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Public Policy Concerns Prevent Application of Comity to Foreign Bankruptcy Proceedings That Discriminate Against Tax Obligations Owed to the United States Government

Michael P. Bigelow

CASE COMMENT

Public Policy Concerns Prevent Application of Comity to Foreign Bankruptcy Proceedings That Discriminate Against Tax Obligations Owed to the United States Government. *Overseas Inns S.A. P.A. v. United States*, 911 F.2d 1146 (5th Cir. 1990).

ABSTRACT

This Case Comment explores the application of comity to foreign bankruptcy proceedings, particularly when comity would render the Internal Revenue Service a general unsecured creditor in bankruptcy. The United States Court of Appeals for the Fifth Circuit held on public policy grounds that comity should not be accorded to a Luxembourg bankruptcy proceeding that discriminated against tax obligations owed to the United States government. This Case Comment discusses the factual setting for the instant decision and presents a brief history of transnational insolvency law. The author finds that the law of transnational insolvency is inconsistent and underdeveloped and that the instant decision furthers the territoriality approach towards international bankruptcy under which United States courts refuse to recognize foreign bankruptcy proceedings. The author concludes that in today's global economy such an approach is unworkable, and that the United States must adopt the universality approach towards transnational insolvency in order to encourage foreign tribunals to recognize United States bankruptcy proceedings and to facilitate the reorganization of multinational corporations.

I. FACTS

Overseas Inns S.A. P.A. (Overseas), a Luxembourg corporation and successor to Western States Limited (Western), a Bahamian corporation, sued to recover taxes assessed and collected by the Internal Revenue Service (IRS), contending that comity should be accorded to a Luxembourg court-approved plan of reorganization (the Plan or the Luxembourg Plan).[1] The Plan treated the IRS as a general unsecured creditor. Under the United States Bankruptcy Code, however, the IRS would have been granted priority status.[2]

On July 12, 1973, Overseas filed United States foreign corporation income tax returns on behalf of Western for the calendar years 1960, 1961, and 1962.[3] Overseas filed the United States returns, which stated that no tax was due, "solely in order to prevent the possible loss of deductions and credits under Internal Revenue Code section 882."[4] The IRS disagreed with Overseas and assessed a deficiency[5] for the years in question, contending that "Western had engaged in trade or business in the United States during [those] years and had derived income from U.S. sources."[6] Overseas denied the allegations and petitioned the United States Tax Court. The Tax Court proceeding was pending on December 16, 1977 when Overseas filed for bankruptcy in Luxembourg.[7] Overseas and the IRS subsequently compromised the tax deficiency, and in January 1978, the Tax Court entered a deficiency judgment for approximately 507,345 dollars, exclusive of interest.[8] Meanwhile, the Luxembourg court[9] appointed two commissaries[10] who were ordered to

1. Overseas Inns S.A. P.A. v. United States, 911 F.2d 1146 (5th Cir. 1990). Under the reorganization plan approved by the Luxembourg court, which characterized the IRS as a general unsecured creditor, Overseas would be able to satisfy its United States federal income tax obligation by paying 23.49% of the taxes owed. *Id.* at 1147.

2. 11 U.S.C. § 507(a)(7)(A) (1988). During the years in question, the payment of taxes was a first priority claim under the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1979).

3. Overseas Inns S.A. P.A. v. United States, 685 F. Supp. 968 (N.D. Tex. 1988). Western had failed to file any United States tax returns for the years 1960, 1961, and 1962. *Overseas*, 911 F.2d at 1147 n.1.

4. *Overseas*, 685 F. Supp. at 968-69.

5. The IRS issued a statutory notice of deficiency in early 1976, within the time prescribed by 26 U.S.C. § 6501. *Id.* at 969.

6. *Id.*

7. *Id.*

8. *Overseas*, 911 F.2d at 1147 n.1. The deficiencies exclusive of interest for 1960, 1961, and 1962 were $103,358.43, $206,811.36, and $197,174.04 respectively. *Id.* at 1147.

