Bankr. S.D.N.Y. 1988); *Metzeler*, 78 B.R. 674 (Bankr. S.D.N.Y. 1987); *Banco de Descuento*, 78 B.R. 337 (Bankr. S.D. Fla. 1987); *Gee*, 53 B.R. 891 (Bankr. S.D.N.Y. 1985); *In re Trakman*, 33 B.R. 780 (Bankr. S.D.N.Y. 1983); *Angulo v. Kedzep Ltd.*, 29 B.R. 417 (S.D. Tex. 1983); *Toga*, 28 B.R. 165 (Bankr. E.D. Mich. 1983); *Egeria II*, 26 B.R. 494 (Bankr. E.D. Va. 1983), *rev'd sub nom. Ciel y Cia. S.A. v. Nereide Societa di Navigazione per Azioni*, 28 B.R. 378 (E.D. Va. 1983), *appeal dismissed sub nom. Ciel y Cia. S.A. v. Commissioner of Egeria Societa di Navigazione per Azioni*, 723 F.2d 900 (4th Cir. 1983); *Culmer*, 25 B.R. 621 (Bankr. S.D.N.Y. 1982); *In re Egeria Societa per Azioni di Navigazione*, 20 B.R. 625 (Bankr. E.D. Va. 1982) [hereinafter *Egeria I*], *rev'd sub nom. Ciel y Cia. S.A. v. Nereide Societa di Navigazione per Azioni*, 28 B.R. 378 (E.D. Va. 1983), *appeal dismissed sub nom. Ciel y Cia. S.A. v. Commissioner of Egeria Societa di Navigazione per Azioni*, 723 F.2d 900 (4th Cir. 1983); *Stuppel*, 17 B.R. 413 (S.D. Fla. 1981); *In re Lineas Areas de Nicaragua, S.A.*, 13 B.R. 779 (Bankr. S.D. Fla. 1981) [hereinafter *Lineas II*]; *In re Lineas*

these have primarily decided requests for preliminary relief or issues relating to jurisdictional or eligibility questions.<sup>202</sup> In enacting § 304, Congress

*Aereas de Nicaragua S.A.*, 10 B.R. 790 (Bankr. S.D. Fla. 1981) [hereinafter *Lineas I*]; *In re Comstat Consulting Servs.*, 10 B.R. 134 (Bankr. S.D. Fla. 1981); *In re Stuppel*, 7 B.R. 341 (Bankr. S.D. Fla. 1980) [hereinafter *Stuppel I*].

Although not controlling, § 304 is discussed at length or relied on by analogy, in several other cases. *See, e.g.*, *Ma v. Continental Bank N.A.*, 1990 U.S. App. Lexis 10017 (7th Cir. June 21, 1990); *Tarricone*, 80 B.R. 21 (Bankr. S.D.N.Y. 1987); *Remington Rand Corp.-Del. v. Business Sys.*, 830 F.2d 1260 (3d Cir. 1987); *In re Enercons Virginia, Inc.*, 812 F.2d 1469 (4th Cir. 1987); *Salen II*, 65 B.R. 466 (S.D.N.Y. 1986), *aff'd*, 825 F.2d 709 (2d Cir. 1987); *Drexel Burnham Lambert Group v. Galadari*, 777 F.2d 877 (2d Cir. 1985); *Salen I*, 773 F.2d 452 (2d Cir. 1985); *In re Florida Peach Corp. of America, Int.*, 63 B.R. 833 (Bankr. M.D. Fla. 1986); *Norton, Lilly & Co. v. Cape Lines, Ltd.*, 75 B.R. 8 (S.D.N.Y. 1985); *RBS Fabrics Ltd. v. G. Beckers & Le Hanne*, 24 B.R. 198 (S.D.N.Y. 1982); *Cornfeld v. Investors Overseas Servs.* 471 F. Supp. 1255 (S.D.N.Y. 1979), *aff'd*, 614 F.2d 1286 (2d Cir. 1979). *See also Refco F/X Assocs. v. Mebco Bank, S.A.*, 108 B.R. 29 (S.D.N.Y. 1989) (plaintiff's motion to confirm an attachment would be granted unless defendant commenced a § 304 case).

The court in *Axona*, 88 B.R. 597 (Bankr. S.D.N.Y. 1988), *aff'd*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991), also discussed § 304 and applicable case law in its decision under § 305 in ordering the suspension of a U.S. chapter 7 case and a turnover of U.S. assets to Hong Kong liquidators.

Several other cases, although not discussing § 304, have raised related transnational insolvency issues. Many of these cases involved the application of comity. *See, e.g.*, *Caddel v. Clairton Corp.*, 105 B.R. 366 (N.D. Tex. 1989) (plaintiffs pursued claims in the United States against a Canadian debtor undergoing liquidation in Canada without obtaining permission to do so from the Canadian court; the U.S. court dismissed plaintiffs' claims and granted comity to the stay in the Canadian proceedings); *Overseas Inns S.A. P.A. v. United States*, 685 F. Supp. 968 (N.D. Tex. 1988) (a Luxembourg corporation commenced suit in the United States seeking the granting of comity to a Luxembourg judgment and reorganization plan that would have enabled the foreign corporate taxpayer to satisfy its U.S. income tax obligation by paying roughly 25% of the taxes owed; the U.S. court declined to accord comity for reasons of public policy); *Kenner Prods. Co. v. Société Foncière et Financier Agache-Willot*, 532 F. Supp. 478 (S.D.N.Y. 1982) (granting comity to French bankruptcy and dismissing the suit brought in the United States by plaintiff to collect on a guaranty from the French debtor).

For a discussion of many of the foregoing cases, see Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 740-41, 745-49; Finister, *supra* note 62, at 353-70; Fischer, *supra* note 5, at 641-49; Gallagher & Hartje, *supra* note 5, at 11-21; Gitlin & Flaschen, *supra* note 62, at 315-22; Given & Vilaplana, *supra* note 62, at 333, 337, 339-40; Glosband & Katucki, *Current Developments*, *supra* note 62; Goldie, *supra* note 62, at 311-22, 326-35; Lam, *supra* note 62; Morales & Deutsch, *supra* note 5, at 1588-94; Nielsen, *supra* note 5, at 562-70; Powers & Mears, *supra* note 62, at 344-46; Trautman, *supra* note 62, at 54-55; Unger, *supra* note 5, at 1174-80.

As is apparent from the aforementioned cases, the Southern District of New York has been involved in more § 304 cases than any other district in the country. Moreover, the Southern District of New York and the Second Circuit have adopted the universality approach. *See, e.g.*, *Koreag*, 130 B.R. 705 (Bankr. S.D.N.Y. 1991); *Banobras*, 91 B.R. 661 (Bankr. S.D.N.Y. 1988); *Axona*, 88 B.R. 597 (Bankr. S.D.N.Y. 1988), *aff'd*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991); *Lines*, 81 B.R. 267 (Bankr. S.D.N.Y. 1988); *Tarricone*, 80 B.R. 21 (Bankr. S.D.N.Y. 1987); *Metzeler*, 78 B.R. 674 (Bankr. S.D.N.Y.); *Salen II*, 825 F.2d 709 (2d Cir. 1987), *aff'd* 65 B.R. 466 (S.D.N.Y. 1986); *Salen I*, 773 F.2d 452 (2d Cir. 1985), *aff'd* 49 B.R. 614 (S.D.N.Y. 1985); *Gee*, 53 B.R. 891 (Bankr. S.D.N.Y. 1985); *Culmer*, 25 B.R. 621 (Bankr. S.D.N.Y. 1982); *Cornfeld*, 471 F. Supp. 1255 (S.D.N.Y. 1979), *aff'd*, 614 F.2d 1286 (2d Cir. 1979); *In re Israel-British Bank (London) Ltd.*, No. 74-B-1322 (Bankr. S.D.N.Y. Jan. 5, 1978); *Finabank*, 568 F.2d 911 (2d Cir. 1977); *IBB*, 536 F.2d 509 (2d Cir. 1976), *cert. denied*, 429 U.S. 978 (1976).

<sup>202</sup>*See e.g.*, *Ernst & Young*, 129 B.R. 147; *Officina Conti*, 118 B.R. 392; *Goerg*, 844 F.2d 1562; *Lines*, 81 B.R. 267; *Metzeler*, 78 B.R. 674; *Banco de Descuento*, 78 B.R. 337; *Gee*, 53 B.R. 891; *Trautman*, 33 B.R.

demonstrated "a desire for greater international cooperation in transnational insolvencies."<sup>203</sup> Nevertheless, judicial reaction has been mixed—the courts have interpreted § 304 inconsistently<sup>204</sup> and have sometimes failed to follow the legislative intent that produced it.

Two distinct approaches, represented by the cases of *In re Culmer*<sup>205</sup> and *In re Toga Manufacturing Ltd.*<sup>206</sup> have emerged.<sup>207</sup> Under the *Culmer* approach, some courts have emphasized the universality factors in § 304, recognized the substantive laws of foreign jurisdictions, and granted the requested section 304 relief.<sup>208</sup> In contrast, other courts have adopted the *Toga* approach, which emphasizes the territoriality factors in § 304(c), and have applied the substantive laws of the U.S. Bankruptcy Code and refused to recognize foreign laws.<sup>209</sup>

Recently, several complex § 304 cases have arisen in which the courts have further confronted the important and difficult question of how to strike a proper balance among the § 304 factors—in other words, what protection U.S. creditors must receive in a foreign bankruptcy proceeding before a U.S. court should grant ancillary assistance under § 304 to that foreign proceeding. Two of these cases adopted the territoriality approach in resolving the issue of what notice and treatment U.S. creditors must receive in a foreign bankruptcy.<sup>210</sup> However, the third followed the universality approach in deciding whether a U.S. or foreign court should adjudicate questions arising in a § 304 case that relate to the interpretation of a U.S. collective bargaining agreement.<sup>211</sup>

#### a. *Culmer* and the Universality Approach

Of all § 304 cases, *Culmer* most completely adopts the universality approach and most comprehensively analyzes all of the factors listed in § 304(c).<sup>212</sup> Under the *Culmer* court's flexible approach, "the [c]ourt is free to broadly mold

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780; *Angulo*, 29 B.R. 417; *Egeria II*, 26 B.R. 494; *Egeria I*, 20 B.R. 625; *Stuppel II*, 17 B.R. 413; *Lineas II*, 13 B.R. 779; *Lineas I*, 10 B.R. 790; *Comstat*, 10 B.R. 134; *Stuppel I*, 7 B.R. 341. See Powers & Mears, *supra* note 62, at 345.

<sup>203</sup>Honsberger, *supra* note 5, at 670; Trautman, *supra* note 62, at 50 (quoting Honsberger, *supra*, at *id.*).

<sup>204</sup>See, e.g., Powers & Mears, *supra* note 62, at 344–45; Trautman, *supra* note 62, at 54.

<sup>205</sup>25 B.R. 621 (Bankr. S.D.N.Y. 1982).

<sup>206</sup>28 B.R. 165 (Bankr. E.D. Mich. 1983).

<sup>207</sup>See, e.g., Powers & Mears, *supra* note 62, at 344–45; Trautman, *supra* note 62, at 54.

<sup>208</sup>See, e.g., *Culmer*, 25 B.R. 621; *Koreag*, 130 B.R. 705; *Gercke*, 122 B.R. 621 (granting partial relief); *Banobras*, 91 B.R. 661 (granting partial relief); *Lines*, 81 B.R. 267; *Metzeler*, 78 B.R. 674; *Banco de Des-cuento*, 78 B.R. 337; *Gee*, 53 B.R. 891; *Angulo*, 29 B.R. 417. See also *Caddel*, 105 B.R. 366; *Salen II*, 825 F.2d 709; *Enercons*, 812 F.2d 1469; *Salen I*, 773 F.2d 452 (non-§ 304 cases). See also *Axona*, 88 B.R. 597 (§ 303(b)(4) case).

<sup>209</sup>See, e.g., *Toga*, 28 B.R. 165; *Papelebras*, 92 B.R. 584; *Interpool*, 102 B.R. 373; *Egeria II*, 26 B.R. 494; *Egeria I*, 20 B.R. 625; *Lineas II*, 13 B.R. 779; *Lineas I*, 10 B.R. 790; *Comstat*, 10 B.R. 134.

<sup>210</sup>*Papelebras*, 92 B.R. 584; *Interpool*, 102 B.R. 373.

<sup>211</sup>*Banobras*, 91 B.R. 661.

<sup>212</sup>See *Gee*, 53 B.R. at 901.

appropriate relief in near blank check fashion.”<sup>213</sup> The § 304 proceeding involved in *Culmer* was ancillary to the liquidation of Banco Ambrosiano Overseas Limited (“BAOL”) occurring in the Bahamas. BAOL, a banking company organized and licensed under Bahamian law, was engaged in the banking business in the Bahamas until the Bahamas Ministry of Finance suspended its license in July 1982. A month later, pursuant to a resolution of the BAOL shareholders in compliance with the Companies Act of the Bahamas: (i) BAOL began voluntary winding-up proceedings; (ii) joint liquidators were appointed (the “Bahamian liquidators”); and (iii) BAOL obtained an order directing that the voluntary liquidation of BAOL continue, subject to the supervision of the Bahamas Supreme Court.

At the time of the commencement of the BAOL liquidation in the Bahamas, BAOL did not do business in the United States, but (similar to Herstatt, Finabank, and IBB) maintained accounts at U.S. banks and financial institutions. The Bahamian liquidators filed a § 304 petition in the Southern District of New York in response to the attempts of U.S. creditors to attach these accounts. The petition sought a variety of injunctive relief, as well as an order that property in the United States be turned over to the Bahamas for administration in the Bahamian liquidation proceeding in accordance with Bahamian law.

The *Culmer* court began its analysis by noting that the issue of whether to grant a turnover order under § 304 was “one of first impression in this Circuit”<sup>214</sup> and then turned to the legislative history of § 304 for guidance. The bankruptcy court noted that Congress had intended that the courts have “‘maximum flexibility in handling ancillary cases’”<sup>215</sup> to enable courts to arrive at a fair result in each case.<sup>216</sup>

Next, the court responded to certain territoriality-based objections raised by creditors under § 304(c)(1), (2), (3), and (4), including their attempt “to cast doubt on the ability of the Bahamian liquidation proceeding to ensure just treatment of holders of claims.”<sup>217</sup> The court found that the creditors had failed to support such assertions—they had “submitted no concrete evidence of any wrongdoing or propensity for wrongdoing on the part of the [Bahamian L]iquidators . . . [and] no concrete facts were ever elicited tending to impugn the impartiality of the [Bahamian L]iquidators or the regularity with which the Bahamian liquidation [wa]s proceeding.”<sup>218</sup>

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<sup>213</sup>*Culmer*, 25 B.R. at 624.

<sup>214</sup>*Id.* at 627.

<sup>215</sup>*Id.* at 628 (quoting H.R. REP. NO. 595, 95th Cong., 1st Sess. 325, reprinted in 1978 U.S.C.C.A.N. 5963, 6281; S. REP. NO. 989, 95th Cong., 2d Sess. 35, reprinted in 1978 U.S.C.C.A.N. 5787, 5821).

<sup>216</sup>*Id.* at 627–28.

<sup>217</sup>*Id.* at 628.

<sup>218</sup>*Id.* See also *id.* at 233.

After disposing of the creditors' unsupported assertions, the court stated that the "central examination" to be made under § 304 is whether the relief sought would "afford equality of distribution of the available assets."<sup>219</sup> After finding that the Bahamian liquidation proceedings complied with this equality of distribution principle, the *Culmer* court found that the Bahamas Supreme Court could "best assure an economical and expeditious administration of [the BAOL] estate."<sup>220</sup> Among the factors considered by the court were that the debtor's records, preliquidation employees, and the Bahamian liquidators and their staff were all in the Bahamas; that the Bahamian liquidators were bound to comply with Bahamian law and the orders of the Bahamas Supreme Court; and that the Bahamian court could most efficiently deal with all of the debtor's creditors, both American and worldwide.<sup>221</sup>

Next, the *Culmer* court pointed out that the Bahamas had the greatest interest in the debtor's liquidation, neither the United States nor New York had any public interest in the matter,<sup>222</sup> and two creditors, each holding a claim greater than all of the claims controverting the § 304 petition, supported the Bahamian liquidation.<sup>223</sup> The court found that a ruling in favor of the objecting creditors would grant them preferences under both Bahamian and U.S. law, and that to "protect the positions of [such] fast-moving American and foreign attachment creditors" would violate the "policy favoring uniform administration in a foreign court."<sup>224</sup>

The court next turned to an analysis of comity and offered its oft-quoted observation that "[a]ll of the factors listed in [s]ection 304(c) have historically been considered within a court's determination whether to afford comity to a proceeding in a foreign nation."<sup>225</sup> The *Culmer* court was not ignoring the other criteria in § 304(c); rather it was observing that, historically, U.S. courts have considered the other § 304(c) factors when deciding whether or not to accord comity to a foreign proceeding (an accurate statement, with the possible exception of the sixth factor regarding a fresh start).<sup>226</sup> In the *Culmer* court's view, to apply the factor of comity requires a court to consider all of

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<sup>219</sup>*Id.* at 628. See also *Banco de Descuento*, 78 B.R. at 340 (quoting *Culmer*, 25 B.R. at 628).

<sup>220</sup>*Culmer*, 25 B.R. at 628 (quoting 11 U.S.C. § 304(c)(1982), now 11 U.S.C.A. § 304(c) (West 1991)).

<sup>221</sup>*Id.*

<sup>222</sup>*Id.* at 628–29. Trautman observes that the *Culmer* case was decided "on the basis of the unstated [choice of law] premise" that the Bahamas, the jurisdiction in which BAOL had its principal place of business, was the "one appropriate forum" whose law should apply to the insolvency of BAOL. Trautman, *supra* note 62, at 55.

<sup>223</sup>*Culmer*, 25 B.R. at 629.

<sup>224</sup>*Id.*

<sup>225</sup>*Id.* Other § 304 cases have adopted the *Culmer* interpretation of comity as the "most significant factor." See *Koreag*, 130 B.R. at 712; *Metzeler*, 78 B.R. at 677; *Gee*, 53 B.R. at 901.

<sup>226</sup>See cases discussed in *supra* Part I. It is not clear that any pre-*Culmer* cases considered the sixth factor.

the other factors within § 304(c).<sup>227</sup> The court did just that, and satisfied itself that the Bahamian liquidation proceeding fulfilled the criteria of § 304(c)(1), (2), (3), and (4).<sup>228</sup> In applying § 304(c)(1), the court noted that “the Bahamian Companies Act, like our own bankruptcy laws, provides a comprehensive procedure for the orderly and equitable distribution of [the debtor’s] assets,”<sup>229</sup> including requiring supervision of the liquidators by the Bahamian courts; forbidding creditors from suing the debtor, except with the prior consent of the court, and limiting creditors to claims in the liquidation; voiding all post-petition transfers, attachments, and executions; avoiding preferences and fraudulent conveyances; requiring court approval for the liquidators to make payments to any creditor or class of creditors; and not preferring the claims of Bahamian citizens.<sup>230</sup> In other words, Bahamian bankruptcy procedures, like U.S. bankruptcy procedures, ensure equality of distribution.

The court next asserted that the territoriality-based § 304(c)(2) factor was satisfied in that Bahamian law and procedure would adequately protect U.S. creditors “against prejudice and inconvenience in the processing of their claims in the Bahamian liquidation proceeding.”<sup>231</sup> Among the factors noted by the court were that Bahamian procedure requires adequate notice, liquidators are required to report quarterly to the creditors and the court, creditors may prove their claims by affidavits that may be submitted by mail, creditors had been given more than three months to submit claims, liquidators have to provide a written statement of the grounds for rejection to all creditors whose claims are rejected, creditors whose claims are rejected have a right of appeal, and the cost to the objecting U.S. creditors in processing their claims in the Bahamas was *de minimis*.<sup>232</sup> In applying § 304(c)(2), the court should have also repeated its earlier finding that the objecting creditors had not substantiated charges of fraud or impropriety regarding the Bahamian proceedings.

The court next found that § 304(c)(3) was satisfied, because Bahamian liquidation prohibits preferential or fraudulent transfers of property, and lastly that § 304(c)(4) was fulfilled since “the distribution of BAOL’s estate in the Bahamas w[ould] be substantially in accord with the order and priorities prescribed by [the U.S. Bankruptcy Code].”<sup>233</sup>

After finding that the Bahamian liquidation proceedings satisfied the § 304(c)

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<sup>227</sup>*Compare Koreag*, 130 B.R. at 712 (when considering comity, all of the other § 304(c) factors, with the exception of the sixth factor, are “inherently taken into account”). But see *Morales and Deutch*, *supra* note 5, at 1593; *Gitlin & Flaschen*, *supra* note 62, at 321. See *supra* note 194.

<sup>228</sup>*Culmer*, 25 B.R. at 629–31. Because this case involved the liquidation of a company, the sixth factor was not applicable.

<sup>229</sup>*Id.* at 629.

<sup>230</sup>*Id.* at 629–30.

<sup>231</sup>*Id.* at 630.

<sup>232</sup>*Id.*

<sup>233</sup>*Id.* at 630–31.

criteria, the court stated that affording comity to the Bahamian proceedings:

would not violate American law or public policy. Whether or not Bahamian law is identical in application to American law, there is nothing inherently vicious, wicked, immoral or shocking to the prevailing American moral sense in the Bahamian laws outlined above. Indeed, it has been shown that these Bahamian laws are not repugnant to our ideas of justice.<sup>234</sup>

The *Culmer* court then reviewed some of the pre-U.S. Bankruptcy Code case law to support its decision further. The court relied on the application of comity to the liquidation laws of Canada by the district court in *Cornfeld v. Investors Overseas Services, Ltd.*,<sup>235</sup> and noted that what *Cornfeld* had articulated about the "substantial similarity between American and Canadian bankruptcy laws may equally be said of the similarity between American and Bahamian bankruptcy law . . . [since the] English Companies Act forms the basis for both the Canadian and Bahamian liquidation rules."<sup>236</sup> Next, the court noted *Gebhard* and its claim that creditors who deal with foreign companies are on notice that they implicitly subject themselves to the foreign laws of the country of the corporation:

[L]ike the Canadian Southern bondholders, the BAOL's creditors' rights are subject to foreign laws and every BAOL creditor must be required to pursue its remedies in the Bahamian liquidation. One who invests in a foreign corporation subjects his investment to foreign law and may not seek to obtain

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<sup>234</sup>*Id.* at 631 (citations omitted).