9. "The District Court of and at Luxembourg, Second Section, sitting as a commer-

establish a plan of either reorganization or liquidation for Overseas.[11] In March 1978, the commissaires proposed a plan of reorganization.[12] The Plan characterized the IRS as a general unsecured creditor and scheduled it to receive 23.49 percent of its claim, or almost 231,475 dollars.[13] The IRS would have enjoyed priority status in a similar United States proceeding.[14]

In December 1978, the commissaires submitted the Plan to the Luxembourg court and Overseas sent a copy to the IRS.[15] The IRS policy, however, did not allow participation in foreign bankruptcy proceedings because the IRS usually would receive less than the amount owed.[16] Because of this policy, the IRS did not object to the proposed Plan, which the Luxembourg court subsequently confirmed in February 1979. Overseas mailed the initial payment provided for by the Plan in March 1979, but the IRS returned it because it was in Belgian Francs.[17] Thereafter, from 1979 until 1983, the IRS accepted Overseas' yearly payments, remitted in United States currency, under the Plan—a total of approximately 179,135 dollars.[18]

The current dispute centers on Overseas' agreement to sell nineteen percent of its Eagle International stock to New Trails, Inc., a United States corporation, in June 1981.[19] Under this agreement, New Trails paid part of the purchase price in cash, with the balance to be paid in semi-annual installments.[20] In 1983 and 1984, the IRS levied on the installment payments for application against Overseas' tax liability. New

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cial court." *Overseas*, 685 F. Supp. at 969 n.2.

10. The two commissaires, a chartered accountant, and an attorney, were both residents of Luxembourg. *Id.* at 969 n.3.

11. *Id.* at 969.

12. The commissaires opted for a reorganization plan because "a financial group was willing to invest enough capital to pay Overseas' sole secured creditor in full and the general unsecured creditors in part." *Overseas*, 911 F.2d at 1147.

13. As of March 1978, the date of the submission of the Plan, the deficiency was $1,003,724.61, consisting of $507,343.83 in taxes and $496,380.78 in interest. *Overseas*, 911 F.2d at 1147 n.1.

14. *See supra* note 2.

15. *Overseas*, 685 F. Supp. at 969.

16. *Overseas*, 911 F.2d at 1147. Although not the focus of this paper, this author believes that the soundness of this policy is highly questionable because the usual result of bankruptcy proceedings is to discharge or reschedule debt, thus facilitating the liquidation or reorganization of the debtor.

17. *Overseas*, 685 F. Supp. at 969.

18. The 1984 payment was placed in escrow. *Overseas*, 911 F.2d at 1147 & n.2.

19. At the time of the bankruptcy proceedings, the Eagle International stock had no market value. *Id.* at 1147.

20. *Id.*

Trails subsequently made three payments to the IRS, totalling almost 919,836 dollars.[21] The IRS denied Overseas' refund claims for the levied payments.

Overseas filed suit in November 1986, arguing that it satisfied its obligation to the government when it paid approximately 179,135 dollars in accordance with the Luxembourg plan and that the IRS had collected almost 919,836 dollars to which it had no entitlement.[22] Overseas moved for summary judgment on the grounds that comity should be accorded to the Luxembourg Plan and that, consequently, the IRS was not entitled to any greater recovery than that allowed by the Luxembourg court.[23] Overseas further argued that United States courts consistently recognize the interests of foreign courts in liquidating or managing the affairs of foreign companies and that United States recognition of foreign reorganizations would enhance certainty and predictability for debtors, creditors, and potential investors.[24] The United States government opposed Overseas' motion for summary judgment on the grounds that courts do not grant extraterritorial effect to decisions in foreign bankruptcy proceedings that prejudice the interests of the United States or its citizens and that Luxembourg law is materially different from United States law in its treatment of the IRS.[25]

The district court denied Overseas' motion for summary judgment,[26] holding that to accord comity to the Luxembourg plan, which would have allowed Overseas "to satisfy a U.S. income tax obligation by paying

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21. New Trails made installment payments of $247,605.48, $236,295.89, and $223,868.85 directly to the IRS. *Id.*

22. *Overseas*, 685 F. Supp at 970.

23. Overseas also contended that the United States government had agreed to accept payments provided for in the Luxembourg plan "in full satisfaction of the taxes owed." Overseas, however, did not seek summary judgment on this issue. *Id.* at 970 n.4.

24. *Id.* at 970.

25. The United States government also claimed that it was denied due process by the Luxembourg court. *Id.* at 970. In Luxembourg, a creditor who does not respond within 15 days of notification of a reorganization proposal is deemed to have accepted the proposal. *Id.* at 970 n.5 (citing Article 8 of the Grand Ducal Order of May 24, 1935 (English translation)).