<sup>235</sup>471 F. Supp. 1255 (S.D.N.Y. 1979), *aff'd*, 614 F.2d 1286 (2d Cir. 1979). This case, decided by a non-bankruptcy court after § 304 was enacted but before it became effective, continued the trend of greater recognition of foreign insolvency proceedings and followed a universality approach. *Cornfeld*, a former officer and director of a Canadian corporation undergoing liquidation in Canada, brought an indemnity action against the corporation. The court relegated *Cornfeld's* claims to the Canadian court and stated that "[c]omity is to be accorded a decision of a foreign court as long as that court is a court of competent jurisdiction and as long as the laws and public policy of the forum state and the rights of its residents are not violated." *Id.* at 1259. It noted that "New York has narrowly construed the exceptions to the comity doctrine: '[F]oreign-based rights should be enforced unless the judicial enforcement of such a [right] would be the approval of a transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense.'" *Id.* (citations omitted). In applying comity the court gave significant weight to the fact that the foreign country involved was Canada and that the "'well-settled policy' in New York [was] that judgments of the Canada courts [were] to be given effect under principles of comity . . . Canada is 'a sister common law jurisdiction with procedures akin to our own.'" *Id.* (quoting *Clarkson Co. v. Shaheen*, 544 F.2d 624, 630 (2d Cir. 1976) (other citation omitted)). The *Cornfeld* court also relied on *Gebhard*, which the court claimed was virtually indistinguishable from the case at bar, and referred to newly enacted §§ 304 and 305 as supporting its application of the principle of comity. *Id.* at 1260.

<sup>236</sup>*Culmer*, 25 B.R. at 631.

greater rights than his co-creditors by suing in an American court.<sup>237</sup>

The extensive relief granted by the *Culmer* court included: (1) enjoining all persons and entities from creating, obtaining, perfecting, or enforcing any setoff, restraint, lien attachment, or judgment against any asset of BAOL or of the Bahamian liquidators located in the district without the prior approval of the Bahamas Supreme Court; (2) enjoining all persons and entities from commencing or prosecuting any other action against or affecting any assets of BAOL or of the Bahamian liquidators located in the district, without the prior approval of the Bahamas Supreme Court; and (3) ordering the turnover of all funds and assets of BAOL located in the district (with the exception of an amount of approximately \$380,000 that two creditors were permitted to retain, pending determination by the Bahamas Supreme Court of their respective rights under Bahamian law to set off this sum against debts owed to them by BAOL) to the Bahamian liquidators for administration in the foreign proceeding; and (4) directing U.S. claimants to the Bahamian liquidation proceedings for resolution of the substantive issues involved in the administration of their claims.<sup>238</sup>

The *Culmer* decision has been heralded by many commentators as exemplifying how § 304 should be applied.<sup>239</sup> By granting the relief requested by the Bahamian liquidators, and thereby ordering the turnover of assets to the Bahamian proceedings, the court furthered the universality approach and helped foster cooperation in cross-border insolvencies.

How one interprets *Culmer* ultimately depends on whether one believes that in a § 304 case the law to be applied is the law of the foreign proceeding. As mentioned earlier, Professor Trautman correctly argues that, in a § 304 case, the law to be applied is the law of the jurisdiction "which would have control under a universalist approach to bankruptcy," which for a business enterprise would be the law where the debtor has its principal place of business<sup>240</sup> (assuming, of course, that the § 304(c) criteria have been met). I agree. This premise is implicit in *Culmer*, as can be seen by the court's discussion of which jurisdiction has the greatest interest in the proceedings, as well as its reliance on *Gebhard*.<sup>241</sup> However, as Professor Trautman points out, this premise should be explicitly acknowledged.<sup>242</sup>

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<sup>237</sup>*Id.* at 632. The court also relied on *Norske Lloyd*, 242 N.Y. 148, and even quoted from Lowell's 1888 law review article. *Culmer*, 25 B.R. at 632-33.

<sup>238</sup>*Culmer*, 25 B.R. at 634.

<sup>239</sup>*See, e.g.*, Powers & Mears, *supra* note 62, at 345; Given & Vilaplana, *supra* note 62, at 339-40; Gallagher & Hartje, *supra* note 5, at 13-16. *But see* Morales and Deutch, *supra* note 5, at 1593; Gitlin & Flaschen, *supra* note 62, at 321. *See also supra* note 194.

<sup>240</sup>Trautman, *supra* note 62, at 55. *See* text accompanying *supra* notes 94 to 97.

<sup>241</sup>*See* text accompanying *supra* notes 222, 237; Trautman, *supra* note 62, at 55.

<sup>242</sup>Trautman, *supra* note 62, at 55.

After finding that the foreign forum is the appropriate forum, the court should ascertain whether the other threshold requirements are met. This is the weakest part of the *Culmer* opinion. As noted earlier, the *Culmer* court wrongly required the foreign debtor to fulfill the requirements of § 109(b).<sup>243</sup> Also, the court failed to mention whether the Bahamian liquidators had authority to come to the United States to seek the protection and turnover of the foreign debtor's assets.

After addressing these preliminary issues, the court should then apply the § 304 criteria and determine whether relief should be granted. In my view, the court may do so by analyzing the factors in § 304 under a comity approach as did the *Culmer* court, or independently of comity analysis. (In my opinion, the former approach is preferable.) In either case, the court should first ascertain whether the foreign proceeding provides for the equitable and orderly treatment of creditors and applies the preeminent bankruptcy principle of equality of distribution, as the *Culmer* court did. Although it is not explicit in the court's decision, this inquiry is fulfilled by ensuring that the factors in § 304(c)(1) and (3) are satisfied. In determining whether the foreign law treats creditors justly, the court should also consider whether the foreign jurisdiction is a sister common law jurisdiction.

A universality approach under § 304 must consider the § 304(c) territoriality factors, as well. Therefore, the court should next ascertain whether the foreign proceedings prejudice or discriminate against U.S. creditors. This inquiry should be conducted under the territoriality-based factors in § 304(c)(2) and (c)(4), either independently or as part of comity analysis under § 304(c)(5). To ensure that U.S. creditors are satisfactorily protected in the foreign proceeding, the court should consider the overall fairness of the foreign proceeding's law and procedure. As Professor Trautman argues:

[U]nfairness should consist only of matters such as discriminatory treatment of foreign creditors or other unfair procedures, rather than a different rule of priority or preference among creditors. Thus, it should require a strong showing by an American creditor that the substantive law of the foreign jurisdiction was not simply different from that of the United States bankruptcy code, but was *fundamentally* unfair, before the creditor could successfully resist transfer of the assets to the foreign proceeding.<sup>244</sup>

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<sup>243</sup>See text accompanying notes 113 to 122 *supra*.

<sup>244</sup>*Id.* at 56 (emphasis added). But see Morales & Deutsch, *supra* note 5, at 1595-96 (asserting that the foreign representative should have the burden of proving that the foreign law does not prejudice U.S. creditors). The application of the § 304(c)(6) factor, as appropriate in cases involving the bankruptcy of individuals, should also be considered when ascertaining the overall fairness of the foreign proceeding.

Trautman rightly notes that "where the business of the enterprise is substantially related to several countries, arguments about expectations and fairness of course lose some of their force." Trautman, *supra*

The *Culmer* court followed a similar approach. It required that creditors produce "concrete evidence" or "concrete facts" in support of their allegations of irregularities in the Bahamian proceedings or of the partiality of the Bahamian liquidators.<sup>245</sup> The *Culmer* court also examined many of the provisions of Bahamian insolvency law before concluding that "[w]hether or not Bahamian law is identical in application to American law, there is nothing inherently vicious, wicked, immoral or shocking to the prevailing moral sense in the Bahamian laws . . . . Indeed, it has been shown that these Bahamian laws are not repugnant to our ideas of justice."<sup>246</sup>

In protecting the interests of local creditors, the court must also ascertain whether such creditors will be inconvenienced in being forced to prove their claims abroad. In making this decision, the court should apply the earlier noted principle from *Gebhard*,<sup>247</sup> as did the *Culmer* court.<sup>248</sup> However, this should not be an absolute rule: inconvenience in proving a claim abroad should be determined in reference to the size of the creditor's claim—a creditor with a large claim is less likely to be inconvenienced than a creditor holding a small claim.<sup>249</sup>

Lastly, in determining whether or not to grant the requested relief, the court should consider whether deferring to the foreign proceeding will "best assure an economical and expeditious administration" of the debtor's estate. The *Culmer* court also considered this factor.

Although the *Culmer* court's analysis of the threshold requirements could have been better and the court could have been more explicit in setting forth some of the principles underlying its § 304 analysis, these are relatively minor weaknesses in an otherwise soundly reasoned opinion. The decision is the benchmark among cases that further the universality approach and acknowledge the importance of granting ancillary assistance to bankruptcy proceedings abroad.

Several other cases have built on the principles from *Culmer* and have followed the universality approach.<sup>250</sup> Perhaps the most important is the non-§ 304 case of *Cunard Steamship Co. v. Salen Reefer Services AB*<sup>251</sup> ("*Salen I*"). In this case the debtor Salen Reefer Services, A.B. ("*Salen Reefer*"), a Swedish company, commenced a bankruptcy proceeding in Sweden on December 19, 1984. An interim administrator was appointed and actions by creditors

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note 62, at 56 n.37. Thus, in cases where the debtor's business is "substantially related" to the United States, the court might well retain control over, and apply U.S. law regarding, certain aspects of the § 304 proceeding (see *Banobras*, 91 B.R. at 667–68), or if necessary, even decide that a full plenary case under U.S. law is preferable.

<sup>245</sup>*Culmer*, 25 B.R. at 629.

<sup>246</sup>*Id.* at 631.

<sup>247</sup>See text accompanying *supra* note 237.

<sup>248</sup>*Culmer*, 25 B.R. at 631–32.

<sup>249</sup>*Id.* at 630.

<sup>250</sup>See *supra* note 208.

<sup>251</sup>773 F.2d 452 (2d Cir. 1985), *aff'g* 49 B.R. 614 (S.D.N.Y. 1985).

against *Salen Reefer* were suspended. However, on January 9, 1985, an English creditor, Cunard Steamship Company, Ltd. ("Cunard") obtained an order of attachment, which *Salen Reefer* moved to dissolve, against some of *Salen Reefer's* assets in the United States. The District Court for the Southern District of New York, relying on principles of comity, deferred to the Swedish bankruptcy proceeding and vacated the attachment. Cunard appealed the decision and in its appeal, *inter alia*, contended that the district court's order contravened the policies underlying § 304. Thus, in the appellate decision, in which the Second Circuit rejected this contention and upheld the district court's extension of comity to the Swedish adjudication (and its vacating of Cunard's attachment), there is a lengthy discussion of § 304.

In its discussion of comity the Second Circuit relied on some pre-U.S. Bankruptcy Code cases, including *Gebhard*, *Finabank*, and *IBB*. It also followed a comity approach similar to that of *Culmer*, and noted that "American courts have consistently recognized the interest of foreign courts in liquidating or winding up the affairs of their own domestic business entities."<sup>252</sup> Moreover, the court cited *Culmer* in support of the proposition that "the modern trend has been toward a more flexible approach which allows the assets to be distributed equitably in the foreign proceeding."<sup>253</sup> The *Salen I* court also noted that "creditors of an insolvent foreign corporation may be required to assert their claims against a foreign bankrupt before a duly convened foreign tribunal."<sup>254</sup>

If the case had been filed under § 304, the same result would most certainly have been reached, given that the case did not involve the claims of any U.S. creditors. Moreover, although the court in its comity analysis did not specifically cite to the factors in § 304(c), it fully discussed all of them (except for the sixth factor, which was inapplicable), and thus lent some credence to the contention of the *Culmer* court that all of the § 304(c) factors may be considered under a comity analysis. First, the court found that recognizing the Swedish bankruptcy proceedings would "facilitat[e] the orderly and systematic

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<sup>252</sup>*Id.* at 458.

<sup>253</sup>*Id.* (citing *Culmer*, 25 B.R. at 629) (other citations omitted).

<sup>254</sup>*Id.* at 458-59. See also *Salen II*, 65 B.R. 466 (S.D.N.Y. 1986). *Salen Dry Cargo A.B.* ["*Salen Dry Cargo*"] the debtor in *Salen II*, and *Salen Reefer*, the debtor in *Salen I*, were related business entities established under the laws of Sweden. Both companies filed for bankruptcy on December 19, 1984. Factually, *Salen I* and *Salen II* were indistinguishable, except for the existence of an English judgment against *Salen Dry Cargo*. *Id.* at 468. In *Salen II*, another non-§ 304 case, the district court "look[ed] to section 304, not because it govern[ed] the proceeding [at bar], but because it provide[d] the best index of how a domestic judgment would be treated if enforcement were sought against a foreign bankrupt." *Id.* at 469. The district court reasoned that, since a domestic judgment would not be enforced by a court applying § 304, the foreign judgment at bar should likewise not be enforced. *Id.* at 470. The court also noted that the Panamanian creditor's efforts to enforce the English judgment were an "attempt to effect an end run around the Swedish bankruptcy proceeding." *Id.* The *Salen II* court also noted that in *Salen I* "[t]he Second Circuit ha[d] already dictated that comity be extended to Swedish bankruptcy proceedings. *Id.* The Second Circuit affirmed. 825 F.2d 709.

distribution of the assets of *Salen* [Reefer]”<sup>255</sup> and that under Swedish law “[t]here is no indication that Cunard [would] be treated in any manner inimical to our policy of equality.”<sup>256</sup> This finding would have fulfilled the requirement of § 304(c)(1). Similarly, the fact that the Swedish court “has the power to issue orders preventing the debtor from dissipating or absconding with assets”<sup>257</sup> and that Cunard would receive a preference if its attachment were upheld would have satisfied § 304(c)(3). The factors in § 304(c)(2) and (4) would have been fulfilled by the court’s finding that “[t]he principles of Swedish bankruptcy law are not dissimilar to those of [the U.S.] Bankruptcy Code”<sup>258</sup> and that “there is no indication that Cunard [would] be prejudiced or treated unjustly if it were to participate in the Swedish bankruptcy proceedings.”<sup>259</sup> In addition, by relying on *Gebhard* the *Salen I* court also rejected the argument that Cunard would be inconvenienced or prejudiced by being forced to prove its claim abroad. It is also implicit in the *Salen I* decision that deferring to the Swedish proceedings would “best assure an economical and expeditious administration” of the debtor’s estate.

The *Salen I* decision is especially important because it further defines the notions of what protection local creditors should receive before a court grants comity to a foreign bankruptcy proceeding. Cunard had contended that the district court’s grant of comity to the Swedish bankruptcy proceeding was inappropriate because the Swedish court lacked “*in personam* jurisdiction over Cunard and *in rem* jurisdiction over the attached property.”<sup>260</sup> The *Salen I* court rejected these contentions and instead upheld the debtor’s contention that jurisdiction over the debtor was the necessary criterion. In so doing, the court contrasted the rationale for granting comity to a final foreign judgment with the rationale for granting comity to a foreign bankruptcy proceeding:

The rationale underlying the granting of comity to a final foreign judgment is that litigation should end after the parties have had an opportunity to present their cases fully and fairly to a court of competent jurisdiction. The extending of comity to a *foreign bankruptcy proceeding*, by staying or enjoining the commencement or continuation of an action against a debtor or its property, *has a somewhat different rationale*. The granting of comity to a foreign bankruptcy proceeding enables the assets of a debtor to be dispersed in an equitable, orderly, and systematic manner, rather than in a haphazard, erratic or piece-

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<sup>255</sup>*Salen I*, 773 F.2d at 459 (citation omitted).

<sup>256</sup>*Id.* at 459–60.

<sup>257</sup>*Id.* at 459.

<sup>258</sup>*Id.*

<sup>259</sup>*Id.*

<sup>260</sup>*Id.* at 457.

meal fashion. Consequently, American courts have consistently recognized the interest of foreign courts in liquidating or winding up the affairs of their own domestic business entities.<sup>261</sup>

This distinction is very important, because it sets forth the proposition that U.S. courts can grant comity to a foreign bankruptcy proceeding although it might be inappropriate to grant comity to a foreign money judgment on similar facts. Thus, the *Salen I* court noted that, although a U.S. court would not grant comity to a foreign court's award of a money judgment against a defendant over whom the foreign court did not have personal jurisdiction, a U.S. court could grant comity to a foreign country's bankruptcy proceeding over the objection of a U.S. creditor although the foreign court did not have personal jurisdiction over such creditor.<sup>262</sup> The *Salen I* court pointed out that the *Gebhard* court did just that, and then cited the principle from *Gebhard* "that 'every person who deals with a foreign corporation impliedly [sic] subjects himself to such laws of the foreign government, affecting the powers and obligations of the corporation with which he voluntarily contracts, as the known and established policy [as] that government authorizes.'"<sup>263</sup> The court concluded that therefore "creditors of an insolvent foreign corporation may be required to assert their claims against a foreign bankrupt before a duly convened foreign bankruptcy tribunal."<sup>264</sup>

Thus, as in *Gebhard* and *Culmer*, the court in *Salen I* granted comity to a foreign bankruptcy proceeding over the objection of a creditor, after finding that the creditor would not be prejudiced, that the foreign proceeding was fundamentally fair, and that the foreign law facilitated equality of distribution.<sup>265</sup>

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<sup>261</sup>*Id.* at 457–58 (emphasis added).

<sup>262</sup>*Id.* at 458 (citing *Culmer*, 25 B.R. at 628–29). It is assumed, of course, that the foreign court had jurisdiction over the debtor and was the appropriate forum for the debtor's bankruptcy.

<sup>263</sup>*Id.* (quoting *Gebhard*, 109 U.S. at 537).

<sup>264</sup>*Id.* at 458–59.

<sup>265</sup>For further discussion of the minimum safeguards creditors are entitled to receive before a U.S. court grants comity to a foreign bankruptcy proceeding, see, e.g., *In re Enercons Virginia, Inc.*, 812 F.2d 1469 (4th Cir. 1987) [hereinafter *Enercons*] and *Drexel Burnham Lambert Group v. Galadari*, 777 F.2d 877 (2d Cir. 1985) [hereinafter *Drexel*]. In *Enercons* the Fourth Circuit upheld a lower court's decision to grant comity to an Italian court's order of appointment of a trustee of a bankrupt Italian company, even though the Italian court clarified the rights of the trustee in an *ex parte* order at a proceeding to which objecting creditors had received "no notice or opportunity to be heard until the time for appeal of the [o]rder had passed." *Enercons*, 812 F.2d at 1473. The Fourth Circuit claimed that "the Italian proceedings were sufficiently analogous to our fundamental concepts of justice as to warrant our extension of comity to them." *Id.* Implicit in the decision is the notion that creditors need not receive notice and an opportunity to be heard at all hearings relating to the powers of a trustee, as long as the original appointment is fundamentally fair.

In *Drexel*, in comparison, the Second Circuit refused to grant comity to liquidation proceedings in Dubai after concluding that further inquiry into the fairness of the Dubai procedures was necessary. The court claimed that the Dubai liquidation decree (which established a committee of receivers to liquidate the debtor's assets and set forth the general guidelines for the liquidation) "appear[ed] to be Dubai's first attempt to frame an insolvency law," *Drexel*, 777 F.2d at 881, and that Drexel Burnham Lambert Group [here-

The decision in *In re Gee*<sup>266</sup> followed the broad *Culmer* approach, and continued to build on many of the notions set forth in *Salen I*. *Gee* involved the conflict in the U.S. courts between Universal Casualty & Surety Company Ltd. ("Universal"), a Cayman Islands reinsurance company undergoing liquidation in the Cayman Islands, and its court appointed liquidator, Allan Gee ("Gee"). The facts of this case, described by the *Gee* court as an "international chess game,"<sup>267</sup> are rather confusing and most details need not be repeated here. In short, Gee filed a petition seeking relief under § 304 to assist the primary liquidation in the Cayman Islands. He sought discovery of persons and entities in the Southern District of New York regarding Universal and the administration of Universal's estate in the Cayman Islands, as well as the issuance of preliminary injunctions to prevent certain individuals from disposing of Universal's assets, books and records located in the Southern District. Universal filed a chapter 11 petition to block the actions of Gee, whom it claimed was biased against it.

The *Gee* court dismissed Universal's chapter 11 petition and granted Gee's § 304 petition. In reaching its holding that it was appropriate "to allow a [§] 304 petition solely for the purposes of discovery [even though] there [was] no property in the United States involved in the foreign proceeding,"<sup>268</sup> the *Gee* court relied on the principle from *Culmer* that "the court 'is free to broadly mold appropriate relief in near blank check fashion.'"<sup>269</sup> The *Gee* court also relied on the principles from *Salen I* that "'American courts have consistently recognized the interest of foreign courts in liquidating or winding up the affairs of their own domestic business entities,' (citation omitted), and that 'the modern trend has been toward a more flexible approach which allows the assets to be distributed equitably in the foreign proceeding.'"<sup>270</sup> The *Gee* court added that "[i]f creditors of a foreign bankrupt, including Ameri-

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inafter "Drexel"] "should have been afforded reasonable discovery and an evidentiary hearing." *Id.* The aspects of the Dubai proceedings that troubled the Second Circuit included the following: Drexel had asserted that the committee of receivers was to function as both a bankruptcy trustee and bankruptcy court and that there would be limited appellate review of the committee's actions; Drexel had contended that Dubai law did not provide for the meeting of creditors or for the notice of sale of the debtor's property; and "Drexel [had] met with a stone wall in its efforts to establish the facts through the ordinary process of discovery and fact finding." *Id.* at 880. Specifically, the committee of receivers had refused to answer Drexel's interrogatories or to produce the debtor for deposition, with the result that "Drexel never was afforded even the barest opportunity to determine the fairness of the proposed Dubai proceeding. This Court also was thwarted in its efforts to discover the facts." *Id.* at 880-81. However, on remand and after discovery and an evidentiary hearing, the district court deferred to the Dubai bankruptcy proceedings. *Drexel Burnham Lambert Group v. Galadari*, 1987 U.S. Dist. Lexis 5030 (S.D.N.Y. Jan. 29, 1987).

<sup>266</sup>53 B.R. 891 (Bankr. S.D.N.Y. 1985).

<sup>267</sup>*Id.* at 892.

<sup>268</sup>*Id.* at 899. The court also noted that the debtor had satisfied the § 109(a) threshold eligibility requirements. *Id.* at 900. See discussion accompanying *supra* notes 127 to 130.

<sup>269</sup>*Id.* at 897 (quoting *Culmer*, 25 B.R. at 624).