The United States government further argued that because Overseas did not take advantage of the 11 U.S.C. § 304 option, which would have allowed it to maintain an ancillary proceeding in the United States, the Luxembourg Plan did not cover assets located in the United States that were after-acquired. *Id.* at 970.

26. In the decision reported at 685 F. Supp. 968, the district court denied Overseas' motion for summary judgment. In May 1989, the district court granted the IRS's motion for summary judgment in an unreported opinion. *Overseas*, 911 F.2d at 1148.

23.49 [percent] of the taxes owed,"[27] would run contrary to United States public policy because the IRS would not have received comparable treatment under United States and Luxembourg law.[28] On appeal to the Fifth Circuit Court of Appeals, *affirmed. Held*: In accordance with existing public policy considerations, comity will not be accorded to foreign bankruptcy proceedings that discriminate against tax obligations owed to the United States government.[29]

II. LEGAL HISTORY

The law of transnational insolvency is seriously underdeveloped and inconsistent. Recent commentators have referred to the development of this area in the United States as "nascent and primitive"[30] and have criticized it as "the bankruptcy of bankruptcy law."[31] This weakness is attributable largely to the relative infrequency with which United States courts have had to deal with transnational insolvencies. Accordingly, these "rare birds" have received "about as much professional attention as did letters of marque and reprisal."[32] In the absence of guiding case law or statutory principles, the international law doctrine of comity has provided a vague standard for resolving international insolvency disputes within the United States.[33] The Supreme Court defined comity in the

27. *Overseas*, 685 F. Supp. at 968.

28. *Id.* at 975.

29. *Overseas*, 911 F.2d at 1159-50.

30. Douglass G. Boshkoff, *United States Judicial Assistance in Cross-Border Insolvencies*, 36 INT'L & COMP. L.Q. 729, 749 (1987) (quoting ELIZABETH WARREN & JAY L. WESTBROOK, THE LAW OF DEBTORS & CREDITORS 721 (1986)).

31. Richard A. Gitlin & Evan D. Flaschen, *The International Void in the Law of Multinational Bankruptcies*, 42 BUS. LAW. 307, 307 (1987) (quoting Kurt H. Nadlemann, *Rehabilitating International Bankruptcy Law: Lessons Taught by Herstatt and Company*, 52 N.Y.U. L. REV. 1, 1 (1977)).

32. Joseph D. Becker, *Transnational Insolvency Transformed*, 29 AM. J. COMP. L. 706, 707 (1981). According to Becker, transnational insolvencies "pass through our courts in sudden flights once or twice in a generation." *Id.* at 706. One recent article stated that "[o]ver the past century, only six noteworthy cases with international bankruptcy implications have been decided by U.S. courts." 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, 303 n.2 (1985). *See also* Barbara K. Unger, *United States Recognition of Foreign Bankruptcies*, 19 INT'L LAW. 1153, 1156 (1985) (stating that United States courts have been forced to rely on very old cases, even in the most recent decisions, because so little guidance has developed in this area).

33. Stacy A. Morales & Barbara A. Deutcsh, *Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity*, 39 BUS. LAW. 1573, 1576 (1984).

seminal case of *Hilton v. Guyot*[34] as "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."[35]

Although comity "does not achieve the force of an imperative or obligation," it is "more than mere courtesy and accommodation."[36] In an early New York Court of Appeals' opinion, Justice Cardozo stated that comity should be accorded unless to do so "would violate some fundamental principle of justice, some prevalent conception of good morals, [or] some deep-rooted tradition of the common weal."[37] This doctrine, however, has been tapered by the influence of a public policy exception[38] that has carried over into the field of transnational insolvency.

Commenting on a Commission Report that failed to include comity as a criterion to be considered by bankruptcy courts (but which did include comity as a factor for consideration by nonbankruptcy courts), one author referred to the comity doctrine as a "nebulous concept."[39] In an attempt to resolve conflicts between principles of comity and insolvency, United States courts have applied two contrasting doctrines: the universality theory and the territoriality theory.[40] Under the universality theory, all of the debtor's assets, wherever located, are subject to one bankruptcy adjudication held in the jurisdiction of the debtor's domicile.[41] Under the territoriality, or pluralism theory, bankruptcy proceedings concurrently take place in each jurisdiction in which the debtor or its assets are located, and no extraterritorial recognition is given to those

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34. 159 U.S. 113 (1895).