<sup>270</sup>*Id.* at 901 (citing *Salen I*, 773 F.2d at 458).

cans, may be required under principles of comity to have their claims adjudicated by a foreign tribunal, then so, too, may the shareholders.”<sup>271</sup>

In considering the § 304(c) criteria, the *Gee* court followed *Culmer* in noting that comity was the “most significant” factor of the six.<sup>272</sup> In affording comity to the order of the Cayman Islands court, the *Gee* court also relied on the notion from *Salen I* that “[f]or comity to be extended, it is necessary only that the foreign court abide by fundamental standards of procedural fairness.”<sup>273</sup> In evaluating the Cayman Islands’ insolvency law, the court noted that the Cayman Islands Companies Law was similar to the U.S. Bankruptcy Code and that the debtor had “shown nothing to this court to persuade it that fundamental standards of fairness were abridged by the Cayman Islands tribunal when it ordered Universal wound up.”<sup>274</sup>

The court found that all of the other applicable § 304(c) factors were likewise satisfied. Section 304(c)(1) was met because there were no provisions in the Cayman Islands insolvency law that would treat the debtor’s creditors unjustly; § 304(c)(2) was satisfied because Cayman Islands’ insolvency law does not prejudice U.S. claimants or prefer the claims of Cayman Island citizens; § 304(c)(3) was satisfied because the Cayman Islands’ insolvency law voids fraudulent preferences; and § 304(c)(4) was satisfied since the distribution of proceeds of the estate under Cayman Islands law is “generally in harmony with the [U.S. Bankruptcy] Code.”<sup>275</sup> Lastly, the court found that the Cayman Islands proceeding would “best assure an economical and expeditious administration of [the debtor’s] estate.”<sup>276</sup> After finding it appropriate to grant the relief requested by the foreign representative, the court cited *Culmer* for the proposition that “[i]t is not necessary that the [Cayman Islands] Companies Law be a carbon copy of the [U.S.] Bankruptcy Code; rather, it must be of a nature that is not repugnant to the American laws and policies—and clearly it is not.”<sup>277</sup>

#### b. *Toga* and the Territoriality Approach

Other recent cases, however, have rejected the *Culmer* approach in favor

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<sup>271</sup>*Id.*

<sup>272</sup>*Id.*

<sup>273</sup>*Id.* at 902 (citing *Salen I*, 773 F.2d at 457).

<sup>274</sup>*Id.*

<sup>275</sup>*Id.* at 904.

<sup>276</sup>*Id.*

<sup>277</sup>*Id.* (citing *Culmer*, 25 B.R. at 621). The court in *Axona*, in suspending a § 303(b)(4) case and ordering a turnover under § 305, further expanded the approach enunciated in *Culmer*, *Salen I*, *Salen II*, and *Gee* and offered the most comprehensive analysis to date of prior case law and of the interconnectedness of the various provisions in the U.S. Bankruptcy Code regarding foreign bankruptcies. For a discussion of *Axona*, see text accompanying *infra* notes 456 to 492. For a more recent case that also developed the universality approach in its decision granting § 304(c) relief and ordering the turnover of assets abroad, see *Koreag*, 130 B.R. 705. See also the other cases listed in note 208 *supra*.

of a narrower view of comity and more limited recognition of foreign bankruptcies.<sup>278</sup> Rather than recognizing the laws of a foreign proceeding and ordering a turnover of assets to the foreign jurisdiction, these courts simply have applied U.S. law. This restrictive approach to comity is exemplified by the court in *Toga*.<sup>279</sup>

In March 1977 and December 1978, Toga Manufacturing Limited ("Toga"), a Canadian corporation, and Peter T. Hesse Enterprises, Inc. ("Hesse"), a Michigan corporation, contracted to make Hesse the exclusive sales representative for Toga in charge of procuring orders for automotive parts from Volkswagen, its subsidiaries, General Motors Corporation ("General Motors"), and Ford Motor Company ("Ford"). The contracts provided for alleged breaches of the contracts to be submitted to the American Arbitration Association ("AAA").

In 1980, Hesse asserted that Toga had wrongly withheld commissions owed to it from sales to companies located outside the United States and filed an arbitration claim with the AAA in Michigan. In February 1982, the arbitration panel entered an arbitration award in favor of Hesse in the amount of \$196,978. In March 1982, Hesse filed a petition in the Wayne County Circuit Court in Michigan to enforce its arbitration award. Toga responded with a motion to vacate the award on the ground that Toga was not represented at the February arbitration hearing.

On April 1, 1982, Toga agreed to a partial settlement by entry of a consent judgment in the amount of \$60,750 (the "consent judgment"), for amounts owed to Hesse from sales to customers located in the United States. The consent judgment also provided for resubmission to arbitration of issues relating to commissions from foreign sales.

Meanwhile, Toga's financial difficulties had worsened and on April 29, 1982, Toga executed a consensual default agreement with its largest secured creditor, Canadian Imperial Bank of Commerce ("CIBC"). Under the agreement CIBC took control of the operation and assets of Toga and appointed Peat Marwick, Ltd. as its receiver (the "Canadian receiver") to continue operating Toga.

Arbitration on the foreign sales commissions commenced on May 3, 1982, and around that time the Canadian receiver repudiated the consent judgment. On May 13, 1982, an arbitration award in favor of Hesse was entered, and on May 21, 1982, confirmed by judgment by the Wayne County Circuit Court.

Hesse reacted to the repudiation of the consent judgment by serving writs of garnishment on Volkswagen, General Motors, and Ford. On May 13, 1982, CIBC intervened in this Wayne County garnishment action and alleged

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<sup>278</sup>See *supra* note 209.

<sup>279</sup>28 B.R. 165 (Bankr. E.D. Mich. 1983). The facts of the case as discussed in the text above are set out in *id.* at 165-67.

that it held a perfected security interest in Toga's accounts receivable that was superior to Hesse's judgment lien. On May 20, 1982, the Wayne County Circuit Court ordered the garnishee defendants to pay the garnished funds to the clerk of the court pending resolution of the priority dispute. On July 9, 1982 the court found CIBC's security interest to be superior to Hesse's judgment lien and directed that the funds be paid to the Canadian receiver. Hesse appealed, and this case was pending at the time of the *Toga* § 304 decision.

On October 18, 1982 an unsecured creditor of Toga commenced an involuntary bankruptcy proceeding against Toga in Ontario, Canada. On November 16, 1982, the Supreme Court of Ontario granted the petition and appointed Peat Marwick, Ltd. as trustee of Toga's estate (the "Canadian trustee"). On December 14, 1982, the Canadian trustee filed a petition in the Bankruptcy Court for the Eastern District of Michigan to commence a section 304 ancillary proceeding and requested the following: (1) an injunction against all of Toga's creditors from commencing or continuing actions against Toga or its assets, and (2) an order directing the Wayne County Circuit Court clerk to turn over the \$215,000 garnishment fund to the Canadian trustee.<sup>280</sup> The Canadian trustee satisfied all of the § 304 threshold requirements, including proving that under Canadian bankruptcy law the debtor's property in the United States was considered property of the debtor's estate.<sup>281</sup>

However, the *Toga* court denied the Canadian trustee's request for injunctive relief and for the turnover order, and thereby allowed Hesse's claim to continue to be litigated in Michigan courts under Michigan law.<sup>282</sup> In reaching its decision, the *Toga* court followed a territoriality-based approach to both comity and the criteria in § 304.

The *Toga* court, like the *Culmer* court, focused on comity, but unlike the *Culmer* court the *Toga* court interpreted comity quite narrowly and relied on early U.S. cases that followed the territoriality approach. Thus, the *Toga* court cited *Harrison* and *Ogden* to support its conclusion that, "[h]istorically, the bankruptcy laws of our country have been hostile towards claims asserted by foreign trustees in bankruptcy against alleged estate property located in the United States."<sup>283</sup> Although it is true that early U.S. cases were hostile to such claims, the *Toga* opinion ignored later cases, such as *Gebhard* and *Culmer*, that

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<sup>280</sup>*Id.* at 167.

<sup>281</sup>More specifically, the *Toga* court noted that section 2 of the Bankruptcy Act, Revised Statutes of Canada, 1970, Chapter B-3, as amended (the "Canadian Bankruptcy Act") defines "property" as including "money . . . whether situated in Canada or elsewhere." *Id.* The court also observed that § 47(c) of the Canadian Bankruptcy Act "defines property of the estate to include 'all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge.'" *Toga*, 28 B.R. at 167.

<sup>282</sup>*Toga*, 28 B.R. at 170-71.

<sup>283</sup>*Id.* at 167.

adopted a more universality-based approach to comity. More importantly, although *Toga* involved a petition brought by a foreign representative from Canada, the *Toga* court even failed to discuss *Cornfeld*,<sup>284</sup> a case that had noted the substantial similarity of U.S. and Canadian bankruptcy law and had granted comity to a Canadian liquidation proceeding.<sup>285</sup>

The *Toga* court also emphasized territorial protections for U.S. creditors in its discussion of § 304. Although the court began its § 304 analysis by conceding that “[s]ection 304 . . . embodies the *universal* theory of conflicts of laws with some qualifications,”<sup>286</sup> the court cursorily discussed the universality factors in § 304(c). Indeed, the court’s analysis primarily focused on § 304(c)(4) and (5), and the discussion of the other § 304 criteria totaled merely five sentences in the opinion. In those five sentences the court acknowledged the following: that “Hesse would receive just treatment of its claim against Toga in the Canadian courts”<sup>287</sup> and that Canadian law provides for equality of distribution<sup>288</sup> (which would have satisfied § 304(c)(1)); and that “Hesse would suffer no inconvenience if it were forced to litigate its claim in Canada”<sup>289</sup> (which would have satisfied § 304(c)(2)).<sup>290</sup>

However, in the court’s view, these findings were outweighed by the fact that the treatment of Hesse’s claim by the Canadian courts would not satisfy § 304(c)(4). More specifically, the court noted that under U.S. law, since Hesse had perfected its judgment by serving writs of garnishment on several of Toga’s creditors, it was a lien creditor<sup>291</sup> entitled to be recognized as holding a secured claim to the extent of its perfected interest.<sup>292</sup> Therefore, under the U.S. Bankruptcy Code Hesse would have been one of the first creditors to receive payment.<sup>293</sup> However, in the court’s opinion, under Canadian law Hesse would most likely have been considered an “ordinary creditor” with a lower

<sup>284</sup>471 F. Supp. 1255 (S.D.N.Y. 1979), *aff’d*, 614 F.2d 1286 (2d Cir. 1979) .

<sup>285</sup>*See supra* note 235. The *Toga* court did, however, mention that the Second Circuit had granted comity to a Canadian insolvency proceeding in *Clarkson*, 544 F.2d 624, but the *Toga* court relied on language from *Clarkson* requiring the protection of local citizens and local policies, *Toga*, 28 B.R. at 170, and failed to mention the universality parts of the *Clarkson* opinion.

<sup>286</sup>*Toga*, 28 B.R. at 167–68.

<sup>287</sup>*Id.* at 168.

<sup>288</sup>*Id.* at 167 n.2. (the court mentioned “equality of distribution among debtors,” but the court must certainly have meant equality of distribution among creditors).

<sup>289</sup>*Id.* at 168.

<sup>290</sup>The court also stated that Canadian law provides for a fresh start for debtors. *Id.* at 167. This would have satisfied § 304(c)(6), if that section had been applicable.

<sup>291</sup>The Uniform Commercial Code defines a “lien creditor” as “a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment.” U.C.C. § 9–301(3) (1991).

<sup>292</sup>*Toga*, 28 B.R. at 168. *See* 11 U.S.C.A. § 506 (West 1991) (determination of secured status).

<sup>293</sup>*Toga*, 28 B.R. at 168.

priority and would have lost the protection of its security interest under U.S. law.<sup>294</sup> Since this discrepancy would have led to a distribution of proceeds *not* substantially in accordance with the order prescribed by the U.S. Bankruptcy Code, the court held that Hesse's claim be litigated in Michigan courts under U.S. law.<sup>295</sup>

The *Toga* court focused on "minor substantive differences between Canadian and U.S. law," rather than considering the overall fairness of Canadian law and the general similarity of Canadian and U.S. law.<sup>296</sup> In so doing, the court espoused a limited view of comity, under which comity should not be accorded to foreign proceedings unless the foreign country either adopts the equivalent of U.S. bankruptcy law priority rules or enters into a treaty with the United States for mutual recognition of each country's bankruptcy laws.<sup>297</sup> In effect, the *Toga* approach makes recognition of foreign bankruptcy proceedings almost impossible, even of sister common law jurisdictions, because no two bankruptcy codes will likely have the same requirements for the distribution of assets. The court's approach harks back to the earlier parochial approach of the late nineteenth century and ignores the growing trend in favor of recognizing and cooperating with foreign bankruptcy proceedings.<sup>298</sup> Indeed, it is now widely recognized that comity does not require that foreign laws be identical to the U.S. Bankruptcy Code, but rather that they need only not be "repugnant to [U.S.] ideas of justice."<sup>299</sup> Given the great overall similarity between Canadian bankruptcy law and the the U.S. Bankruptcy Code, a difference in priority for garnishor/judgment creditors as prescribed by Canadian bankruptcy law certainly does not appear to be fundamentally unfair or "repugnant" to U.S. notions of justice.

As noted earlier, the legislative history states that in applying § 304, a court is to "be permitted to make the appropriate orders under *all* of the circumstances of each case, rather than being provided with inflexible rules."<sup>300</sup>

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<sup>294</sup>*Id.* The court relied on § 107 of the Canadian Bankruptcy Act and the case, *The Canadian Credit Men's Trust Assoc. v. Beaver Trucking*, 1959 S.C.R. 311 (Can. 1959), for the proposition "that funds paid by garnishee defendant into an escrow account held by [a] court pursuant to a writ of garnishment [do] not constitute security for the garnishor/judgment creditor." *Toga*, 28 B.R. at 168.

<sup>295</sup>*Toga*, 28 B.R. at 170.

<sup>296</sup>*Axona*, 88 B.R. at 611.

<sup>297</sup>Gallagher & Hartje, *supra* note 5, at 21 (criticizing the *Toga* approach). See also Fischer, *supra* note 5, at 640-49; Goldie, *supra* note 62, at 326-29. The *Toga* court noted that the proposed United States of America-Canada Bankruptcy Treaty (1979), if ratified, would have led the court to grant the Canadian Trustee's requested relief, but found that "[t]his treaty has not been ratified and we are not bound by it." *Toga*, 28 B.R. at 169.

<sup>298</sup>See Fischer, *supra* note 5, at 635, 645, 647; Gallagher & Hartje, *supra* note 5, at 21.

<sup>299</sup>*Culmer*, 25 B.R. at 631; accord *Axona*, 88 B.R. at 611; *Gee*, 53 B.R. at 904. See also *Salen I*, 773 F.2d at 457 ("the foreign court must abide by fundamental standards of procedural fairness"); Gallagher & Hartje, *supra* note 5, at 21; Trautman, *supra* note 62, at 56. The New York courts have narrowly construed the exceptions to the comity doctrine. See *supra* note 235.

<sup>300</sup>Legislative history quoted in text accompanying note 191 *supra* (emphasis added).

Thus, for the purposes of argument, even if one concedes that Hesse would not have received a distribution "substantially in accordance" with U.S. law, in light of all of the circumstances involved in *Toga*, a single statutory divergence between Canadian bankruptcy law and the U.S. Bankruptcy Code should not have outweighed all of the other § 304 factors supporting the granting of the § 304 relief requested by the Canadian trustee,<sup>301</sup> including the following: (i) Canada was the appropriate jurisdiction for the primary bankruptcy proceeding; (ii) the property in the United States was considered property of the estate under Canadian law; (iii) the Wayne County Circuit Court had held that the CIBC's security interest was superior to Hesse's judgment lien; (iv) Hesse would have received just treatment of its claim in Canadian courts and would have shared equally under Canadian law with other garnishor/judgment creditors; (v) Canada and the United States are sister common law jurisdictions with similar bankruptcy laws; (vi) enforcement of the Canadian law regarding garnishor/judgment creditors would not have been fundamentally unfair or repugnant to U.S. ideas of justice; (vii) Hesse would not have suffered discriminatory treatment or inconvenience in processing its claim in Canada; and (viii) deferring to the Canadian proceeding would have assured an economical and expeditious administration of the debtor's estate.

The interests of U.S. creditors must certainly be protected, but not to the extent provided in *Toga*.<sup>302</sup> The general rule to be applied in § 304 cases should be that U.S. creditors are not entitled to the application of U.S. law for all acts committed prior to the commencement of a primary bankruptcy proceeding abroad. Rather, in the absence of discriminatory treatment or other fundamentally unfair procedures, U.S. creditors should only be entitled to be treated the same as other similarly situated creditors in the primary bankruptcy proceeding, under the applicable bankruptcy law of the country in which the primary

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<sup>301</sup>See Finister, *supra* note 62, at 370 ("in a case where the secured status of a creditor is subject to change under foreign law, this fact should be considered a factor against affording Section 304 relief and weighed against the remaining factors to determine if, overall, relief should be granted.")

<sup>302</sup>Some commentators disagree with the approach urged here. For instance, Richard A. Gitlin and Evan D. Flaschen interpret the *Toga* decision as a "practical solution to the conflict between domestic policy and principles of comity." Gitlin & Flaschen, *supra* note 62, at 321. They distinguish the results in *Toga* from the results in *Culmer* and *Salen I* on the ground that the garnishments obtained in *Toga* were obtained before the bankruptcy proceedings were commenced in Canada, unlike the attachments in question in the two other cases that were obtained after the foreign bankruptcy cases had been commenced. *Id.* They argue that, if the foreign representatives in *Culmer* and *Salen I* had originally commenced bankruptcies in the United States, rather than abroad, the attachments in those cases would have been invalid under U.S. law and therefore the courts were correct in avoiding attachments in deference to foreign law. In contrast, they argue that, if the foreign representative in *Toga* had commenced a bankruptcy in the United States, rather than abroad, the garnishments in question would have been valid under U.S. law, and therefore "[t]o void those garnishments because the debtor entered bankruptcy proceedings in Canada six months later would run counter to American public policy and could lead to unnecessary forum shopping by multinational debtors." *Id.* I criticize their approach in note 179 *supra*.

proceeding occurs.<sup>303</sup>

The court in the *Lineas* bankruptcy proceedings also preferred the interests of U.S. creditors.<sup>304</sup> This bankruptcy involved the insolvency of an air carrier, whose stock was owned by the government of Nicaragua and which operated between Nicaragua and the United States. The provisional trustee of the air carrier appointed under Nicaraguan law (the "Nicaraguan trustee") sought a turnover of all of the debtor's property located in the United States (including office and maintenance equipment, furniture, bank accounts, vehicles and most importantly, a Civil Aeronautics Board ("C.A.B.") certificate permitting the debtor to operate scheduled flight service into the United States). The Nicaraguan trustee also sought injunctive relief to enjoin the commencement or continuation of all litigation in the United States against the foreign debtor or its property.

The bankruptcy court for the Southern District of Florida granted partial injunctive relief. First of all, the court enjoined the commencement of any new proceedings against the debtor or its property in any federal court, except for suits commenced in bankruptcy courts. Secondly, the court enjoined all litigants from enforcing or executing on any judgments obtained without first obtaining the court's leave, but allowed pending actions to continue up to and through the entry of judgment.<sup>305</sup> The court also issued a turnover order that

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<sup>303</sup>See Trautman, *supra* note 62, at 56, 58; Gallagher & Hartje, *supra* note 5, at 21. Thus, in *Toga* it would have been fair for a garnishor/judgment creditor in the United States to have lost the benefit of its perfected security interest under U.S. law, and to have been treated the same as other garnishor/judgment creditors in the Canadian insolvency proceeding. In contrast, ordering § 304 relief would be troubling on the following facts:

A foreign debtor whose principal place of business is in country X files for bankruptcy in country X. The foreign debtor also does business in the United States and has U.S. employees. The foreign representative files a petition in the United States for § 304 relief and satisfies the § 304 threshold requirements. The foreign representative seeks the turnover of all of the foreign debtor's U.S. assets to country X to be administered under the law of country X.

Assume that the foreign debtor's U.S. employees would be entitled to priorities in distribution under § 507(a)(3) and (4) in a plenary bankruptcy case under U.S. law. See 11 U.S.C.A. § 507(a)(3), (4) (West 1991). Also assume that under the bankruptcy law of country X, only employees employed in country X are entitled to a priority in distribution in bankruptcy cases commenced in country X. (Thus, the U.S. employees would be treated as ordinary unsecured creditors.) If the U.S. court were to grant the requested § 304 relief, the U.S. employees would lose their U.S. priority and would be treated worse than would the foreign debtor's employees who are employed in country X. Since the U.S. employees would not be treated as well as similarly situated employees in country X, the equality of distribution principle would be violated, and the U.S. employees would encounter discrimination and fundamental unfairness in the bankruptcy proceeding in country X. On these facts, ordering the requested § 304 relief would therefore be inappropriate. A plenary U.S. bankruptcy case (in which the U.S. employees receive their § 507 priorities), in conjunction with a subsequent suspension/turnover order under § 305, would yield a fairer result. See Part II.C *infra*.

<sup>304</sup>*Lineas II*, 13 B.R. 779; *Lineas I*, 10 B.R. 790.

<sup>305</sup>*Lineas I*, 10 B.R. at 791.

was a "turnover in name only";<sup>306</sup> the order was issued upon the Nicaraguan trustee's representation that none of the debtor's assets located in the United States would be removed and that such assets would "be applied primarily to satisfy the debts owing to the U.S. creditors."<sup>307</sup> The turnover order further protected U.S. creditors by prohibiting the Nicaraguan trustee "from in any way encumbering, assigning or abandoning the debtor's known assets located in the United States . . . as well as any additional assets discovered in this country."<sup>308</sup> The turnover order, in effect, was not a turnover order at all and was intended to benefit U.S. creditors at the expense of the debtor's other creditors—the amount of the undisputed claims of U.S. creditors alone was greater than the value of the debtor's tangible assets in the United States.<sup>309</sup>

A few months later the bankruptcy court also ordered the appointment of an independent co-trustee to prepare a disinterested evaluation of the debtor's most valuable asset, the C.A.B. certificate, and to present his evaluation to the C.A.B.<sup>310</sup> The co-trustee was appointed to protect the interest of two of the debtor's U.S. creditors who together held the largest claim against the debtor. The creditors had asserted that the Nicaraguan trustee had a conflict of interest, and the court found that the Nicaraguan trustee "presumably . . . [had] no interest in preserving the [C.A.B.] certificate for this debtor and will do all he can to accomplish his government's wish to replace the debtor by another carrier that has no obligation to the U.S. creditors."<sup>311</sup> The court made this claim even though it also acknowledged that the Nicaraguan trustee, his counsel, and the Nicaraguan government all had "fully and meticulously discharged their duties and commitments . . . [and that t]here [was] no basis . . . for any criticism of any of these parties."<sup>312</sup>

In the *Lineas* court's analysis, "look[ing] to Nicaragua for payment [was] an alternative to be avoided if possible under § 304(c)(2)."<sup>313</sup> This was the court's only reference to a specific § 304(c) factor. Rather than discussing the § 304(c) criteria, the court assumed that the case should be administered under U.S. law. Granted, the *Lineas* court might well have had legitimate concerns about the laws of Nicaragua, a nation then in revolutionary flux, and the C.A.B. certificate appears to have been deserving of U.S. administration.<sup>314</sup> These factors, however, justified the need for a full U.S. bankruptcy to be commenced under § 303(b)(4) and not for the transformation of a § 304 case into a full-

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<sup>306</sup>Morales & Deutch, *supra* note 5, at 1589.

<sup>307</sup>*Lineas I*, 10 B.R. at 791.

<sup>308</sup>*Id.*

<sup>309</sup>*Lineas II*, 13 B.R. at 780.

<sup>310</sup>*Id.* at 781.

<sup>311</sup>*Id.* at 780.

<sup>312</sup>*Id.*

<sup>313</sup>*Id.*

<sup>314</sup>Gallagher & Hartje, *supra* note 5, at 17.

blown case under U.S. law, a purpose for which § 304 was not intended.<sup>315</sup>

c. Recent Cases—Attempting to Define the Minimum Necessary Protection for U.S. Creditors

Recently, the courts in two other cases, *In re Papeleras Reunidas, S.A.* ("Papeleras")<sup>316</sup> and *Interpool, Ltd. v. Certain Freights of M/V Venture Star*<sup>317</sup> denied requests for § 304 relief. In *Papeleras*, the first reported § 304 case involving the recognition of Spanish insolvency law, the court achieved the correct result, but for many of the wrong reasons, and its analysis included many arguments that subvert the application of the factors in § 304(c).

The *Papeleras* § 304 proceeding involved a dispute between the Spanish corporation Papeleras Reunidas, S.A. ("Papeleras") and its major U.S. creditor Republic Tobacco, Inc. ("Republic"), formerly known as Adams Apple Distributing Company ("Adams"). Papeleras produced paper products sold worldwide, including the Papeleras "Bambu" cigarette rolling papers (the "Papeleras papers"). The facts of the case are rather extensive. The trademarks relating to the Papeleras papers were registered in many countries, including the United States. In 1975 Papeleras entered into a contract with Adams that designated Adams as the exclusive distributor of the Papeleras papers in the United States for five years.

Problems soon arose under the contract, and by early 1976 both parties stopped performance. Adams sued Papeleras in the U.S. District Court for the Northern District of Illinois for damages resulting from Papeleras's alleged breach of their agreement, and Papeleras counterclaimed. In August, 1984 the court rendered judgment in the amount of US\$1,450,973 in favor of Adams, and in November 1985 the Court of Appeals for the Seventh Circuit affirmed.<sup>318</sup> With the award of this judgment, Adams became Papeleras's largest creditor. Meanwhile, Papeleras entered into a replacement exclusive distribution agreement for the United States with the New York corporation Bambu Sales, Inc. ("Bambu").

While the dispute between Adams and Papeleras was working its way through the U.S. courts, but before the judgment was entered, Papeleras encountered financial problems in Spain. On November 7, 1979, the board of directors of Papeleras petitioned a Spanish court to commence a Spanish insolvency

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<sup>315</sup>*Id.*

<sup>316</sup>92 B.R. 584 (Bankr. E.D.N.Y.). The facts of the case as discussed in the text above are set out in *id.* at 586-89.

<sup>317</sup>102 B.R. 373 (D.N.J. 1988), *appeal dismissed*, 878 F.2d 111 (3d Cir. 1989).

<sup>318</sup>*Adams Apple Distributing Co. v. Papeleras Reunidas, S.A.*, No. 77 C 868, *mem. op.* (N.D. Ill., October 26, 1984), *aff'd*, 773 F.2d 925 (7th Cir. 1985).

procedure called "suspension of payments," and on November 20, 1980, the Spanish court declared that Papeleras was in suspension of payments.

Papeleras' creditors were given notice of the debtor's suspension of payments procedure through newspaper publication, and shareholders were notified by mail. Although Adams and its president owned shares of Papeleras's stock, they stipulated that they never received notice of the suspension of payments procedure (nor of the subsequent liquidation proceedings), until Papeleras's counsel informed Adams's counsel in August 1984.

On November 20, 1981 the Spanish court approved a plan of payment between Papeleras and the majority of its listed creditors. Adams was not a party to this plan because it was not listed as a creditor in the suspension of payments proceeding. (Disputed claims are not recognized under Spanish law until rendered undisputed.) In late 1983 Papeleras failed to make a scheduled payment, and in March 1984 it ceased operations. The Spanish court directed that Papeleras be liquidated, and on March 16, 1984, appointed three liquidators (the "Spanish liquidators").

As noted above, in August 1984 Adams was awarded judgment in its breach of contract action against Papeleras and also learned of the liquidation of Papeleras. In October 1984 Adams moved to impose a lien on Papeleras's U.S. trademarks in the district court in Illinois. The Spanish liquidators opposed the motion, and argued that under Spanish law creditors are not allowed to seize the assets of a company in liquidation to satisfy their own claims.<sup>319</sup> In an affidavit filed with the court, the Spanish liquidators' attorney also claimed that no sale of the trademarks was planned. The court granted Adams's motion for the imposition of the lien, but agreed to set aside the lien if Papeleras provided the court with certified English translations of the Spanish law relied on by the liquidators and if the Spanish proceedings recognized Adams's status as a creditor.<sup>320</sup>

The Spanish liquidators never provided the district court with the certified translations and the lien continued. Despite their attorney's representations to the contrary, in October 1984 the Spanish liquidators sold the trademarks to Bambu in Madrid while the motion for the liens was still pending in the United States. (The district court later discovered that the Spanish liquidators had been negotiating with Bambu since March, 1984—thus, they had been negotiating a sale of the trademarks at the very time that their lawyer had told the district court that no sale was planned.) Three days after the sale, Bambu recorded its assignment of the trademarks in Washington, D.C.

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<sup>319</sup>*Papeleras*, 92 B.R. at 588.

<sup>320</sup>*Id.* According to the Seventh Circuit, the district court was concerned that, since disputed claims are not recognized under Spanish law, Papeleras' appeal would prevent Adams from having its claim considered in the Spanish liquidation. *Adams Apple Distributing Co.*, 773 F.2d at 928.

Adams learned of the transfer of the trademarks from Papeleras to Bambu when it attempted to record its lien and discovered Bambu's prior registration. Adams responded by commencing an action in the U.S. District Court for the Northern District of Illinois alleging that the transfer of trademarks constituted a fraudulent conveyance under U.S. law. For venue reasons this action was dismissed, and an identical action was commenced in the U.S. District Court for the Eastern District of New York.

In February 1985, the Spanish liquidators commenced a § 304 ancillary proceeding in an attempt to prevent Adams from seizing the payments due Papeleras under the transfer of trademarks agreement with Bambu. The Bankruptcy Court for the Eastern District of New York dismissed the § 304 petition and allowed the fraudulent conveyance action under U.S. law to continue.

The *Papeleras* court analyzed the § 304(c) criteria in detail. The court first turned to the requirement in § 304(c)(1) that the holders of all claims receive "just treatment." The court noted that Spanish bankruptcy law does not overtly discriminate against non-Spanish creditors.<sup>321</sup> Nevertheless, the court found that "[d]eferring to the Spanish proceeding [would] not afford just treatment to Adams,"<sup>322</sup> because Adams' claim, which would have been recognized under U.S. law, was not recognized under Spanish law. In short, § 101(5) of the U.S. Bankruptcy Code includes unliquidated and disputed claims,<sup>323</sup> and in the court's opinion this broad definition of claim should also apply to "claims" in § 304(c)(1). Under Spanish law, however, "only 'constitutive' or liquidated, undisputed claims" are recognized.<sup>324</sup>

This approach by the *Papeleras* court misconstrued the application of § 304(c)(1), which instead requires the U.S. court to look at the fairness of the foreign law to ensure the just treatment of *all* creditors under the application of the foreign law.<sup>325</sup> This section does not require that U.S. creditors receive the same treatment as they would under U.S. law. Under this well accepted reading of § 304(c)(1), if the *Papeleras* court had determined that Spanish law did not discriminate against non-Spanish creditors (and that Spanish law provided a comprehensive scheme for the orderly and just treatment of creditors), the court should have found section 304(c)(1) to be satisfied.

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<sup>321</sup>*Papeleras*, 92 B.R. at 590.

<sup>322</sup>*Id.*

<sup>323</sup>Section 101(5) defines "claim" as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C.A. § 101(5) (West 1991).

<sup>324</sup>*Papeleras*, 92 B.R. at 590. Under Spanish law Adams' claim could not be recognized until the Seventh Circuit affirmed Adams' judgment in November 1985, but by then most of Papeleras's assets had been liquidated. *Id.*

<sup>325</sup>See *Finister*, *supra* note 62, at 367-68. See also *Culmer*, 25 B.R. at 629-30; *Gee*, 53 B.R. at 903; *Toga*, 28 B.R. at 168; *Axona*, 88 B.R. at 612.

The *Papeleras* court also erred in its application of § 304(c)(3). Rather than applying Spanish preferential and fraudulent transfer law, if so applicable, the court suggested that U.S. avoidance law should be considered. In discussing preferential dispositions of property, the court acknowledged that “[t]estimony was presented that Spanish law disallows preferential transfers”<sup>326</sup>—the Spanish liquidators had argued that Spanish preferential transfer law should be applied so that all creditors in the Spanish proceedings would be treated equally and that to allow the U.S. creditor to satisfy a judgment obtained after the commencement of the liquidation would benefit the American creditor at the expense of all other creditors.

The *Papeleras* court, however, ruled against the Spanish liquidators on this point. The court found that the application of Spanish law would violate an important American policy:

Nowhere in the legislative history of the [U.S.] Bankruptcy Code did the drafters of § 304, as well as § 547 dealing with preferences, note that the treatment of various types of claims under the [U.S.] Bankruptcy Code may give rise to the equivalent of preferential transfers if contrary to a foreign country’s laws.<sup>327</sup>

In other words, since the holder of a valid judgment lien would be treated as the holder of a secured claim up to the value of its collateral under U.S. bankruptcy law, the court would not defer to the application of Spanish preference law that avoided such a lien.<sup>328</sup> In the court’s view, if Spanish preference law were to be applied “a preference would certainly occur in favor of all the other creditors”<sup>329</sup> from the perspective of the U.S. creditor under U.S. law. In so finding, the court misconstrued the application of § 304(c)(3), which is intended to further the principle of universality. For all creditors worldwide to be treated equally in the foreign proceedings, the preference laws to be applied must be the preference laws of the foreign jurisdiction (if they have extra-territorial effect). By judging the fairness of the foreign preference law from

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<sup>326</sup>*Papeleras*, 92 B.R. at 591. The applicability of Spanish avoidance powers was the only threshold requirement discussed by the court, and even the court’s analysis of this requirement was incomplete—the court never inquired as to whether Spanish avoidance law is intended to have extra-territorial effect. It is implicit in the court’s decision that the other threshold requirements had been met. The court should have explicitly discussed these factors.

<sup>327</sup>*Id.*

<sup>328</sup>The court never addressed the point, however, of why Adams’s judgment lien would be treated as a valid secured claim under U.S. law. If the Spanish debtor or Spanish liquidators had filed for liquidation under the U.S. Bankruptcy Code rather than under Spanish law, at the time of the filing of the petition Adams (which had not yet obtained a judgment) would have been treated as an unsecured creditor. In addition, the automatic stay of § 362(a)(1) would have prevented Adams from continuing its action against *Papeleras*, § 362(a)(2) would have prohibited the enforcement of its judgment, and § 362(a)(4) would have prevented post-petition perfection of its lien. 11 U.S.C.A. § 362 (West 1991).

<sup>329</sup>*Papeleras*, 92 B.R. at 591.

the perspective of a U.S. creditor, the court vitiated the principle of equality of distribution in favor of the protection of a local creditor.<sup>330</sup>

Likewise, in its somewhat confusing discussion of the application of fraudulent transfer law, the court's primary concern was whether the actions of the Spanish liquidators violated U.S. law, rather than whether Adams's efforts to satisfy its judgment constituted a fraudulent disposition under applicable Spanish law. The *Papeleras* court acknowledged that deferring to the application of foreign fraudulent transfer law might be beneficial in some cases and understandably went on to argue the following:

However, in cases such as this, where both parties have taken significant steps over many years to protect their interests, and the foreign proceedings in particular have all but been consummated, the parties' acts consistent with the foreign law should be examined to determine whether the disposition of the property here should be prevented by deferring to the foreign country.<sup>331</sup>

Therefore, it would have been justifiable for the *Papeleras* court to examine whether fraudulent transfers are avoided under Spanish bankruptcy law and, if so, whether the Spanish liquidators had actually exercised those powers.<sup>332</sup>

Instead, however, the court discussed a number of "questionable conveyances" in the Spanish proceedings that would contravene U.S. law. For example, the court noted that the procedures followed in the sale of the trademarks by the Spanish liquidators to Bambu—more particularly, the failure to give notice to creditors and interested international buyers (including Adams, which the Spanish liquidators knew would bid if given the opportunity to do so), the failure to obtain the approval of the Spanish court, and the failure to notify the U.S. court<sup>333</sup>—although passing muster under Spanish law, would violate U.S. law. The court described several other "questionable conveyances" as

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<sup>330</sup>See text accompanying *supra* notes 173 to 187.

<sup>331</sup>*Papeleras*, 92 B.R. at 592.

<sup>332</sup>*Contra Finister*, *supra* note 62, at 369. Finister argues:

Once a court investigates whether preferential or fraudulent conveyances actually occurred, it has entered into areas of substantive bankruptcy law. No longer is the court reviewing foreign law to determine whether it is appropriate to lend assistance to the foreign proceeding. Rather, the court's application of substantive law will convert the Section 304 proceeding into a separate bankruptcy case administering United States assets.

*Id.* Finister's concerns aside, in determining whether or not to lend assistance to a foreign proceeding it is only appropriate that the U.S. court have the power to investigate whether the foreign proceeding in fact utilizes the avoiding powers under foreign law. Such an inquiry need not convert the § 304 proceeding into a separate bankruptcy case. To hold otherwise would enable a foreign proceeding to gain recognition based on the existence of, rather than compliance with, avoidance laws. See *Axona*, 88 B.R. at 613.

<sup>333</sup>*Papeleras*, 92 B.R. at 592.

well,<sup>334</sup> and was concerned by the fact that, when the Spanish court approved the suspension of payments procedure for *Papeleras*, the debtor's assets exceeded its liabilities, yet at the time of liquidation over \$20,000,000 in claims were to go unpaid.

Many of these "questionable conveyances" certainly called into question the overall fairness of the Spanish proceedings and would have justified the court to seek detailed explanations from the Spanish liquidators, and if satisfactory responses had not been forthcoming, to dismiss the § 304 petition (in reliance on § 304(c)(2) and (5)). However, these questionable actions by the Spanish authorities were not relevant to the application of § 304(c)(3).

Turning to the § 304(c)(2) requirement that claim holders in the United States be protected against prejudice and inconvenience in processing claims in the foreign proceeding, the *Papeleras* court reached the right conclusion but partially for the wrong reason. In claiming that Adams should have received notice of the Spanish proceeding, the *Papeleras* court cited *Culmer*. In finding that § 304(c)(2) was satisfied, the *Culmer* court first noted that under Bahamian law and procedure "[a]dequate notice of the Bahamian proceeding is required."<sup>335</sup>

The notice issue in *Papeleras* was more complex than in *Culmer*, however. In *Culmer* notice was given to a U.S. creditor holding a claim recognized under Bahamian law. In *Papeleras* notice was not given to a U.S. company that was not recognized as a creditor under Spanish law. Recall, Adams's disputed claim could not be recognized under Spanish law until it was rendered undisputed. Even so, Adams was still entitled to receive notice—Spanish law sets forth certain procedures for the adding of a creditor, including allowing a putative creditor to petition the creditors' committee or to commence a lawsuit.<sup>336</sup> For the putative creditor to avail itself of either of these remedies, it must first receive notice of the suspension of payments or the liquidation.<sup>337</sup> Thus, Adams as the holder of a disputed claim should have been given notice and an opportunity to be heard in the Spanish proceeding. Adams could then have set forth reasons under Spanish law why it should have been added as a creditor in the Spanish proceeding, and it would have been up to the Spanish court to adjudicate this issue. Also, Adams was a shareholder of *Papeleras* and should have received notice

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<sup>334</sup>See *id.* at 592–93.

<sup>335</sup>*Culmer*, 25 B.R. at 630.

<sup>336</sup>*Papeleras*, 92 B.R. at 590 n.14.

<sup>337</sup>Spanish law also provides that the creditors' committee may add a creditor without the putative creditor having to petition. But allowing creditors potentially in conflict with the putative creditor to decide whether the putative creditor should join their committee (and thus share in any distributions made to creditors) is potentially unfair and could likely cause the creditor to suffer inconvenience and prejudice in the processing of its claim. *Id.*

in that capacity.<sup>338</sup>

The *Papeleras* court, however, did not limit its analysis to asserting that Adams would be subject to inconvenience and prejudice in the processing of its "claim" by reason of its not receiving notice. Rather, it claimed that "[b]y reason of its not having been given notice of the Spanish proceeding, Adams was not recognized as a creditor, thus depriving it of the opportunity to participate in the proceeding, prejudicial to its rights."<sup>339</sup> The fallacy in this assertion is that the court assumed that, if Adams had received notice of the Spanish proceeding, then Adams would have been recognized as a creditor; in fact, even if Adams had received notice, Adams would not have been recognized as a creditor since its claim was not one recognized under Spanish law.

The *Papeleras* court thus interpreted § 304(c)(2) as requiring that a claim holder under U.S. law be treated as a claim holder under foreign law. This interpretation takes the territoriality principle in § 304(c)(2) too far—the determination of who is a claim holder in a foreign proceeding should be a matter to be decided by the foreign court under foreign law.

In addition to the lack of notice to Adams, there were a number of other factors in the case, discussed by the *Papeleras* court elsewhere in its decision (but not in its analysis of § 304(c)(2)), that demonstrate that Adams had suffered further discrimination in processing its claims in the Spanish proceeding. For instance, as noted earlier, the Spanish liquidators' attorney misled the U.S. court about the intention of the Spanish liquidators to sell the trademarks. In light of this lack of honesty, the procedures followed by the Spanish liquidators for their sale of the trademarks also called into question the fundamental fairness of the Spanish proceeding,<sup>340</sup> as did the many "questionable conveyances" noted by the court in its discussion of § 304(c)(3).

In finding that section 304(c)(4) was not satisfied because the foreign law relegated a lien holder to the status of at best an unsecured creditor,<sup>341</sup> the *Papeleras* court followed an approach similar to that of the *Toga* court. (Interestingly enough, there is no reference to *Toga* in the *Papeleras* opinion.) The *Papeleras* court also noted that Adams' status as the holder of an equitable lien would not be recognized by the Spanish proceeding. The shortcomings of such an approach that focuses on particular differences in statutory schemes of distribution, rather than on considering such schemes in the context of the overall fairness of the foreign law and the general similarity of the foreign law

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<sup>338</sup>The *Papeleras* court failed to mention this point in its discussion of § 304(c)(2).

<sup>339</sup>*Papeleras*, 92 B.R. at 590.

<sup>340</sup>In and of itself, the lack of notice and a hearing regarding the sale of the trademarks does not demonstrate the inherent unfairness of the Spanish proceeding. Although notice and a hearing would be required under § 363(b) of the U.S. Bankruptcy Code, 11 U.S.C.A. § 363(b) (West 1991), there is no requirement in § 304 that the procedural requirements in the foreign proceeding must be a carbon copy of the U.S. procedures.

<sup>341</sup>*Papeleras*, 92 B.R. at 593.

and U.S. law, have been discussed earlier.<sup>342</sup>

Lastly, the court turned to an analysis of comity under § 304(c)(5). The court rejected the approach in *Culmer*, *Gee* and *Metzeler*, which treated comity as the focal point of the § 304(c) inquiry, and instead viewed comity as just one of six factors to be considered.<sup>343</sup> The court found support for its view in Representative Don Edwards's remarks in the legislative history to § 304 in which he said, "Section 304(c) is modified to indicate that the court shall be guided by considerations of comity *in addition* to the other factors specified therein."<sup>344</sup> Notwithstanding this remark, as mentioned earlier, the historical development of the comity doctrine supports the view taken by *Culmer*, *Gee* and *Metzeler*.<sup>345</sup>

The *Papeleras* decision states that comity is only one of six factors that must be considered, and the court's meager discussion of comity indicates that it actually gave comity even less weight than that. Indeed, the court's application of comity to the facts of the case constituted a mere two sentences of its eleven-page opinion:

In light of all of the foregoing facts peculiar to this instant case, if this court should defer to the Spanish proceeding, Adams will be prejudiced by the omissions of Spanish law and the lack of candor by *Papeleras* and [the Spanish] liquidators. The principles of comity dictate the dismissal of the ancillary proceedings.<sup>346</sup>

Given the fact that the notion of comity incorporates the other factors listed in § 304(c), on the facts of the case the court reached the correct conclusion. But more analysis by the court would have been helpful. There are strong policy reasons for granting comity to a bankruptcy proceeding in the appropriate forum when that proceeding adopts the principle of equality of distribution (satisfying § 304(c)(1)) and disallows preferential and fraudulent transfers (satisfying § 304(c)(3)), and granting ancillary assistance to that proceeding would further the economical and expeditious worldwide administration of the estate. However, in *Papeleras* these factors were outweighed by the fact that the criteria in § 304(c)(2) (and in the court's view, § 304(c)(4)) were not fulfilled. Therefore, the *Papeleras* court was justified in denying comity to the Spanish proceedings and in allowing the fraudulent conveyance action to continue under U.S. law.

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<sup>342</sup>See text accompanying notes 296 to 299 *supra*.

<sup>343</sup>*Papeleras*, 92 B.R. at 594.

<sup>344</sup>*Id.* at 594 (quoting Rep. Don Edwards) (emphasis added by court).

<sup>345</sup>See text accompanying *supra* notes 226 to 227.

<sup>346</sup>*Papeleras*, 92 B.R. at 594-95.

Thus, although the *Papeleras* decision reached the correct result, it failed to grapple with many of the important issues and misapplied many of the criteria to be considered when ruling upon a § 304 request for relief. Rather than evenhandedly applying the universality and territoriality factors contained in § 304(c) and attempting to ascertain the overall fairness of the foreign law, the court instead put its own territoriality-based gloss on the § 304(c) factors and interpreted these factors from the perspective of a U.S. creditor seeking the application of U.S. law.