35. *Id.* at 164.

36. Somportex Ltd. v. Philadelphia Chewing Gum Corp., 453 F.2d 435, 440 (3rd Cir. 1971), *cert. denied*, 405 U.S. 1017 (1972).

37. Loucks v. Standard Oil Co., 120 N.E. 198, 202 (N.Y. 1918). Based on Justice Cardozo's opinion in *Loucks* as well as on opinions of other commentators, the New York Court of Appeals, in perhaps the most commonly quoted test for determining the recognition of foreign judgments, held that for comity to be withheld, the proceeding in question must be "inherently vicious, wicked or immoral, and shocking to the prevailing moral sense." Intercontinental Hotels Corp. v. Golden, 203 N.E.2d 210, 212 (N.Y. 1964).

38. *See, e.g.,* Laker Airways Ltd. v. Sabena, Belgian World Airlines, 731 F.2d 909, 931 (D.C. Cir. 1984).

39. Morales & Deutcsh, *supra* note 33, at 1587.

40. *See* Ulrich Huber, *Creditor Equality in Transnational Bankruptcies: The United States Position*, 19 VAND. J. TRANSNAT'L L. 741, 744 (1986); *see also* Unger, *supra* note 32, at 1154; Gitlin & Flaschen, *supra* note 31, at 309.

41. Unger, *supra* note 32, at 1154. *See also* Huber, *supra* note 40, at 744; Gitlin & Flaschen, *supra* note 31, at 309.

proceedings beyond a state's borders.[42] The United States has never formally adopted one approach to the exclusion of the other, but has adopted principles of both on a case-by-case basis. This failure to adopt a single approach has contributed to the inconsistency in international bankruptcy resolution.

A. *Traditional Adherence to Territoriality Approach*

Prior to the enactment of section 304[43] of the Bankruptcy Code of 1978, the United States often utilized the territoriality approach in resolving transnational insolvencies.[44] Beginning with *Harrison v. Sterry*,[45] in which the Supreme Court held that "the bankrupt law of a foreign country is incapable of operating a legal transfer of property in the United States,"[46] United States courts have been "hostile"[47] to foreign bankruptcy proceedings. The Supreme Court later discussed *Harrison* in *Ogden v. Saunders*,[48] stating in dicta that a foreign discharge in bankruptcy may not be defense to an action by a creditor with assets in the United States.[49] The years following *Ogden* brought only one notable exception to the early rule favoring United States creditors and their interests.[50]

Local creditors benefit from the territoriality approach in that they do

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42. Unger, *supra* note 32, at 1155; *see also* Huber, *supra* note 40, at 745; Gitlin & Flaschen, *supra* note 31, at 309.

43. This section authorizes the commencement of an action ancillary to a foreign proceeding in order to administer assets of the foreign debtor which are located within the United States. 11 U.S.C. § 304 (1988). The former Bankruptcy Act, however, was still in force in January 1979, when the Luxembourg court approved the Overseas reorganization plan. *Overseas*, 685 F. Supp. at 973 n.15.

44. Unger, *supra* note 32, at 1155 (stating that case law history reflected a de facto acceptance of the territoriality theory by United States courts prior to the adoption of the Bankruptcy Code).

45. 9 U.S. (5 Cranch) 289 (1809).

46. *Id.* at 302.

47. Unger, *supra* note 32, at 1156.

48. 25 U.S. (12 Wheat.) 213 (1827).

49. The United States "has at least taken its stand against [] comity, and asserted a right to protect its own interests." *Id.* at 362.

50. Morales & Deutcsh, *supra* note 33, at 1578. In the exception, *Canada Southern Railway v. Gebhard*, 109 U.S. 527 (1883), the Supreme Court held that the reorganization of a railway owned by the Canadian government was binding on dissenting American creditors, reasoning that unless all creditors could be bound by the reorganization plan, it would fail. *Canada Southern Railway*, 109 U.S. at 534-39. *See* Stephen Bainbridge, *Comity and Sovereign Debt Litigation: A Bankruptcy Analogy*, 10 MD. J. INT'L L. & TRADE 1, 36 (1986).

not have to petition a foreign court and generally receive better treatment in their home states.[51] The disadvantages of this approach to the bankruptcy process, however, are many. Under the territoriality theory as applied by United States courts the doctrine of creditor equality, which is fundamental to the bankruptcy system, is diminished.[52] Furthermore, multiple and potentially conflicting proceedings in different jurisdictions, as well as preferential treatment based on nationality, are likely results of this theory's application.[53] These multiple proceedings result in a duplicity of administrative expenses, further diminishing the amount of funds which will be available for distribution to the creditors of the estate.[54]

The United States traditionally has been one of the least cooperative states when dealing with foreign bankruptcies.[55] United States courts generally have permitted domestic creditors to satisfy their claims before allowing foreign trustees to take possession of the foreign debtor's property located in the United States.[56] The pervasive attitude of United States courts has been to abandon the principle of equal treatment of creditors in similar positions, if the rights of the foreign debtor under foreign law would diminish the rights of United States creditors under United States law.[57] In the mid 1970s, however, "drastic changes"[58] occurred in the application of the comity doctrine, caused in part by the failure of several major international banks,[59] and, according to some

51. Unger, *supra* note 32, at 1155.

52. The idea that creditors in similar positions should receive equal treatment has remained a constant attribute of bankruptcy throughout history. Gitlin & Flaschen, *supra* note 31, at 307.

53. Unger, *supra* note 32, at 1155.

54. Huber, *supra* note 40, at 745.

55. Gitlin & Flaschen, *supra* note 31, at 314. *See also* John D. Honsberger, 30 CASE W. RES. L. REV. 631, 636 (1980) (stating that United States courts traditionally have rejected the extraterritorial effect of foreign bankruptcy laws). *But see* JAY L. WARREN & ELIZABETH WESTBROOK, THE LAW OF DEBTORS & CREDITORS 721 (1986) (stating that the United States has been less parochial and more accommodating than most other countries regarding transnational insolvencies).

56. Unger, *supra* note 32, at 1155.

57. Gitlin & Flaschen, *supra* note 31, at 314.

58. Huber, *supra* note 40, at 757.

59. In 1974, the failure of the Herstatt Bank, a major commercial bank located in West Germany, caused an increased awareness in the United States of transnational insolvency problems and led to a "formal shift" toward a policy of increased recognition of foreign bankruptcy proceedings. *Id. See generally* Joseph D. Becker, *International Insolvency: The Case of Herstatt*, 62 A.B.A. J. 1290 (1976). Following the Herstatt affair and the foreign bankruptcies of two international banks (Israel-British Bank (London) Ltd. v. FDIC, 536 F.2d 509 (2nd Cir. 1976), *cert. denied*, 429 U.S. 978

commentators, caused a movement towards the universality theory.[60]

B. *Recent Move Toward the Universality Approach*

Through the enactment of Bankruptcy Code section 304,[61] the United States has begun to encourage the universality theory by allowing foreign representatives limited access to United States courts.[62] Courts interpreting this provision have been inclined to recognize the effect of foreign proceedings over the property of a foreign debtor located in the United States.[63] Indeed, recent decisions have accorded comity to foreign bankruptcy judgments from Italy,[64] Sweden,[65] France,[66] Bermuda,[67] Canada,[68] and Luxembourg.[69]

In theory, the universality approach is more likely to result in the equitable distribution of the estate because all of the property and parties involved appear before one court.[70] This approach also encourages greater efficiency of judicial resources and avoids multiple and inconsistent adjudications.[71] A criticism of the universality theory is that creditors may have to prove their claims in a foreign bankruptcy court, thereby suffering inconvenience and hardship greater than would be imposed by the standards of the local law to which they are accustomed.[72]

In order for the universality approach to function effectively all juris-

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(1976) and Banque de Financement v. First Nat'l Bank of Boston, 568 F.2d 911 (2nd Cir. 1977)), Congress enacted section 304 and thus initiated a trend towards adoption of the universality theory.

60. *See* Unger, *supra* note 24, at 1183; Daniel M. Glosband & Christopher T. Katucki, *Current Developments in International Insolvency Law and Practice*, 45 BUS. LAW. 2273, 2274 (1990). *See also* Gitlin & Flaschen, *supra* note 31, at 314-15.