The other recent case denying the recognition of a foreign liquidation proceeding, *Interpool*, offers an interesting comparison to the *Papeleras* decision, for it too denied ancillary assistance on the grounds that the foreign proceeding had prejudiced the interests of U.S. creditors and subjected them to unfair procedures. *Interpool* is the first reported § 304 case to consider Australian law and the first reported case since *Toga* that failed to recognize the bankruptcy proceedings of a sister common law jurisdiction.<sup>347</sup>

This case involved the complicated dealings between KKL Kangaroo Lines ("KKL"), an Australian company that operated a liner service, and Wah Kwong, which leased ships to KKL. On January 14, 1986, Wah Kwong commenced involuntary liquidation proceedings in Australia against KKL. On February 17, 1986 the Australian courts ordered KKL to wind up operations and appointed a liquidator ("the Australian liquidator"). The Australian liquidator then entered into several agreements with Wah Kwong and its subsidiaries.

From the time of the commencement of the involuntary proceedings against KKL, KKL retained various freight monies in the United States. Several U.S. trucking concerns had claims against KKL, and various lien creditors seized assets of KKL in the United States. On February 27, 1986, the Australian liquidator filed a petition in the U.S. Bankruptcy Court for the District of New Jersey to commence a § 304 ancillary case. Shortly thereafter, several U.S. creditors commenced an involuntary chapter 7 liquidation case against KKL in the U.S. Bankruptcy Court for the Central District of California. The chapter 7 case was transferred to the U.S. District Court for the District of New Jersey, and on April 28, 1987, the § 304 petition was also transferred to the same court. During the rest of 1987 and 1988, the district court entered several orders providing for interim relief, including (1) enjoining KKL's creditors from proceeding against KKL's assets and (2) collecting and subsequently distributing outstanding freight monies. In October 1988 the district court confronted

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<sup>347</sup>To date U.S. courts in § 304 or related cases have recognized bankruptcy proceedings in the following sister common law jurisdictions: Bahamas (*Culmer*, 25 B.R. 621); the Cayman Islands (*Gee*, 53 B.R. 891); Bermuda (*Lines*, 81 B.R. 267); the United Kingdom (*Gercke*, 122 B.R. 621); Canada (*Ernst & Young*, 129 B.R. 147); and Hong Kong (*Axona*, 88 B.R. 597)(§ 303(b)(4) case). Also, U.S. courts in non-U.S. Bankruptcy Code cases have recognized bankruptcy proceedings in the following sister common law jurisdictions: the United Kingdom (*IBB Turnover Orders*, *supra* note 58); Canada (*Caddel*, 105 B.R. 366; *Clarkson*, 544 F.2d 624; *Cornfeld*, 471 F. Supp. 1255).

the issue of whether (1) to grant the final § 304 petition (and allow U.S. assets to be administered under Australian bankruptcy law) and dismiss the competing chapter 7 case, or (2) to deny the section 304 relief and appoint a chapter 7 trustee to administer the assets of KKL in the United States under U.S. law. The court opted for the latter course of action.<sup>348</sup>

To understand the court's resolution of this issue, several other facts must be set out. KKL, organized in 1981, at first was owned by a liner company, Karlander Australia ("Karlander"). In 1983 KKL became an independent company. In November 1983 KKL executed a heads of agreement with Karlander ("the heads of agreement"), in which KKL agreed to assume the business of Karlander and to pay off Karlander's creditors. In turn, in January, 1984 Karlander transferred to KKL its rights (valued at between US\$3 million and \$40 million) in an arbitration with Weyerhaeuser Co. ("the Weyerhaeuser arbitration").

Wah Kwong then entered the picture. A subsidiary of Wah Kwong loaned US\$6 million to KKL, and in exchange KKL assigned its rights in the Weyerhaeuser arbitration to Wah Kwong. The arrangements between KKL and Wah Kwong became further entwined. Indeed, their relationship "was described as a joint venture agreement."<sup>349</sup> Wah Kwong's president sat on KKL's board of directors, KKL assigned its earnings to Wah Kwong through a Wah Kwong subsidiary, and a Wah Kwong representative was required to co-sign all KKL checks.

However, relations soured between KKL and Wah Kwong and problems ensued for both parties. In January 1986, a vessel was arrested in Los Angeles. Wah Kwong then issued a press release claiming that KKL owed it US\$10 million and blocked payments to creditors. The creditors responded by shortening their credit terms, which caused a shortage of funds for KKL. KKL asserted that Wah Kwong milked it of funds and therefore was in breach of their agreement. Wah Kwong claimed that KKL could not meet its obligations under the agreement. In any case, the result was that KKL ended up in liquidation and Wah Kwong went into receivership.<sup>350</sup>

In May 1986, three months after the Australian liquidator had petitioned in the United States for ancillary relief under § 304, an agreement ("the

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<sup>348</sup>*Interpool*, 102 B.R. at 380. On appeal the Third Circuit held that, in a § 304 case when a foreign representative "seeks dismissal of a competing bankruptcy proceeding against the foreign debtor, such relief is governed by section 305 and the court's decision is nonreviewable. Because this is such a case, we lack jurisdiction to hear the liquidator's appeal and therefore we will dismiss it." *Interpool*, 878 F.2d at 115. Because the appeal was from the district court to the court of appeals, this decision withstands the changes made to § 305(c) by the Judicial Improvements Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (the "Judicial Improvements Act of 1990"). The facts of the case as discussed in the text above are set out in *Interpool*, 102 B.R. at 374-76.

<sup>349</sup>*Interpool*, 102 B.R. at 375.

<sup>350</sup>*Id.* at 376.

deed") was concluded in Australia between the Australian liquidator, KKL, Karlander, and several Wah Kwong subsidiaries. The deed specified that any proceeds from the Weyerhaeuser arbitration would be paid to the Australian liquidator, who in turn would distribute the first US\$6 million to a Wah Kwong subsidiary in satisfaction of the earlier loan to KKL. After paying out some other distributions from the proceeds, the Australian liquidator would hold the remainder of the proceeds for the purposes of administering KKL while in liquidation.

In deciding whether to grant the requested § 304 relief, the *Interpool* court noted that it would be guided by the factors enumerated in § 304(c), and especially by the notions of comity.<sup>351</sup> However, unlike the courts in cases such as *Culmer* and *Gee*, the *Interpool* court discussed the other § 304(c) factors only in passing.

In its discussion of comity, the *Interpool* court cited *Salen I* for the requirement that "the foreign court must abide by fundamental standards of procedural fairness" for comity to be granted,<sup>352</sup> and for the proposition that "[t]he rationale underlying the granting of comity to a final foreign judgment is that litigation should end after the parties have had an opportunity to present their cases fully and fairly to a court of competent jurisdiction."<sup>353</sup> In the court's view, resolving the issue of whether to grant comity to the actions of the Australian court was dependent on the following:

- a) whether the United States creditors have the ability to pursue their rights in Australian courts; and
- b) whether there is enough parity in the essence of the Australian Bankruptcy Rules so that the United States creditors w[ould] be similarly protected in both jurisdictions.<sup>354</sup>

In analyzing the first factor, the court noted that Australian law grants U.S. creditors the right to pursue their claims in Australian liquidation proceedings, and cited various sections from the Companies Code of Australia (the "Australian Companies Code"<sup>355</sup>) in support. For instance, § 420(1) allows a creditor to complain to the court about the conduct of the liquidator in connection with the performance of his duties, and provides that "the Court may

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<sup>351</sup>*Id.* at 377. It is implicit in the court's decision that the threshold criteria had been satisfied. The court should have explicitly discussed these factors. Perhaps the court discussed these factors in its earlier § 304 orders.

<sup>352</sup>*Id.* (citing *Salen I*, 773 F.2d 452).

<sup>353</sup>*Id.* (quoting *Salen I*, 773 F.2d at 457).

<sup>354</sup>*Id.*

<sup>355</sup>At the time *Interpool* was decided, each Australian state had adopted the Australian Companies Act 1981 (Cth) in its own state code. However, rather than referring to the New South Wales Companies Code (the "Australian Companies [NSW] Code"), all references herein will instead track the court's references to the Australian Companies Code.

inquire into the matter and take such action as it sees fit.”<sup>356</sup> In addition, the Australian court “may require that the Liquidator answer any inquiry in relation to the winding up and may direct an examination of the Liquidator.”<sup>357</sup> Lastly, the court noted that the Australian court “has independent powers to direct the Liquidator to lodge a report with respect to any matter.”<sup>358</sup> After reviewing these sections of Australian law, the *Interpool* court stated that “[i]t would seem, therefore, that access to Australian courts relating to actions of the Liquidator is not restricted.”<sup>359</sup>

Nevertheless the court concluded as follows:

However, from the briefs, affidavits, and testimony of the [Australian] Liquidator, it appears that the creditors would not have an opportunity in Australia to petition the Australian Court to set aside the [Australian] Liquidator’s actions in ratifying the agreement between the [Australian] Liquidator and Wah Kwong. It appears from the record that winding up proceedings are essentially *ex parte* proceedings in Australia, and as such, do not provide the same recourse as do our Bankruptcy Rules.<sup>360</sup>

In reaching this conclusion the *Interpool* court followed a territoriality approach: “Protection of United States creditors is of utmost importance to this Court. Actions taken by a foreign court in a foreign bankruptcy are to be given deference if, and only if, there would be no substantial violation of the law that would

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<sup>356</sup>*Interpool*, 102 B.R. at 378 (citing § 420(1)(b) Australian Companies Code). Since *Interpool* was decided, Australian company law has been federalized. New insolvency legislation has been enacted in the Australian Corporations Act 1989, as amended by the Australian Corporations Legislation Amendment Act 1990 (Cth) and the Australian Corporations Legislation Amendment Act 1991 (Cth). This law, in turn, has been adopted by the Australian states and the Northern Territory and operates Australia-wide. It will be cited as the “Australian Corporations Law.” Section 420(1)(b) of the Australian Companies Code has been replaced by § 536(1)(b) of the Australian Corporations Law.

<sup>357</sup>*Interpool*, 102 B.R. at 378 (citing § 420(3) Australian Companies Code, now § 536(3) Australian Corporations Law).

<sup>358</sup>*Interpool*, 102 B.R. at 378 (citing § 418(3) Australian Companies Code, now § 533(3) Australian Corporations Law). The *Interpool* court erroneously cited § 418(2). Also, the court should have added that the Australian court has this power if it appears to the court that during the winding up of the company an involved party has been guilty of an offense, that the liquidator has not made a report with respect to that matter, and that a person interested in the winding up (which would certainly include a U.S. creditor) had applied to the court or that the court so moves on its own accord. § 418(3) Australian Companies Code, now § 533(3) Australian Corporations Law. In its initial discussion of Australian insolvency law, the *Interpool* court also cited section 413 of the Australian Companies Code, now section 511 of the Australian Corporations Law. *Interpool*, 102 B.R. at 378. However, its reliance on this section was inapposite, because this section applies only to voluntary windings up in Australia and not to windings up by the court. Since the *Interpool* decision states that KKL was the subject of involuntary liquidation proceedings filed by Wah Kwong, it appears that the case involved a compulsory winding up by the court.

<sup>359</sup>*Interpool*, 102 B.R. at 378.

<sup>360</sup>*Id.*

be applied in the United States.”<sup>361</sup> In comparing the protections that the U.S. creditors had received under Australian law with the protections that they would have received under U.S. law, the court claimed: “[t]here is no requirement that Australian law and United States law be identical. However, before a section 304 Petition may be granted, this Court must be convinced that the foreign Court has or will abide by fundamental standards of procedural fairness.”<sup>362</sup> This assertion to the contrary, the *Interpool* opinion, in effect, sets forth the requirement that for § 304 relief to be granted, the foreign law *must* be identical to the U.S. law.<sup>363</sup>

Among the protections under U.S. law discussed by the court are that creditors be notified prior to the ratification of agreements between the trustee and any creditors<sup>364</sup> and that the trustee and the creditors hold a series of meetings regarding the liquidation of the assets in the debtor’s estate.<sup>365</sup> The *Interpool* court then claimed that under Australian law “[m]atters are dealt with in a completely different fashion, and notice is not required . . . [, and that] while a creditor may call a meeting, that creditor would have to know of the proceedings before making such a request.”<sup>366</sup> The court concluded:

Since, in this case, the creditors were not notified prior to the date the Court ratified the agreement between the [Australian] Liquidator and Wah Kwong, and in addition, were not notified of the original § 304 filing, this Court finds that the procedural protections available to creditors in the United States were not given to the United States creditors in Australia. This is a serious omission.”<sup>367</sup>

The court next examined the different substantive treatment that the U.S. creditors had received under Australian law, and focused on the lack of an equitable subordination remedy and the role of the court in ensuring that a fair result is reached:

United States courts have both the power and the duty to sift through the circumstances surrounding any claims to

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<sup>361</sup>*Id.*

<sup>362</sup>*Id.* (citation omitted).

<sup>363</sup>Daniel M. Glosband & Christopher T. Katucki, *U.S. Court Declines Recognition of Australian Insolvency Proceedings*, 2 INT’L CREDITORS’ RTS. & INSOLVENCY REP. 4, 5 (1990) [hereinafter *Australian Insolvency Proceedings*]. See also Michael R. Hughes, *An Australian Perspective on Interpool*, 2 INT’L INSOLVENCY & CREDITORS’ RTS. REP. 32 (1990).

<sup>364</sup>Fed. R. Bankr. P. 2002(a)(3) (West 1991). The *Interpool* court erroneously cited R. 2002(a)(5), Rules of Bankruptcy Procedure, now Fed. R. Bankr. P. 2002(a)(5) (West 1991). *Interpool*, 102 B.R. at 378.

<sup>365</sup>*Interpool*, 102 B.R. at 378–79.

<sup>366</sup>*Id.* at 379.

<sup>367</sup>*Id.*

see that justice is done in the administration of bankrupt estates. The Court must look to whether the transaction being scrutinized was entered into in good faith, and not with a view to the sole benefit of one creditor.<sup>368</sup>

In short, the court was concerned that the doctrine of equitable subordination “does not exist in *anywhere close to the same form* [under Australian law] as that found in the U.S. Bankruptcy Code. Nor is there any comparable procedure under Australian law.”<sup>369</sup> The court was especially concerned about the inability of the Australian court to remedy the “substantial allegations of insider machinations” by Wah Kwong.<sup>370</sup> The court concluded that:

[t]he lack of procedural redress in the first instance and substantive redress in the second instance could significantly affect creditors’ rights and chances for a fair settlement of their grievances and claims against the Australian company.

Both the laws and public policy of the United States [would] be violated if the case [were] permitted to proceed under Australian law. . . . and this Court does not intend to stand idly by while United States’ citizens and creditors are harmed.<sup>371</sup>

These are strong words, fighting words, and closer analysis is necessary to determine whether the thrust of the court’s criticisms of Australian insolvency law and its denial of the § 304 petition are borne out.

In evaluating the *Interpool* decision, one must return to some propositions from *Salen I*. As mentioned earlier, the *Interpool* court cited the proposition from *Salen I* that “[t]he rationale underlying the granting of comity to a final foreign judgment is that litigation should end after the parties have had an opportunity to present their cases fully and fairly to a court of competent jurisdiction.”<sup>372</sup> However, the court omitted the second, more pertinent, proposition from *Salen I* that:

[t]he extending of comity to a foreign bankruptcy proceeding, by staying or enjoining the commencement or continuation of an action against a debtor or its property, has a somewhat different rationale. The granting of comity to a foreign bankruptcy proceeding enables the assets of a debtor to be dispersed in an equitable, orderly, and systematic manner, rather than in a haphazard, erratic or piecemeal fashion.<sup>373</sup>

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<sup>368</sup>*Id.* (citation omitted).

<sup>369</sup>*Id.* at 379–80.

<sup>370</sup>*Id.* at 380.

<sup>371</sup>*Id.*

<sup>372</sup>*Id.* at 377 (quoting *Salen I*, 773 F.2d at 457).

<sup>373</sup>*Salen I*, 773 F.2d at 457–58.

The fact that the *Interpool* court cited only the first and not the second proposition from *Salen I* is illuminating—throughout its opinion, the *Interpool* court analyzed Australian law through glasses tinted with the U.S. Bankruptcy Code<sup>374</sup> and harked on the unfairness of the essentially *ex parte* nature of the Australian proceedings and the inadequacy of a few provisions of Australian law. However, the court failed to mention the much more important similarities between U.S. and Australian law and the provisions in Australian insolvency law that promote the “equitable, orderly, and systematic” treatment of a debtor’s estate. If the court had first attempted to discover whether Australian law satisfied the § 304(c) universality criteria (such as by adopting the *pari passu* principle and avoiding preferential and fraudulent transfers), and then turned to the issue of whether Australian law and procedure were “fundamentally fair” and would protect U.S. creditors against inconvenience and discrimination, the *Interpool* court would have discovered many factors in favor of recognition. Australian law includes many provisions that offer the very protection for U.S. creditors that § 304 requires.

Australia is a sister common law jurisdiction that has enacted insolvency provisions in its companies act that are similar to the insolvency provisions in the companies acts of other common law jurisdictions whose laws have been recognized in § 304 cases.<sup>375</sup> Australian insolvency law also adopts the principle of equality of distribution, and as one commentator states, “One of the main reasons why a company is wound up, is to ensure the just division among the creditors, and the distribution among the members, of the assets of the company.”<sup>376</sup> Moreover, the Australian Companies Code includes provisions for avoiding preferential or fraudulent transfers of property that would otherwise unjustly benefit certain creditors at the expense of other unsecured creditors.<sup>377</sup> Lastly, Australian insolvency law does not discriminate against foreign creditors—under Australian law “foreign creditors rank equally with local creditors.”<sup>378</sup>

Since it appears that Australian insolvency law fulfills the § 304(c)(1) and (3) criteria, the next issue that arises is whether Australian law is funda-

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<sup>374</sup>The court’s openly territorial approach is exemplified by its misquoting of § 304(c)(1): “[a]dditionally, our [U.S.] Bankruptcy Code requires that ‘just treatment be accorded United States creditors.’” *Interpool*, 102 B.R. at 378 (misquoting U.S.C. § 304(c)(1) (1982)). § 304(c)(1) says no such thing; it is not a territoriality factor. Rather, section 304(c)(1) requires the “just treatment” of *all* creditors—it is concerned with the equality of treatment and distribution to all creditors worldwide.

<sup>375</sup>See *supra* note 347.

<sup>376</sup>CCH, *LAW OF COMPANIES IN AUSTRALIA* (2d ed. 1986) [hereinafter “CCH”], ¶ 1287 at 520. See also *id.* ¶ 1280 at 512 (the object of the rules regarding proof of claims “is to put all unsecured creditors on an equal basis and to pay them *pari passu*.”)

<sup>377</sup>See §§ 451, 452, 453 Australian Companies Code, now, respectively §§ 565, 566, 567 Australian Corporations Law.

<sup>378</sup>W.E. PATERSON, H.H. EDNIE, & H.A.J. FORD, 3 *AUSTRALIAN COMPANY LAW* (3d ed. 1987) § 438/5 at 85,154.

mentally fair and would properly safeguard the interests of U.S. creditors under § 304(c)(2). In addition to the Australian law provisions enumerated by the *Interpool* court, several others should be noted. First of all, in a winding up by the court, the court appoints a liquidator<sup>379</sup> who as “an officer of the court . . . is directly answerable to the court for the manner in which he discharges his duties.”<sup>380</sup> The liquidator “occupies a fiduciary position in relation to the company, its creditors and contributories.”<sup>381</sup> Among the liquidator’s duties are to advertise a date by which all creditors must submit particulars or formal proof of their claims<sup>382</sup> and to examine (and admit or reject) each proof.<sup>383</sup>

The *Interpool* court was concerned that the U.S. creditors did not receive notice of the proceeding at which the Australian liquidator entered into the agreement with Wah Kwong’s subsidiary.<sup>384</sup> This omission certainly is important, but its overall importance must be put in perspective. It must be kept in mind that U.S. bankruptcy law provides for more creditor participation than do the insolvency laws of many other jurisdictions, including Australia. No doubt, an approach that encourages participation by creditors is an effective means of policing against fraud and dishonest dealings in the administration of bankruptcies, but this does not mean that such participation need be a *sine qua non* for recognizing foreign insolvency proceedings under § 304. Thus, although U.S. creditors should be given notice of the commencement of a liquidation to enable them to file their proofs of claim (as they were in *Interpool*),

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<sup>379</sup>§ 372(1) Australian Companies Code, now § 472(1) Australian Corporations Law.

<sup>380</sup>CCH, *supra* note 376, ¶ 1242 at 482.

<sup>381</sup>*Id.*

<sup>382</sup>The creditors receive notice to submit the particulars of their claims by advertisement in daily newspapers. Regs. 111(2), 120(2)(a), (b) Australian Companies Regulations, now, respectively, regs. 5.6.39(2), 5.6.48(2)(a) Australian Corporations Regulations; Australian Companies Forms 129, 130, Schedule 2, Australian Companies Regulations, now, respectively, Australian Corporations Forms 533, 534, Schedule 2, Australian Corporations Regulations. See CCH, *supra* note 376, ¶ 1280 at 514. Australian law also requires that written notice regarding formal proof be given “to every person who, to the knowledge of the liquidator, claims to be a creditor of the company, and whose debt or claim has not been admitted.” Reg. 120(2)(c) Australian Companies Regulations, now reg. 5.6.48(2)(b) Australian Corporations Regulations.

<sup>383</sup>Regs. 125, 126 Australian Companies Regulations, now, respectively, regs. 5.6.53, 5.6.54 Australian Corporations Regulations. See CCH, *supra* note 376, ¶ 1281 at 515.

<sup>384</sup>In *Interpool* the creditors did not question the notice requirements for filing particulars or proofs of claim. Rather, the U.S. creditors’ arguments focused on their failure to receive notice of both the proceeding at which the Australian liquidator entered into the arrangements with Wah Kwong’s subsidiary and the § 304 filing. The U.S. creditors would have had a much stronger case if they had failed to receive newspaper notice of the commencement of the liquidation, as occurred in *Papeleras*. Given the inherent difficulties of local newspaper notices reaching creditors abroad, Australia and Spain should consider amending their creditor notification procedures and requiring that all creditors receive written notice of the date by which to submit the particulars or proofs of their claims. See Fed. R. Bankr. P. 2002(a)(8). Such an amendment would increase the likelihood that creditors abroad would receive notice, thereby increasing the likelihood that insolvency proceedings in those countries would be granted § 304 ancillary assistance.

beyond that they should be entitled only to the application of fundamentally fair procedures—which need not necessarily include notice and an opportunity to be heard at each hearing or meeting which they would be entitled to attend under U.S. bankruptcy law. However, if U.S. creditors do not receive notice and an opportunity to be heard at such hearings or meetings, to comply with the requirements of § 304(c)(2) the U.S. court should ascertain whether the foreign bankruptcy proceedings have other procedures to safeguard the interests of creditors.

Although Australian procedures for the participation of creditors are not as comprehensive as those in the U.S. Bankruptcy Code, Australian law does provide other means to protect the interests of creditors. For example:

There flows from the fiduciary position of a liquidator a responsibility ratified by statute to act honestly in the exercise of his powers and the discharge of his duties and generally to act bona fide in the interests of the company *and particularly the creditors* and contributories.

. . .

A liquidator should maintain an even and impartial hand between all the individuals whose interests are involved in the winding up. This must particularly be the stance of a court-appointed liquidator, who, as an officer of the court, should maintain this impartiality.<sup>385</sup>

It thus appears that Australian insolvency law sets high standards for the performance of a liquidator's duties (which compare favorably with the standards for trustees or debtors in possession in the United States). Since in practice some liquidators might not perform up to such high standards, Australian law also provides for the statutory supervision of liquidators by both the courts and the Australian Securities Commission (replacing the National Companies and Securities Commission in existence at the time of *Interpool*). The *Interpool* court noted that section 420 of the Australian Companies Code provides for scrutiny of the Australian liquidator's actions by the court, but claimed that this section focuses on misfeasance by the liquidator.<sup>386</sup> However, section 420 is not limited to misfeasance—section 420(2) provides that if the court finds that there was “a misfeasance, *neglect*, or *omission* on the part of the liquidator . . . the [c]ourt may order the liquidator to make good any loss that the estate of the company has sustained thereby and make such order or orders as it sees fit.”<sup>387</sup> In addition, section 420(1) provides that if it appears to the court “that

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<sup>385</sup>CCH, *supra* note 376, ¶ 1245 at 489–90 (emphasis added) (citation omitted).

<sup>386</sup>*Interpool*, 102 B.R. at 379 n.4 (citing § 420 Australian Companies Code, now § 536 Australian Corporations Law).

<sup>387</sup>§ 420(2) Australian Companies Code, now § 536(2) Australian Corporations Law (emphasis added).

a liquidator has not faithfully performed or is not faithfully performing his duties . . . or a complaint is made to the [c]ourt . . . by any person with respect to the conduct of the liquidator in connection with the performance of his duties . . . the [c]ourt may take such action as it sees fit.”<sup>388</sup> Also, section 420(3) provides for the court’s power to examine the liquidator.<sup>389</sup>

An assortment of other provisions in the Australian Companies Code should also have protected the interests of U.S. creditors. For example, section 377(1) requires “the authority of the [c]ourt, of the committee of inspection<sup>390</sup> or of a resolution of the creditors” for the liquidator to exercise certain powers, including making any compromise or arrangement with creditors.<sup>391</sup> Section 377(5) ensures that all of the powers listed in section 377 are subject to the control of the court, and grants all creditors the right to apply to the court “with respect to any exercise or proposed exercise of any of these powers.”<sup>392</sup> Section 542 grants the court the power to make an order against liquidators if the court is satisfied that the liquidator is guilty of fraud, negligence, and related offenses.<sup>393</sup> Lastly, it should be noted “that the right to a winding up is in most cases . . . a class right.”<sup>394</sup> The Supreme Court of Tasmania expressed this principle, in the personal bankruptcy context, in *Re Hood*<sup>395</sup> as follows:

[O]nce the machinery of the Bankruptcy Act has been put in motion by one creditor filing a petition the case is thereafter affected with the interests of other creditors and the public . . . [, and] it is the duty of the [c]ourt to exercise a robust initiative to ensure that the interests of the general body of creditors and the public are protected.<sup>396</sup>

This brief investigation into Australian insolvency law demonstrates that Australian courts also have the duty, as the *Interpool* court said about their U.S. counterparts, to “see that justice is done” and to ensure that transactions have been “entered into in good faith, and not with a view to the sole benefit

<sup>388</sup>§ 420(1) Australian Companies Code, now § 536(1) Australian Corporations Law.

<sup>389</sup>§ 420(3) Australian Companies Code, now § 536(3) Australian Corporations Law.

<sup>390</sup>Australian law provides that:

[a] committee of inspection is a representative group of creditors and contributors appointed to superintend the liquidator’s administration of the company’s property and to give him directions . . . which he is bound to obey. It has been suggested that a committee of inspection is advisable in all but small windings up.

CCH, *supra* note 376, ¶ 1203 at 455. It cannot be discerned from the facts reported in *Interpool* whether or not such a committee was appointed in this case.

<sup>391</sup>§ 377(1)(c) Australian Companies Code, now § 477(1)(c) Australian Corporations Law.

<sup>392</sup>§ 377(5) Australian Companies Code, now § 477(6) Australian Corporations Law.

<sup>393</sup>§ 542 Australian Companies Code, now § 598 Australian Corporations Law.

<sup>394</sup>Professor E.L.G. Tyler, unpublished teaching outline, University of Hong Kong.

<sup>395</sup>[1971] A.L.R. 151.

<sup>396</sup>Tyler, *supra* note 394 (quoting *Re Hood*, [1971] A.L.R. at 153).

of one creditor.”<sup>397</sup> Perhaps most importantly, for the Australian liquidator to have entered into an agreement to compromise Wah Kwong subsidiary’s claim would have required the authorization of the court or of the committee of inspection, or a resolution of the creditors under § 377(1)(c) of the Australian Companies Code.<sup>398</sup> Certainly the Australian liquidator could not have ratified a sweetheart deal on his own. Rather, “[t]he exercise by a liquidator of his powers (specifically those conferred by sec. 377) is always subject to the control of the court and any creditor or contributory may apply to the court challenging the proposed exercise of them.”<sup>399</sup> Thus, the interests of U.S. creditors should have been protected, or in the words of an Australian commentator:

[W]hen the liquidator applies to ratify a compromise, it is the court which considers the interests of creditors and other interested parties. In situations where there are clearly competing interests, the Australian courts regularly make specific directions requiring that the liquidator give notice of his application to named persons, and entitling them to be joined as parties. Initially the necessity to apply for directions of this kind is a matter for the liquidator and his advisors. Ultimately, however, it is the court’s responsibility to ensure that all interested parties are represented. In this commentator’s experience, it would have been unprecedented for the Supreme Court of New South Wales to not have positively considered the interests of the United States creditors before sanctioning the agreement between the liquidator and the Wah Kwong subsidiary.<sup>400</sup>

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<sup>397</sup>*Interpool*, 102 B.R. at 379.

<sup>398</sup>§ 377(1)(c) Australian Companies Code, now § 477(1)(c) Australian Corporations Law. Section 420(1) and (2) Australian Companies Code (now § 536(1) and (2) Australian Corporations Law), in conjunction with § 377(1)(c) and (5) (now §§ 477(1)(c) and (6) Australian Corporations Law) arguably would have enabled the Australian court to undo the agreement entered into by the Australian liquidator and the Wah Kwong subsidiary. See CCH, *supra* note 376, ¶ 1242 at 482 (“[W]hilst recognizing that the court has to take cognizance of the conduct of official liquidators (and has the power to confirm, reverse, or modify the decisions of a liquidator), the court does not exercise its powers in this regard lightly”) (emphasis added). However, it should be noted that prior Australian law was more explicit on this point, for unlike present law, it included a section that provided that “[a]ny person aggrieved by any act or decision of the liquidator may apply to the [c]ourt which may confirm reverse or modify the act or decision complained of and make such orders as it thinks fit.” § 279 Australian Uniform Companies Act. See CCH, *AUSTRALIAN COMPANY LAW CASEBOOK* (1986), ¶ 1244 at 395–97 (discussing the application of this prior § 279 by the court in *Re Mineral Securities Australia Ltd.* (in liq.) [1973] 2 N.S.W.L.R. 207 and noting that the “comments by [the court in that case] on the principles of review of the [Australian Uniform] Companies [Act] of the liquidator’s actions must now be read with caution for . . . there is now no equivalent section in the [Australian] Companies Code to the former sec. 279.” *Id.* ¶ 1244, at 397).

<sup>399</sup>CCH, *supra* note 376, ¶ 1247, at 497. See also Hughes, *supra* note 363, at 32.

<sup>400</sup>Hughes, *supra* note 363, at 32.

Unfortunately, the *Interpool* court failed to acknowledge the duty of the Australian court to consider the interests of U.S. creditors. Rather, the court concentrated on the failure of Australian law to provide for notice prior to the ratification of the agreement between the Australian liquidator and the Wah Kwong subsidiary, or to permit equitable subordination of that agreement. Although it is true "that the doctrine of equitable subordination does not exist in anywhere close to the same form as that found in the United States Bankruptcy Code,"<sup>401</sup> the Australian court had other remedies to protect the interests of U.S. creditors.

Indeed, even if the *Interpool* court had found that this lack of an effective equitable subordination remedy failed to comply with the requirement of § 304(c)(4), this factor alone should not have outweighed the many factors that supported the granting of § 304(c) relief, including the following:<sup>402</sup> (i) Australia was the appropriate jurisdiction for the primary bankruptcy; (ii) the Australian laws complied with the requirements of § 304(c)(1) and (3); (iii) although Australian insolvency laws contain different safeguards than those under U.S. law, they do not appear to be fundamentally unfair or repugnant to our ideas of justice, and the U.S. creditors' allegations fell short of the "concrete evidence" or "concrete facts" necessary to support a finding that the creditors had confronted or would likely confront discrimination or inconvenience in the Australian proceedings<sup>403</sup> (thus § 304(c)(2) was satisfied); and (iv) deferring to the Australian proceedings would have enabled the assets of *Interpool* to be dispersed in an "economical and expeditious" manner. It therefore appears that comity and ancillary assistance should have been granted to the Australian winding up.

Compared to the facts of *Papeleras*, those of *Interpool* provided a far weaker case for nonrecognition. For example, the U.S. creditor in *Papeleras* did not receive notice of the suspension of payments declaration for forty-five months or notice of the commencement of the liquidation for five months, and was thereby prejudiced in its ability to obtain a timely hearing on recognition of its claim under Spanish law and participation in the insolvency proceedings. In contrast, in *Interpool* the U.S. creditors received notice of the commencement of the winding up and instead challenged the lack of notice about an agreement entered into between the Australian liquidator and a major creditor (and about the lack of notice of the commencement of the § 304 case<sup>404</sup>).

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<sup>401</sup>*Interpool*, 102 B.R. at 379.

<sup>402</sup>See *supra* note 301 and accompanying text; Finister, *supra* note 62, at 370.

<sup>403</sup>The *Interpool* court could have required the U.S. creditors to come forward with evidence to support their allegations of the impropriety of the dealings between the Australian liquidator and Wah Kwong's subsidiary.

<sup>404</sup>The court mentioned this factor only in passing. If true, it would raise questions under U.S., not Australian, law.

Secondly, in *Papeleras* the Spanish liquidators and their counsel were not forthright in their dealings with the U.S. court and the U.S. creditor, and a number of other "questionable conveyances" had been brought to the attention of the U.S. court. In *Interpool*, in comparison, there was no evidence that the Australian liquidator had discriminated against the U.S. creditors. The U.S. court asserted that Australian bankruptcy procedures in general were unfair, and the U.S. creditors alleged that the relationship between the debtor and a major creditor had prejudiced and would continue to prejudice their interests; but the court's findings about the unfairness of the Australian law were tenuous at best, and the creditors failed to offer any concrete evidence to support their allegations.

*Interpool* stands as the most serious rejection of the *Culmer* approach since *Toga* and "may have a more far reaching effect since it questions in general terms the notice procedures of Australian insolvency law, thereby suggesting that Australian proceedings should rarely be recognized by U.S. Bankruptcy Courts."<sup>405</sup> The *Interpool* approach hinders the likelihood of further cooperation in cross-border insolvencies and sends the signal to other jurisdictions that § 304 relief will be hard to obtain.

Another recent case, *In re Banco Nacional de Obras y Servicios Publicos, S.N.C. ("Banobras")*,<sup>406</sup> also stresses the importance of protecting the interests of U.S. creditors, but in the context of the universality approach. In *Banobras*, the first reported case to address the difficult issues arising when a collective bargaining agreement governed by U.S. law is involved in the insolvency of a foreign debtor, the court reached a compromise: it recognized the foreign insolvency proceedings for most purposes (such as for controlling the disposition of the foreign debtor's estate and the claims against the estate), but held that the issues involved in adjudicating the claims of union members arising under the collective bargaining agreements and U.S. labor law were to be adjudicated in a U.S. court under U.S. law (as long as the U.S. court determined that it had jurisdiction and that a collective bargaining agreement existed).<sup>407</sup> *Banobras* is thus the first reported § 304 case since *Lineas I* and *II* that has granted limited recognition to a foreign insolvency proceeding. However, in contrast to the poorly reasoned and openly territorial approach of *Lineas I* and *II*, the *Banobras* court offered a thoughtful, balanced solution to a difficult problem.

The *Banobras* case involved the bankruptcy of *Aeronaves*, a Mexican company owned by Mexican government agencies. *Aeronaves* operated *Aeromexico* (Mexico's national airline), which operated in the United States, as well as in

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<sup>405</sup>Glosband & Katucki, *Australian Insolvency Proceedings*, *supra* note 363, at 5; Glosband & Katucki, *Current Developments*, *supra* note 62, at 2278.

<sup>406</sup>91 B.R. 661 (Bankr. S.D.N.Y. 1988). The facts of the case are set out in *id.* at 662-64.

<sup>407</sup>*Id.* at 668.

Mexico. Of Aeromexico's 12,500 workers, 350 in the United States were represented by the International Association of Machinists and Aerospace Workers, AFL-CIO ("the IAM"). On behalf of these employees, the IAM entered into two collective bargaining agreements with Aeronaves that became effective on June 1, 1983, and amendable on May 31, 1986 ("the 1983 agreements"). The IAM alleged that Aeronaves and the IAM entered into another agreement on March 14, 1987, that modified the 1983 agreements ("the 1987 agreement") by providing that the 1983 agreements were to remain in full force and effect, subject to specific amendments including specific wage and benefit reductions to be effective through March, 1990. These reductions were to be contingent upon Aeronaves obtaining the same reductions from the International Brotherhood of Teamsters ("the IBT") within 120 days; if those reductions were not obtained, the wages and benefits of the IAM members were to "snap-back" to levels as provided in the 1983 agreements.<sup>408</sup>

In September, 1987 the IAM notified Aeronaves that since Aeronaves had not obtained the same reductions from the IBT, the wages and benefits for the IAM should snap-back to the 1983 levels. Aeronaves disagreed and two months later responded in a letter to the IAM claiming that there was no existing contract between Aeronaves and the IAM.

The disagreement continued, and in March, 1988 the IAM commenced a suit in the Southern District of New York ("the S.D.N.Y.") against Aeronaves for declaratory and injunctive relief ("the IAM action"). The complaint sought, *inter alia*, a declaration that the 1983 agreements were in full force and effect and a determination of rights pursuant to the 1983 and 1987 agreements. Aeronaves's answer, filed on April 13, 1988, denied most of IAM's allegations and asserted that the district court did not have jurisdiction.<sup>409</sup>

Two days later, Aeronaves commenced a bankruptcy case under Mexican bankruptcy law. The filing was precipitated, in great part, by labor problems in Mexico. On April 21, 1988 Banco Nacional de Obras y Servicios Publicos, S.N.C., the bankruptcy trustee of Aeronaves ("the Mexican trustee"), commenced a section 304 proceeding in the U.S. Bankruptcy Court for the S.D.N.Y. to restrain "American creditors from pursuing in any court other than the Mexican bankruptcy court or [the Bankruptcy Court for the S.D.N.Y.] claims against Aeronaves or its property in [the United States]."<sup>410</sup> The U.S. bankruptcy court recognized the Mexican proceeding, and then (with the consent of the debtor's major creditors) granted such preliminary injunctive relief and entered a consent order that stayed the IAM Action.

After the labor contracts between Aeronaves and its unions, including the IAM, were rejected in the Mexican bankruptcy proceedings, the IAM asked

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<sup>408</sup>*Id.* at 663.

<sup>409</sup>*Id.*

<sup>410</sup>*Id.* at 662.

the U.S. bankruptcy court to modify its previously ordered relief and to permit the IAM action to continue. The IAM claimed that the U.S. Railway Labor Act ("the USRLA"), which "provides a unique regulatory scheme,"<sup>411</sup> governed the IAM action. The IAM sought the application of this U.S. labor law by a U.S. court to determine whether a collective bargaining agreement between IAM and Aeronaves had been in force on the date of Aeronaves's bankruptcy and, if so, to determine the union's rights as well.<sup>412</sup> The IAM acknowledged that it would not be able to execute on any monetary damages award, but argued that such an award would be "essential to a complete and accurate assessment of the claims of the American employees against Aeronaves."<sup>413</sup> The union also argued that it would be inconvenient and financially onerous for individual U.S. employees to travel to Mexico to litigate there whether a collective bargaining agreement existed between the IAM and Aeronaves.

The Mexican trustee countered that the Mexican bankruptcy court should resolve the claims arising from the alleged breach of the collective bargaining agreement, and would do so more quickly than would the U.S. court. The Mexican trustee also asserted that the IAM would not be prejudiced if its claims were determined by the Mexican court, since the dispute involved "ordinary principles of contract law" which the Mexican court could apply correctly.<sup>414</sup>

After reviewing an extensive number of cases involving U.S. labor law and the USRLA, the *Banobras* court rejected the Mexican trustee's contentions and held in favor of the IAM. The court claimed that "American labor law is an area which is *sui generis*"<sup>415</sup> and cited an earlier case for the proposition that "[a] collective bargaining agreement is not an ordinary contract for the purchase of goods and services, nor is it governed by the same old common-law concepts which control such private contracts."<sup>416</sup> Rather, Congress had enacted a "specialized statutory scheme" for common carriers,<sup>417</sup> the heart of which was "to compel the parties to negotiate their differences in good faith. If they reach an impasse, they must then follow a series of procedures set forth by the [US]RLA."<sup>418</sup>

The court then discussed the amendments made to the U.S. Bankruptcy Code in the aftermath of *NLRB v. Bildisco and Bildisco*<sup>419</sup> to demonstrate fur-

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<sup>411</sup>*Id.* at 664.

<sup>412</sup>*Id.* at 663.

<sup>413</sup>*Id.*

<sup>414</sup>*Id.* at 664.

<sup>415</sup>*Id.*

<sup>416</sup>*Id.* at 665 (citation omitted).

<sup>417</sup>*Id.*

<sup>418</sup>*Id.*

<sup>419</sup>465 U.S. 513 (1984). See 11 U.S.C. § 1113(c) (West 1991).

ther the "Congressional concern with the implementation of labor policies."<sup>420</sup> The court also noted that "[t]he 'rule is well-established that technical rules of contract do not control the question of whether a collective bargaining agreement has been reached.'"<sup>421</sup> Thus, the court determined that the resolution of the issues involving the collective bargaining agreement would be better resolved by a U.S. court with the proper expertise.

The court next turned to § 304 to determine if modifying its earlier ordered relief (to enable the IAM action to continue in the U.S. courts) would be appropriate, and stated that it would be guided by principles of comity. The court added, however, that comity would not be granted "if it would result in forcing American creditors to participate in foreign proceedings in which their claims w[ould] be treated in some manner inimical to this country's policy of equality."<sup>422</sup> The *Banobras* court followed a universality-based approach, and held that:

Mexico's interest in administering Aeronaves's estate must be balanced against the interests of the union members in having the IAM Action proceed in the United States. So long as the foreign law is not repugnant to our own, the scale will ordinarily tip in favor of having the foreign tribunal liquidate claims against the estate, because the equitable and orderly distribution of the debtor's property can best be accomplished in a single proceeding. Here, however, there is the added wrinkle that, to determine the amount of the union members' claims, the tribunal must first decide whether a collective bargaining agreement existed and what its terms were[,] issues which turn on a specialized area of law laced with strong policy considerations.<sup>423</sup>

In balancing these interests, the court decided in favor of the union members and held that "the IAM Action should be tried by a judge fully sensitive to the unique nature and purposes of the [US]RLA, experienced in the complexities of the statutory scheme and familiar with the policies sought to be effectuated by Congress."<sup>424</sup> The court was cognizant that its ruling would cause

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<sup>420</sup>*Banobras*, 91 B.R. at 665.

<sup>421</sup>*Id.* (citations omitted).

<sup>422</sup>*Id.* at 667 (citing *Salen I*, 773 F.2d at 459-60).

<sup>423</sup>*Id.* (citation omitted).

<sup>424</sup>*Id.* at 668. The court found that the union members would be prejudiced both if they were forced to litigate their claims individually and if the Mexican bankruptcy court construed and applied specialized aspects of U.S. labor law. *Id.* at 667.

Compare *Gercke*, 122 B.R. at 627, where the debtor and a U.S. creditor entered into a contract and agreed to a choice of forum clause (choosing the courts of the District of Columbia) and a choice of law clause (choosing the laws of the District of Columbia). In August, 1989 the U.S. creditor commenced a breach of contract action in the Superior Court of the District of Columbia. In January, 1990 insolvency proceedings were commenced against the debtor in the Companies Court, Chancery Division of the High

some prejudice to the Mexican trustee, but found that this prejudice was minimized by the presence in New York of the trustee's bankruptcy and labor counsel. The court also suggested that prejudice as to timing could be minimized through expedited proceedings.<sup>425</sup>

According to the *Banobras* decision, the U.S. district court was to decide only those issues relating to the collective bargaining agreement. First of all, the court was to determine whether it had jurisdiction and whether a collective bargaining agreement existed. If so, then the court was to interpret the terms of the agreement and to fix the amount of the claims of the union members arising under the agreement. However, the *Banobras* court noted that the Mexican court was to determine the allowability of such claims under Mexican law, as well as the priority of such claims in the distribution scheme in the Mexican proceedings.<sup>426</sup> Moreover, the court concluded that, if the district court were to find that it did not have jurisdiction or that a collective bargaining agreement did not exist, then "the Mexican bankruptcy court, which maintains control over the disposition of Aeronaves's estate and all the claims against it, should be free to make a determination as to where the claims of the employees [would] be liquidated."<sup>427</sup>

In its flexible application of § 304, the *Banobras* decision reached a reasonable balance between the principles underlying U.S. labor law and those underlying § 304. The court was thus correct in granting recognition of the Mexican proceedings to resolve all issues other than those involved in fixing the claims of the U.S. creditors under U.S. labor law. However, in striking this balance under what appears to be a comity approach,<sup>428</sup> the court should have explicitly discussed the other § 304(c) criteria. For example, in its application of comity, the court considered the possible prejudice and inconvenience to U.S.

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Court in the United Kingdom, and in April, 1990 a § 304 petition was filed in the District of Columbia. The District of Columbia bankruptcy court enjoined further litigation in the superior court. Moreover, the U.S. court distinguished the case at bar from that in *Banobras*, *id.*, and allowed the Companies Court to decide when and where to hear the breach of contract action. *Id.* at 627, 629, 632. The U.S. court stated that the creditor's claim was "a basic common law claim that the Companies Court is fully capable of adjudicating," *id.* at 629, and that "there is no evidence that the Companies Court would fail to interpret the contract under District of Columbia law." *Id.* at 632. However, like the *Banobras* court, the *Gerçek* court did not cooperate completely with the foreign proceeding. Although the court found that the application of § 304 criteria supported enjoining further litigation in the superior court, the *Gerçek* court determined that they did not support extending the injunction to an enforcement of a production order by the superior court. Thus, the *Gerçek* court issued a limited injunction that enjoined "further litigation in the Superior Court except to the extent of enforcing the production order, including granting of any appropriate sanctions in the event of a failure to comply." *Id.* at 634.

<sup>425</sup>*Banobras*, 91 B.R. at 667.

<sup>426</sup>*Id.* at 668 n.7.

<sup>427</sup>*Id.* at 668.

<sup>428</sup>*Contra Finister*, *supra* note 62, at 360-61 ("the court disregarded comity in deciding whether to modify previously granted Section 304 relief. The court recognized that the principle of comity exists and yet seemed to summarily ignore it. The court chose instead to rely on the principles of prejudice and inconvenience to decide the case.")

creditors, yet never mentioned that this factor is contained in § 304(c)(2).<sup>429</sup> To avoid ambiguity, the court should have stated that pursuant to § 304(c)(5) and (2), it would not recognize the Mexican proceedings for the purpose of resolving the labor issues.<sup>430</sup>

The *Banobras* decision is correct as a matter of law, but it did cause practical timing problems for the parties. The parties feared that by the time the IAM action worked its way through the U.S. courts the Mexican insolvency of Aeronaves would be completed, and they therefore began to negotiate to settle their differences. On June 30, 1990, the parties executed a settlement agreement, which was later approved by the U.S. bankruptcy court.<sup>431</sup>

#### B. SECTION 303(b)(4) (INVOLUNTARY CASES COMMENCED BY FOREIGN REPRESENTATIVES)

As mentioned earlier, § 304 is not the exclusive remedy under the U.S. Bankruptcy Code for a foreign representative who seeks to protect the assets of a foreign debtor that are located in the United States.<sup>432</sup> Rather than commence an ancillary case, a foreign representative might decide to commence a full involuntary case against a foreign debtor, under chapter 7 or chapter 11, by filing a verified petition with the bankruptcy court under § 303(b)(4).<sup>433</sup>

<sup>429</sup>But see *id.* at 363 (asserting that the *Banobras* court relied only on § 304(c)(2) and weighed the prejudice to U.S. creditors against the prejudice to the Mexican debtor in applying this section).

<sup>430</sup>Likewise, in deferring to the Mexican proceedings for other purposes, the court should have stated that Mexican law treats creditors equitably, adopts the equality of distribution principle (satisfying § 304(c)(1)), and prevents preferential and fraudulent transfers of property (satisfying § 304(c)(3)); and is fundamentally fair and safeguards foreign creditors against discrimination and inconvenience (satisfying § 304(c)(2) and (4)). The court should also have noted that Mexican law was by its own terms applicable to the assets in the United States and that the other threshold requirements had been satisfied. The court may not have explicitly discussed these factors because it was amending previously granted § 304 relief, rather than granting new § 304 relief. See *id.* at 361 n.120.

<sup>431</sup>The Settlement Agreement and Release by and between International Association of Machinists and Aerospace Workers, AFL-CIO and Banco Nacional de Obras y Servicios Públicos, S.N.C., as Trustee in Bankruptcy of Aeronaves de Mexico, S.A. de C.V., June 30, 1990, NY, NY, USA, approved by the U.S. Bankruptcy Court, S.D.N.Y., August 13, 1990. [hereinafter the "*Banobras* Settlement Agreement"]. This agreement provided that the Mexican trustee would pay US\$11,500,000 to be distributed to the employees represented by the IAM who worked for Aeronaves (the "Employees"). In exchange, the IAM and the employees would execute releases of their claims, and the IAM would, *inter alia*, discontinue its suits in the U.S. courts and agree to the Mexican trustee's removal of Aeronaves's property from the United States and to the entry of § 304 relief on the same terms and conditions as that entered against the other creditors. *Banobras* Settlement Agreement, at 5-16.

<sup>432</sup>See text accompanying notes 59 to 61 *supra*.

<sup>433</sup>Section 303(b)(4) provides as follows:

(b) An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—

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(4) by a foreign representative of the estate in a foreign proceeding concerning such person.

11 U.S.C.A. § 303(b)(4) (West 1991). See, e.g., *Axona*, 88 B.R. at 606. See also Fed. R. Bankr. P. 1002 (West 1991); *id.* 1003, 1010, 1011, 1018.

If filing under chapter 7, the foreign representative must show that the foreign debtor meets the eligibility requirements of § 109(a) and (b), or, if filing under chapter 11, the requirements of § 109(a) and (d).<sup>434</sup> The foreign representative should also demonstrate that she has been duly appointed in the foreign proceeding, that the foreign proceeding has been commenced in the appropriate forum, and that foreign law authorizes the foreign representative to commence proceedings in the United States to protect the foreign debtor's property or to assist in the administration of the foreign debtor's estate. Section 1408 of title 28 of the United States Code specifies the proper venue for the foreign representative's filing of a § 303(b)(4) petition,<sup>435</sup> and § 1409 specifies the proper venue for proceedings arising under title 11 or arising in or related to cases under title 11.<sup>436</sup>

Unlike the filing of a § 304 petition, the filing of a chapter 7 or chapter 11 involuntary petition creates an estate under § 541, comprised of property "wherever located and by whomever held."<sup>437</sup> Also, the filing of a petition under § 303(b)(4) operates as an automatic stay under § 362 against a broad range of creditor actions, including, but not limited to, the following: the commencement or continuation of prepetition actions against the debtor; the enforcement against the debtor or property of the estate of prepetition judgments; acts to obtain possession of property of the estate; acts to create, perfect, or enforce liens against property of the estate, or against property of the debtor to the extent that such liens secure prepetition claims; and creditor collection efforts against the debtor for prepetition debts.<sup>438</sup> The automatic stay, in effect, gives the debtor a breathing spell from the actions of creditors, and in addition protects unsecured creditors by preventing the swiftest-acting creditors from pursuing their own remedies against the debtor or the debtor's property to the detriment of other unsecured creditors.

Of course, in a chapter 7 case filed by a foreign representative, an interim trustee is selected by the United States trustee<sup>439</sup> and continues to serve as trustee in the case unless the creditors elect their own trustee.<sup>440</sup> It is doubtful that a foreign representative would be able to fulfill the § 321 requirement that the trustee, if an individual, "resides or has an office in the judicial district within which the case is pending, or in any judicial district adjacent to such district"<sup>441</sup> or, if a corporation, has "an office in at least

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<sup>434</sup>11 U.S.C.A. § 109(a), (b), (d) (West 1991). The foreign debtor must also be a debtor under the U.S. Bankruptcy Code and thereby satisfy § 101(13). 11 U.S.C.A. § 101(13) (West 1991).

<sup>435</sup>28 U.S.C.A. § 1408 (West 1991).

<sup>436</sup>*Id.* § 1409.

<sup>437</sup>11 U.S.C.A. § 541(a) (West 1991).

<sup>438</sup>*Id.* § 362. *See Axona*, 88 B.R. at 606.

<sup>439</sup>11 U.S.C.A. § 701 (West 1991).

<sup>440</sup>*Id.* § 702(d).

<sup>441</sup>*Id.* § 321(a)(1).

one of such districts.”<sup>442</sup> Thus, by commencing a chapter 7 case, the foreign representative risks losing control over the U.S. assets, as well as incurring additional administrative expense.<sup>443</sup> However, the trustee appointed in the U.S. case might work in concert with the foreign representative.<sup>444</sup>

The current statutory scheme does not offer any guidance as to when it would be more appropriate for a foreign representative to commence a § 303(b)(4) case, rather than a § 304 case. At first glance it would appear that a foreign representative should file a petition under § 303(b)(4) if she decides that a full administration under U.S. law (concurrent with the foreign administration) is in the best interests of the debtor and creditors. Perhaps the most important reason why a foreign representative might decide to file under § 303(b)(4), rather than under § 304, is that in a case filed under § 303(b)(4) a trustee or debtor in possession may exercise the trustee’s U.S. Bankruptcy Code avoidance powers<sup>445</sup> or investigative powers.<sup>446</sup> However, giving free reign to a foreign representative to decide whether to seek the application of foreign law under § 304 or the application of U.S. law under § 303(b)(4) might well lead to problems involving “section shopping.” Because this issue might well arise when a court decides to dismiss a case or suspend proceedings under § 305 (as it did in *In re Axona International Credit & Commerce Ltd.* (“Axona”)),<sup>447</sup> it is addressed in part C below.

### C. SECTION 305 (ABSTENTION)

Under the common law a court with jurisdiction over a particular matter is required to take such jurisdiction.<sup>448</sup> However, § 305 recognizes that there are cases in which it would be appropriate for the court to decline jurisdiction.<sup>449</sup> Section 305 provides as follows:

(a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under

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<sup>442</sup>*Id.* § 321(a)(2).

<sup>443</sup>*American Express Int’l Banking Corp. v. Johnson* [1984] HKLR 372, 377 (discussing disadvantages of Hong Kong liquidators commencing a chapter 7 case in the United States).

<sup>444</sup>*See, e.g., Axona*, 88 B.R. 597; *IBB*, 536 F.2d 509.

<sup>445</sup>*See Axona*, 88 B.R. at 600–01, 606. *See also* 11 U.S.C.A. § 544(a) (West 1991) (strong arm powers as hypothetical lien creditor or bona fide purchaser); *id.* § 544(b) (trustee as successor to certain actual unsecured creditors); *id.* § 545 (statutory liens); *id.* § 546 (limitations on avoidance powers); *id.* § 547 (preferences); *id.* § 548 (fraudulent transfers); *id.* § 549 (postpetition transfers).

<sup>446</sup>*See Axona*, 88 B.R. at 607; 11 U.S.C.A. § 704(4) (West 1991); *id.* § 1106(3). A foreign representative might also file a § 303(b)(4) petition to avoid the venue problems discussed earlier. *See text accompanying note 136 supra*; Boshkoff, *U.S. Judicial Assistance*, *supra* note 5, at 744.

<sup>447</sup>88 B.R. 597 (Bankr. S.D.N.Y. 1988), *aff’d*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991).

<sup>448</sup>H.R. REP. No. 595, 95th Cong., 1st Sess. 325, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6289; S. REP. No. 989, 95th Cong., 2d Sess. 35, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5281.

<sup>449</sup>*Id.*

this title, at any time if—

(1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or

(2)(A) there is pending a foreign proceeding; and

(B) the factors specified in section 304(c) of this title warrant such dismissal or suspension.

(b) A foreign representative may seek dismissal or suspension under subsection (a)(2) of this section.

(c) An order under subsection (a) of this section dismissing a case or suspending all proceedings in a case, or a decision not so to dismiss or suspend, is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title [sic] or by the Supreme Court of the United States under section 1254 of this title [sic].<sup>450</sup>

A few cases involving foreign proceedings have arisen under § 305. For instance, in *In re Gee*<sup>451</sup> the court granted a § 304 petition and dismissed a subsequently filed competing chapter 11 petition.<sup>452</sup> And in *In re Trakman*,<sup>453</sup> where much of the relief sought by a foreign representative under section 304 was duplicative of a previously filed related interpleader action in a U.S. district court, the court suspended the § 304 ancillary proceedings to allow “the district court and the parties before it in the interpleader action to continue undistracted in their efforts to resolve the issues before them.”<sup>454</sup>

The most thorough analysis of § 305 to date was offered by the court in *Axona*,<sup>455</sup> the first case in which a court granted an application under § 305(b) seeking the suspension of a chapter 7 case commenced under § 303(b)(4) and the turnover of local assets to a foreign representative for administration in the foreign proceeding. The bankruptcy court in this case closely examined the interconnectedness of the statutory scheme contained in §§ 303(b)(4), 304, and 305 and the extent to which this scheme may be used to foster cooperation in the transnational insolvency context.

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<sup>450</sup>11 U.S.C.A. § 305 (West 1991) (emphasis added) (The Judicial Improvements Act of 1990 added the words in italics, but the new title references are incorrect. Sections 158(d), 1291, 1292, and 1254 are contained in title 28).

<sup>451</sup>53 B.R. 891 (Bankr. S.D.N.Y. 1985).

<sup>452</sup>*Id.* at 905. See Gitlin, Flaschen & Grimes, *supra* note 5, at 87.

<sup>453</sup>33 B.R. 780 (Bankr. S.D.N.Y. 1983).

<sup>454</sup>*Id.* at 783–84. By suspending, rather than dismissing, the § 304 petition, the court preserved rights to avoid preferential transfers that had existed as of the day of the petition and fostered judicial economy for the benefit of the debtor and creditors. *Id.* See also *Interpool*, 878 F.2d 111 (discussed in note 348 *supra*); *In re Goerg*, 930 F.2d 1563 (11th Cir. 1991).

<sup>455</sup>88 B.R. 597 (Bankr. S.D.N.Y. 1988), *aff'd*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991). The facts of the case as discussed in the text above are set out in *Axona*, 88 B.R. at 599–602.

This case involved Axona International Credit and Commerce Limited ("Axona"), a Hong Kong registered deposit taking company that operated as a wholesale bank and had its principal place of business in Hong Kong, and spawned litigation in both the United States and Hong Kong. Like the debtors in *Herstatt*, *IBB*, *Finabank*, and *Culmer*, Axona never engaged in the banking business in the United States, but did have assets located there in the form of substantial bank deposits amounting to several million dollars. In the wake of Axona's financial collapse in November 1982, three U.S. banks (collectively "the attaching creditors") each obtained *ex parte* attachments of Axona's bank deposits in the United States. A fourth bank, Chemical, initiated other maneuvers in an attempt to secure its position.<sup>456</sup>

On February 2, 1983 a creditor filed a petition with the Supreme Court of Hong Kong for the compulsory winding up of Axona. On February 4, 1983 the Hong Kong court appointed joint provisional liquidators, and on March 4, 1983 the court ordered the winding up of Axona and continued the two liquidators as permanent liquidators ("the H.K. liquidators").

On February 8, 1983, the Hong Kong court authorized the H.K. liquidators to file an involuntary chapter 7 petition against Axona under § 303(b)(4) to avoid preferential transfers and thereby preserve Axona's U.S. assets. The H.K. liquidators commenced a full involuntary liquidation under § 303(b)(4), rather than an ancillary case under § 304, in reliance on their U.S. counsel's conclusion that it was doubtful that a foreign representative would be able to utilize a trustee's avoiding powers in a § 304 case.<sup>457</sup> In April 1983 Judge Galgay entered an order for relief over the objections of the attaching creditors.<sup>458</sup> An interim trustee was appointed, and he continued to serve as trustee under § 702(d) ("the U.S. trustee").<sup>459</sup>

With the assistance of the H.K. liquidators, the U.S. trustee began to marshal Axona's assets in the United States, and then commenced adversary proceedings against the attaching creditors to avoid preferential transfers. The attaching creditors moved to dismiss the chapter 7 case in the United States, and also initiated proceedings in Hong Kong to challenge the right of the H.K. liquidators to commence a § 303 case under U.S. law. In the Hong Kong

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<sup>456</sup>*Axona*, 88 B.R. at 599–600. Axona repaid a thirty-day unsecured time loan that had been made the day before by Chemical's branch in Hong Kong (and was to be repaid in New York), and Chemical issued "a new demand loan collateralized by a US\$3,000,000 'call account' opened at Chemical's Hong Kong branch." *Id.* at 600. Six days later, Chemical's Hong Kong branch "sold" the recently acquired demand loan to Chemical's New York main office and also transferred the US\$3,000,000 cash collateral account to that office. Chemical's New York office "then 'deemed itself insecure' with respect to the demand loan and offset its claim against Axona," thereby fully setting off Axona's indebtedness to the bank. *Id.*

<sup>457</sup>*Id.* at 601. For further support of the assertion that a foreign representative may not utilize U.S. avoidance powers in a § 304 case, see text accompanying notes 179 to 187 *supra*.

<sup>458</sup>Judge Galgay was the judge who issued the *IBB* Turnover Orders, *supra* note 58.

<sup>459</sup>11 U.S.C.A. § 702(d) (West 1991).

actions, the attaching creditors sought: (1) declaratory relief that they were entitled under Hong Kong law to retain the benefit of their attachments in New York; (2) dismissal of the adversary proceedings and bankruptcy case in New York; and (3) a summons directing the H.K. liquidators to withdraw all proceedings in the United States.

The Hong Kong court dismissed these applications and upheld the earlier Hong Kong court decision to authorize and empower the H.K. liquidators to proceed under § 303(b)(4). The court clearly stated the reasons for its ruling "so that the U.S. Court [would] know precisely what Hong Kong's views [were] upon this matter."<sup>460</sup> The court first claimed that it appeared that the attaching creditors' motivation for bringing the actions in the Hong Kong courts was to avoid the application of U.S. preference law. The court noted that, unlike U.S. preference law, Hong Kong law requires the court to consider "difficult questions of intention."<sup>461</sup> In the court's view, having no defense to the preference claim in the United States, the attaching creditors "launched into a massive counter-attack, a massive filibuster" in which they sought a ruling that under Hong Kong law they were entitled to retain the benefit of their attachments in New York.<sup>462</sup>

In rejecting the attaching creditors' contentions, the Hong Kong court first found that, since the H.K. liquidators had sought legal advice and the court's approval to commence proceedings in the United States, they had not committed misfeasance or breach of duty.<sup>463</sup> Secondly and perhaps most importantly, the court agreed with the submission by the H.K. liquidators' attorney and by the Hong Kong official receiver that Hong Kong's companies code is "a domestic code. It governs domestic executions against goods and lands within the jurisdiction of the court, or attachments which have occurred in Hong Kong, and does not extend to matters taking place outside the jurisdiction of this court."<sup>464</sup> In the court's opinion, such extra-territorial matters (including the question of preferences in insolvency) were to be determined by the *lex situs*, which in this case was the law of the United States. Applying its territorial interpretation of Hong Kong law, the court claimed that "you do not produce equality by seeking artificially to impose one [law] on everybody. The only route to equality here, is to treat all people equally in their respective jurisdictions by affording dominance to the laws in those jurisdictions."<sup>465</sup> The court went on to conclude that it therefore was proper for the H.K. liquidators to

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<sup>460</sup>American Express Int'l Banking Corp. v. Johnson [1984] HKLR 372, 380.

<sup>461</sup>*Id.* at 378. See § 266, Companies Ordinance (cap 32, LHK 1991); § 49 Bankruptcy Ordinance (cap 6, LHK 1991).

<sup>462</sup>American Express Int'l Banking Corp., [1984] HKLR at 378.

<sup>463</sup>*Id.* at 379-80.

<sup>464</sup>*Id.* at 381, 384.

<sup>465</sup>*Id.* at 382.

have filed a petition under § 303 (rather than under § 304) of the U.S. Bankruptcy Code to take advantage of the broader avoidance powers available under U.S. law.

At the end of his opinion, the Hong Kong judge, Justice Hunter, turned to the “direct attack on the motivation and the bona fides” of the Hong Kong court and of the H.K. liquidators that the attaching creditors had lodged in their documents filed in the New York actions<sup>466</sup> – allegations that the H.K. liquidators were discriminating against U.S. creditors and “playing fast and loose” with the jurisdiction of the U.S. court, in an attempt to gain a favorable forum.<sup>467</sup> Justice Hunter strongly denied the charges. First of all, he asserted that the H.K. liquidators had not “singled out” the attaching creditors, but rather the attaching creditors had “selected themselves” by engaging in self-help.<sup>468</sup> Secondly, he stressed that the Hong Kong court and the H.K. liquidators had sought the assistance of the U.S. court “on behalf of the whole body of creditors, which include a considerable number of United States creditors.”<sup>469</sup> Lastly, he claimed that there had been no forum shopping by the Hong Kong court, and that in effect it was the attaching creditors that had shopped for a forum – their obligations were “Hong Kong obligations, incurred by Hong Kong companies,” but they chose to sue and grab Axona’s assets in New York, thereby making “the New York Court the dominant court under Hong Kong law.”<sup>470</sup>

Back in the United States, the attaching creditors withdrew their motion to dismiss the U.S. case, and eventually the U.S. trustee entered into a settlement agreement with each of them. The U.S. trustee also commenced an adversary proceeding against Chemical, which was also settled.<sup>471</sup> These settlement agreements enabled the U.S. trustee to collect more than US\$7,000,000. Meanwhile, the H.K. liquidators had amassed an estate in Hong Kong of over US\$5,000,000.

The H.K. liquidators and the U.S. trustee (“the joint applicants”) together filed a joint application (“the joint application”) requesting “in the interests of comity, equity, and economical and expeditious administration”<sup>472</sup> that the U.S. bankruptcy court, pursuant to § 305(b), suspend the U.S. proceedings<sup>473</sup> and order the turnover of funds in the United States to the H.K. liquidators to be distributed in the Hong Kong winding up proceedings in accordance

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<sup>466</sup>*Id.* at 388.

<sup>467</sup>*Id.* (quoting documents filed by the Attaching Creditors in New York).

<sup>468</sup>*Id.* at 389.

<sup>469</sup>*Id.*

<sup>470</sup>*Id.*

<sup>471</sup>The settlement agreement entered into with Chemical reserved the bank’s right to contest the jurisdiction of the U.S. bankruptcy court to administer Axona’s U.S. bankruptcy case. *Axona*, 88 B.R. at 602.

<sup>472</sup>*Id.*

<sup>473</sup>The joint application chose suspension, rather than dismissal, because a few open matters remained, including the question of whether the U.S. estate would be required to pay U.S. taxes. *Id.* at 602 n.7.

with Hong Kong law. The joint applicants asserted that the chapter 7 case had achieved its intended purposes and that ordering the requested relief would not prejudice any creditors.

Chemical alone opposed the joint applicants' request. In defense of its position, Chemical raised statutory, jurisdictional, and constitutional arguments. Some of Chemical's arguments challenged the ability of the H.K. liquidators to commence a § 303(b)(4) case, and others challenged the propriety of suspending the chapter 7 proceedings and ordering a turnover of assets to the Hong Kong proceedings. At the heart of Chemical's challenge was its belief that its 1982 maneuvers were a part of a Hong Kong transaction that should be governed by Hong Kong law, and therefore that the use of U.S. law to avoid that transaction was inappropriate. The bankruptcy court rejected these arguments.

Chemical's statutory challenge was that it would be inappropriate for the court to grant a suspension of the proceedings under § 305(a) once the H.K. liquidators had invoked the U.S. Bankruptcy Code's avoiding powers.<sup>474</sup> The court rejected the bank's "assault on the plain language of the statutory scheme" relied upon by the H.K. liquidators.<sup>475</sup> In so doing, the court discussed the interplay among §§ 303, 304, and 305 and stressed the "established goal of U.S. and international bankruptcy law to preserve assets for equitable jurisdiction for all creditors wherever located."<sup>476</sup> The court concluded that the clear language of the U.S. Bankruptcy Code—supported by the legislative history, earlier cases such as *Finabank* and *IBB*, and recent cases such as *Culmer* and *Salen I*—enables a foreign representative to choose between commencing either a full case under § 303(b)(4) or an ancillary case under § 304.<sup>477</sup>

Chemical also argued that this statutory scheme gave the foreign representative a "unilateral option" to choose whether to seek the application of foreign or U.S. law. The court rejected this argument by noting that, if any of Axona's creditors had commenced an involuntary case against Axona under § 303(b)(1) or (2), "Chemical would have been met with an identical adversary proceeding to avoid the November 1982 'setoff.'"<sup>478</sup>

In discussing how § 305 fits into the statutory scheme, the court focused on whether suspension would be appropriate under § 305(a)(2), or more specifically, whether the criteria in § 304(c) warranted suspension. The court rejected Chemical's statutory argument, as well as its argument that suspension should not be ordered on grounds of comity. The court found Chemical's reading of comity to be "myopic,"<sup>479</sup> and instead followed the broad

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<sup>474</sup>*Id.* at 607.

<sup>475</sup>*Id.* at 604.

<sup>476</sup>*Id.*

<sup>477</sup>*Id.* at 604–06.

<sup>478</sup>*Id.* at 606.

<sup>479</sup>*Id.* at 608 n.19.

pro-recognition comity approach of *Culmer*, *Salen I*, *Salen II*, and *Gee*. The *Axona* court paid particular attention to the fact that U.S. courts had granted comity to other sister common law jurisdictions, like Hong Kong, whose winding up procedures were based on the British Companies Act.<sup>480</sup> It noted that Hong Kong's "Companies Ordinance is strikingly similar to the [U.S. Bankruptcy] Code and provides a comprehensive procedure for the orderly and equitable distribution of assets to all creditors."<sup>481</sup> The court concluded this argument by stating that "[c]omity does not require the laws of different jurisdictions to be *identical*. . . . Whether or not Hong Kong law is identical to American law, Hong Kong law is not repugnant to our ideas of justice, and is inherently fair and regular. As a result, comity should be accorded in the instant matter."<sup>482</sup>

The court then noted that Chemical had "invited" the court "to determine whether the 1982 restructuring of its loan would withstand an attack under Hong Kong law," but the court refused to do so.<sup>483</sup> Instead, the court focused on Chemical's "flawed analysis" and noted that, although the November 1982 restructuring involved Chemical's New York branch, Chemical had argued that it was unfair for the H.K. liquidators to utilize U.S. law to undo that transaction.<sup>484</sup>

The court next found that the other criteria in § 304 were satisfied. The court found that § 304(c)(1) was satisfied because Hong Kong law, like U.S. law, "provides a comprehensive procedure for the orderly and just treatment of all Axona's creditors."<sup>485</sup> In addition, most of Axona's debts arose in Hong Kong, Axona's books and records were located there, and the H.K. liquidators were "best situated to evaluate creditors' claims fairly and at a minimum expense."<sup>486</sup> Also, the court found that approving the joint application would ensure an economical and expeditious administration of the estate.

In finding that granting the joint application would not prejudice or inconvenience U.S. creditors under § 304(c)(2), the court stressed that Hong Kong law does not discriminate against non-resident creditors. The court also discussed the procedures available under Hong Kong law to a creditor dissatisfied with the H.K. liquidators' treatment of its claim. Moreover, since Chemical had a substantial claim against Axona, the cost of processing its claim

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<sup>480</sup>*Id.* at 610.

<sup>481</sup>*Id.*

<sup>482</sup>*Id.* at 610–11 (citation omitted).

<sup>483</sup>*Id.* at 611. Chemical and the joint applicants disagreed about whether the restructuring would have been avoidable under Hong Kong law. *Id.* at 604 n.12.

<sup>484</sup>*Id.* at 611–12. Earlier in the opinion, the court had also noted that "[w]hile Chemical attempted to characterize the November 1982 restructuring as Hong Kong based, without any U.S. connection, the facts belie this characterization." *Id.* at 604 n.11.

<sup>485</sup>*Id.* at 612.

<sup>486</sup>*Id.*

in Hong Kong would be *de minimis* in relation to the amount of the claim.<sup>487</sup>

In finding that § 304(c)(3) was satisfied, the court looked not only to whether Hong Kong law prohibited preferential or fraudulent transfers, but also to the fact that the U.S. trustee and H.K. liquidators had successfully avoided preferential transfers.<sup>488</sup> Lastly, the court found that the Hong Kong distribution scheme satisfied § 304(c)(4).<sup>489</sup>

After demonstrating that all of the criteria contained in § 304(c) had been satisfied, the court addressed Chemical's jurisdictional challenge. Chemical asserted that the U.S. court did not have subject matter jurisdiction over Axona's § 303(b)(4) case, and therefore that Axona's case could only be maintained under § 304. The court rejected Chemical's argument and found that the court did have subject matter jurisdiction. The court correctly noted that the H.K. liquidators fit into the U.S. Bankruptcy Code's definition of "foreign representative" and the Hong Kong proceeding, of a "foreign proceeding." Most importantly, the court rightly found that Axona's substantial U.S. bank accounts were a "sufficient predicate for subject matter jurisdiction" under § 303(b)(4).<sup>490</sup>

Lastly, the court turned to Chemical's constitutional challenges. It rejected Chemical's assertion that giving the foreign representative the unilateral ability to forum shop to gain the benefit of U.S. preference and setoff law violated Chemical's fifth amendment equal protection and due process rights. In response to Chemical's due process challenge, the court found that "Chemical must be presumed to have been on notice that it would or could be subject to United States law applicable to its conduct."<sup>491</sup> Among the factors noted by the court were the following: Chemical was a New York bank doing business in New York, its relationship with Axona involved a longstanding New York account, and Chemical involved its main office in New York in the November 1982 restructuring.<sup>492</sup>

After addressing all of Chemical's arguments, the *Axona* court granted the relief requested in the joint application, by suspending the U.S. case and proceedings and ordering the turnover of assets to the H.K. liquidators. To protect

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<sup>487</sup>*Id.* at 613.

<sup>488</sup>*Id.* Finister criticizes this part of the *Axona* approach. Finister, *supra* note 62, at 368–69. For a criticism of Finister's position, see *supra* note 332.

<sup>489</sup>*Axona*, 88 B.R. at 613. Elsewhere in its opinion, the court also noted its rejection of the "limited focus in *Toga* on the minor substantive differences between Canadian and U.S. law." *Id.* at 611. See Finister, *supra* note 62, at 365, 369. Finister claims that "[i]n *Axona*, even the change of a United States creditor's status from secured to unsecured under the foreign law was held not to violate section 304(c)(4)." *Id.* at 369 (emphasis added). However, this issue was never addressed by the *Axona* court. Rather, in *Axona* the status of a U.S. creditor was changed from secured to unsecured under U.S. law.

<sup>490</sup>*Axona*, 88 B.R. at 614–15.

<sup>491</sup>*Id.* at 617.

<sup>492</sup>*Id.*

the interests of certain U.S. creditors, the court conditioned the turnover order on the U.S. trustee first paying all administrative expenses and certain priority claims, and retaining U.S.\$500,000 to complete the administration of the U.S. estate.<sup>493</sup> The court also required that, prior to making any distribution to creditors, the H.K. liquidators notify all creditors who had filed a claim in the U.S. proceedings but had not filed in the Hong Kong proceedings of their right to file in the Hong Kong proceedings (and of the procedures for doing so), and that such claims once filed would be administered in accordance with Hong Kong law.<sup>494</sup>

On appeal, the district court affirmed the bankruptcy court's decision "in all respects."<sup>495</sup> In rejecting Chemical's contention that §§ 303(b)(4) and 304 "grant a foreign representative a unilateral option to determine whether U.S. or foreign avoidance law should apply,"<sup>496</sup> the court noted that in fact the bankruptcy court is delegated this option—it is the bankruptcy court that must weigh the § 304(c) criteria and decide whether to order relief and whether to grant comity to foreign bankruptcy laws.<sup>497</sup> Likewise, the court found that deciding whether to suspend proceedings after avoidance powers have been exercised is also "an element that should be considered by the bankruptcy judge in weighing the factors enumerated in § 304(c)."<sup>498</sup>

While the *Axona* case was before the Second Circuit, Congress amended § 305(c) as part of the Judicial Improvements Act of 1990. The amendment resolved a jurisdictional matter at issue in *Axona*, for it provided for review of a bankruptcy court's orders under § 305(a) by the district court, but limited further review by the court of appeals or the U.S. Supreme Court.<sup>499</sup> In light of the amendment, the Second Circuit dismissed the appeal.<sup>500</sup>

Although the bankruptcy court's decision has been upheld, certain other difficulties have arisen, and the turnover order has not yet been made. Thus, although *Axona's* Hong Kong winding up and U.S. chapter 7 case were commenced back in 1983, creditors are still awaiting their distributions as of the time this article is being written.

The bankruptcy court in *Axona* was clearly correct in finding that the foreign representative was authorized to commence a § 303(b)(4) case under the current statutory scheme. Likewise, the court was correct in suspending

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<sup>493</sup>*Id.* at 618. Ordering the payment of administrative expenses and priority claims before allowing the estate assets to be turned over was clearly correct, given that this was a plenary U.S. bankruptcy case.

<sup>494</sup>*Id.* at 618-19.

<sup>495</sup>*In re Axona Int'l Credit & Commerce Ltd.*, 115 B.R. 442, 448 (S.D.N.Y. 1990).

<sup>496</sup>*Id.* at 447.

<sup>497</sup>*Id.*

<sup>498</sup>*Id.* at 448.

<sup>499</sup>*In re Axona Int'l Credit & Commerce Ltd.*, 924 F.2d 31, 35 (2d Cir. 1991). See text accompanying *supra* note 450. See also *Goerg*, 930 F.2d 1563 (applying amended § 305).

<sup>500</sup>*Axona*, 924 F.2d at 36.

the chapter 7 case and proceedings and ordering the turnover of assets to the Hong Kong proceeding. However, its analysis offers little guidance about when it would be better for a foreign representative to commence a plenary case under § 303(b)(4), rather than an ancillary case under § 304, to protect the U.S. assets of a foreign debtor.

The bankruptcy court would have been wise to turn to the Hong Kong decision of Justice Hunter. As mentioned earlier, he found that it was appropriate for the H.K. liquidators to commence a § 303(b)(4) case in the United States because the attachments by the three attaching creditors were beyond the jurisdictional reach of the Hong Kong courts, and Hong Kong law would therefore defer to the *lex situs* as governing the transactions. Under this approach, the application of U.S. bankruptcy law to avoid those attachments was clearly justified.

Given that two plenary cases—one in Hong Kong and one in the United States—were warranted, the issue arose as to which transactions each case should govern. Although the U.S. court unfortunately failed to discuss this matter in depth,<sup>501</sup> it was certainly justified in applying U.S. law to all transactions in the United States. Given that the bankruptcy court found that there was a strong U.S. connection in Chemical's 1982 restructuring, this restructuring should have been subject to the application of U.S. law.<sup>502</sup>

The *Axona* bankruptcy court's decision, the first to order the turnover of assets under § 305 in a full case commenced under § 303(b)(4), is an important addition to the case law regarding the treatment of foreign bankruptcies under U.S. law. First of all, by enabling a foreign representative to commence a full bankruptcy case to utilize the avoiding powers set forth in the U.S. Bankruptcy Code and then suspending the case and ordering the turnover of the debtor's U.S. assets to the foreign proceeding (after ensuring that the interests of U.S. creditors had been protected), the *Axona* court built on the pre-U.S. Bankruptcy Code turnover orders in *IBB*. Secondly, as mentioned earlier, the decision offers a thorough discussion of the interplay among §§ 303, 304, and 305. Thirdly, by interpreting the factors contained in § 304(c) for the purpose of determining whether to suspend a case under § 305(a) similarly to the way in which the courts in *Culmer*, *Gee* and *Koreag* interpreted them for the purpose of determining whether to order relief in § 304 ancillary cases, the *Axona* court further demonstrates the inter-connectedness of the

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<sup>501</sup>It is also unfortunate that the U.S. court declined Chemical's invitation to determine whether its 1982 restructuring would be avoidable under Hong Kong law. Chemical claimed that it would not be avoidable, and the joint applicants disagreed. *Id.* at 604 n.12. Interestingly, there is dicta (albeit, somewhat unclear) in Justice Hunter's Hong Kong opinion that suggests that the *lex situs* for the discharge of Chemical's indebtedness was the law of New York. *American Express Int'l Banking Corp.*, [1984] HKLR at 381-82.

<sup>502</sup>Chemical would have been able to make a much stronger argument in favor of the application of Hong Kong law if its 1982 restructuring had completely occurred in Hong Kong and had not involved its main office in New York.

statutory scheme contained in §§ 303(b)(4), 304, and 305.

Most importantly, the decision demonstrates the importance of enabling a foreign representative to commence a plenary case in the United States when a § 304 case might not be appropriate. However, as noted earlier, further guidance is necessary for assisting foreign representatives in choosing between § 303(b)(4) and § 304—otherwise problems involving section shopping (with important choice of law consequences) will likely result.

Perhaps the following guidelines would prove helpful. When the principal insolvency of a foreign debtor occurs in a country that has territoriality-based insolvency laws that are not applicable abroad, § 304 relief should not be available to a foreign representative if she seeks the application of foreign avoidance powers to avoid certain transactions in the United States.<sup>503</sup> In such cases, the foreign representative should commence a § 303(b)(4) case to gain the benefits of U.S. law and perhaps should seek the turnover of assets to the principal bankruptcy proceeding. However, if the foreign representative does not seek the application of foreign law, but rather seeks other forms of relief, such as injunctive relief, discovery or the turnover of assets in the United States (which are not subject to local attachments or liens), § 304 relief might be available, and the foreign representative should be allowed to petition for either § 304 or § 303(b)(4) relief. In comparison, when the principal insolvency of a foreign debtor occurs in a country that has insolvency laws with extra-territorial effect that are applicable in the United States, as a general rule, the foreign representative should commence a § 304 case.<sup>504</sup> To prevent section shopping, I would propose that courts treat foreign representatives' compliance with these guidelines as another threshold requirement that must be satisfied in both § 304 and § 303(b)(4) cases.<sup>505</sup>

## CONCLUSION

Building on the principles espoused in *Gebhard* more than a century ago and demonstrating an increased willingness by the United States to recognize

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<sup>503</sup>See *supra* note 99.

<sup>504</sup>An exception to this general rule might well occur in cases in which the earlier discussed multi-district venue problems arise. See text accompanying note 136 *supra* and accompanying text. Of course, the choice between §§ 303(b)(4) and 304 becomes more difficult if the foreign proceeding has some laws with extra-territorial effect and some laws with purely domestic effect. Other difficulties might well arise in cases in which the foreign debtor's business is "substantially related" to the United States. See *supra* note 244. In such cases, the U.S. court will have to decide which course is preferable.

<sup>505</sup>Furthermore, if a foreign representative complies with these section shopping guidelines and commences a § 304 case but some of the foreign debtor's creditors commence a plenary bankruptcy case against the foreign debtor under § 303(b)(1) or (2), the foreign representative should request the U.S. court to dismiss or suspend the competing case or proceedings. Lastly, if a U.S. court finds that the threshold requirements for a § 304 case have been satisfied but later denies the request for § 304 relief or dismisses the § 304 case, the foreign representative should then be allowed to commence a plenary bankruptcy case against the foreign debtor (unless, as is likely, the foreign debtor's creditors have already done so). See note 303 *supra*.

foreign bankruptcies, the statutory scheme comprised of §§ 303(b)(4), 304, and 305 is an admirable attempt to foster cooperation in transnational insolvencies. Many § 304 cases have followed the *Culmer* universality approach and have recognized and assisted foreign bankruptcy proceedings. One of these cases, *Metzeler*, has held that the avoiding powers to be applied in a § 304 case are those powers vested in the foreign representative pursuant to the law of the jurisdiction in which the primary bankruptcy occurs. Other § 304 cases, such as *Culmer* and *Koreag*, and the § 303(b)(4) *Axona* case, have ordered the turnover of assets to foreign proceedings to be administered under foreign law. Many non-U.S. Bankruptcy Code cases, such as *Salen I* and *Salen II*, have also promoted the universality approach.

Unfortunately, other cases, including *Toga* and most recently *Interpool*, have refused to grant requested § 304 relief to assist foreign bankruptcies, even when the primary foreign bankruptcies occurred in sister common law jurisdictions. Instead, these cases have set forth an approach premised on protecting the interests of U.S. creditors under U.S. law. Implicit in cases such as these is the requirement that the foreign laws and procedures be identical to those under U.S. law.

It is time for U.S. bankruptcy judges, lawyers, and creditors to reject the territoriality approach and acknowledge that the U.S. does not have a monopoly over fair bankruptcy procedures. Many other countries have bankruptcy laws and procedures that, although differing in some respects from U.S. laws and procedures (such as by setting forth different priority rules or by requiring less creditor participation), are based on similar principles (the most important of which is the principle of equality of distribution), are just and fair in their overall treatment of debtors and creditors, and are deserving of recognition by U.S. courts.

What John Lowell wrote a hundred years ago is just as appropriate today:

It is obvious that, in the present state of commerce and of communication, it would be better in nine cases out of ten that all settlements of insolvent debtors with their creditors should be made in a single proceeding, and generally at a single place; better for the creditors, who would *thus share alike*, and better for the debtor, because all his creditors would be equally bound by his discharge.<sup>506</sup>

Back in the 1880's, Lowell was forced to admit that "[i]t is not so easy to see how this result is to be reached in actual practice."<sup>507</sup> Today, however, with the existence of § 304, not only has this result been reached in individual cases, but it is now possible to make this result the norm in cross-border insolvencies involving assets in the United States.

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<sup>506</sup>Lowell, *supra* note 11, at 264 (emphasis added).

<sup>507</sup>*Id.*

In this article I have put forth an interpretation of § 304 which, if adopted, would increase the likelihood of cross-border cooperation becoming the “norm” in transnational insolvencies. To summarize, a court should first ascertain whether the foreign representative has satisfied the following § 304 threshold requirements: (1) that the foreign proceeding has been commenced in the appropriate forum (which for a corporate debtor should be where the debtor’s principal place of business is located, and for an individual should be the debtor’s domicile); (2) that the foreign representative has been duly appointed in the foreign proceeding; (3) that the foreign debtor qualifies as a debtor under foreign law; (4) that the foreign law authorizes the foreign representative to commence proceedings in the United States regarding the foreign debtor’s property and/or the administration of the foreign debtor’s estate and, if need be, that the foreign substantive law has extra-territoriality effect; (5) that the foreign debtor has met at least one of the § 109(a) criteria; (6) if need be, that the foreign debtor has assets in the relevant district; (7) that venue properly lies; and (8) that the foreign representative has complied with the guidelines preventing section shopping that I have suggested above.

Once the threshold requirements have been met, the U.S. court handling the case should apply the § 304(c) criteria in deciding whether to grant the requested § 304 relief. In so doing, the court should ask whether comity should be accorded to the foreign proceeding. (In my view, the standard of comity should be the standard from *Culmer*: the court should enquire whether the foreign laws are repugnant to U.S. ideas of justice.) In considering comity, or in addition to considering comity (in my opinion, the former approach is preferable), the court should consider the other § 304(c) factors.

In considering the § 304(c) factors, the court should seek answers to the following questions. First, does the foreign proceeding provide for the “orderly and equitable” treatment of creditors? More particularly, does the foreign proceeding apply the equality of distribution principle (thereby satisfying § 304(c)(1))? Does the foreign law provide for the avoidance of preferential and fraudulent transfers and (if applicable) have those avoidance powers been exercised (thereby satisfying § 304(c)(3))? Second, are the foreign laws and procedures fundamentally fair (considering, *inter alia*, the application of the § 304(c)(4) and (c)(6) factors), and does the foreign proceeding sufficiently safeguard the interests of U.S. creditors (thereby satisfying § 304(c)(2))? Even if creditors allege that they have encountered or are likely to encounter fundamentally unfair laws or procedures, discriminatory treatment or inconvenience in the foreign proceedings, the court may nonetheless answer the second question affirmatively if the creditors fail to produce “concrete evidence” in support of their allegations. Third, would deferring to the foreign proceeding “best assure an economical and expeditious administration” of the debtor’s estate?

If these questions can all be answered affirmatively, then the U.S. court should grant the requested § 304 relief. Such relief should include applying the substantive law of the primary proceeding, if it has extra-territorial effect and extends to transactions in the United States, and ordering the turnover of the U.S. assets to the foreign proceeding to be administered under the foreign law. Thus, the *Culmer-Metzeler* result should become the norm. Noncooperation with the primary proceeding should be limited to cases in which one or more of the above criteria are not met, such as *Papeleras*, in which it was clear that a U.S. creditor had encountered fundamental unfairness and prejudice in the foreign proceeding. Where the above criteria are satisfied for some, but not all, of the requested relief, the court, as in *Banobras*, should cooperate with the foreign proceeding as much as possible, but retain U.S. control over those aspects of the cross-border insolvency as is justified to protect the interests of local creditors.

The lack of a precise formula in § 304 will hopefully prove to be one of the section's strengths. Given the recent worldwide recession, many more § 304 cases will likely arise in the near future. The treatment by U.S. courts of these cases may well determine whether § 304 will survive in its present form or whether amendments will be necessary to achieve the worthwhile goal of increased cooperation in transnational insolvencies.

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#### EDITOR'S ADDENDUM

Shortly before publication of this article, the bankruptcy court's decision in *In re Koreag, Controle et Revision S.A.*, 130 B.R. 705 (Bankr. S.D.N.Y. 1991) was vacated and remanded by the Second Circuit in *In re Koreag, Controle et Revision S.A.*, 961 F.2d 341 (1992).

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