61. 11 U.S.C. § 304 (1988).

62. Glosband & Katucki, *supra* note 60, at 2274. *See also* Cornfeld v. Investors Overseas Servs., Ltd., 471 F. Supp. 1255, 1260 (S.D.N.Y. 1979) (stating that section 304 is indicative of legislative policy supporting international comity).

63. Unger, *supra* note 32, at 1155-56.

64. In re Enercons Virginia, Inc., 812 F.2d 1469 (4th Cir. 1987).

65. Cunard S.S. Co. v. Salen Reefer Servs. AB, 773 F.2d 452 (2d Cir. 1985).

66. Kenner Prods. Co. v. Societe Fonciere et Financiere Agache-Willot, 532 F. Supp. 478 (S.D.N.Y. 1982).

67. Daniels v. Powell, 604 F. Supp. 689 (N.D. Ill. 1985).

68. Cornfeld v. Investors Overseas Servs., Ltd., 471 F. Supp. 1255 (S.D.N.Y. 1979); Clarkson Co. v. Shaheen, 544 F.2d 624 (2d Cir. 1976).

69. In re Colorado Corp., 531 F.2d 463 (10th Cir. 1976); IIT v. Cornfeld, 462 F. Supp. 209 (S.D.N.Y. 1978), *rev'd on other grounds*, 619 F.2d 909 (2d Cir. 1980).

70. Unger, *supra* note 32, at 1154-55.

71. *Id.* at 1155.

72. Honsberger, *supra* note 55, at 634.

dictions must adopt and enforce it.[73] Uniform enforcement, however, conflicts with the inherent bias of the bankruptcy system to protect the interests of local creditors.[74] Thus, United States courts are being called upon to balance the "visible and immediate damage to . . . [United States] interests . . . against the less tangible and more long-range interest in moving toward greater integration of different insolvency systems."[75] In an attempt to help in this balancing, section 304 lists several factors to be considered in transnational insolvencies.[76] The comity doctrine is one of the factors listed.[77] The result has been a frustration of the development of the universality theory in the United States approach to transnational insolvencies. Recent decisions seem to indicate a continued application of the protectionist approach,[78] especially when public policy is involved.[79]

C. *The Public Policy Exception to the Comity Doctrine*

Inherent in the doctrine of comity is an exception for public policy.[80] A well settled principle states that comity need not be accorded to foreign

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73. Unger, *supra* note 32, at 1155. *See also* Honsberger, *supra* note 55, at 634 ("It is axiomatic that the universality theory cannot function without universal acceptance.").

74. Unger, *supra* note 32, at 1155.

75. Boshkoff, *supra* note 30, at 745.

76. Section 304(c) lists six factors for United States courts to consider when determining whether to grant the relief requested:

> (1) just treatment of all holders of claims against or interests in such estate;
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> (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
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> (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
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> (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

11 U.S.C. § 304(c) (1988).

77. 11 U.S.C. § 304(c)(5) (1988). For an excellent discussion on the legislative history behind the inclusion of comity as a separate factor to be considered, see Morales & Deutcsh, *supra* note 33, at 1586-88.

78. *See* Glosband & Katucki, *supra* note 60, at 2275-79 (evaluating four recent cases that have declined to recognize foreign bankruptcy proceedings).

79. *See, e.g.,* In re Toga Mfg., 28 B.R. 165, 168-70 (Bankr. E.D. Mich. 1983); Interpool, Ltd. v. Certain Freights of M/V Venture Star, 102 B.R. 373, 380 (D.N.J. 1988), *appeal dismissed*, 878 F.2d 111 (3d Cir. 1989).

80. "There may be no yielding [to foreign judgments], if to yield is inconsistent with our public policy." Russian Republic v. Cibrario, 139 N.E. 259, 260 (1923).

judgments that violate the public policy concerns of the forum state: "[A] foreign judgment not entitled to full faith and credit under the Constitution will not be enforced within the United States when contrary to the crucial public policies of the forum in which enforcement is requested."[81] In 1895, the Supreme Court formally adopted this exception in *Hilton v. Guyot.*[82]

The public policy exception has been the catalyst behind many of the recent transnational insolvency cases that refused to accord comity to foreign bankruptcy proceedings.[83] For example, in *In re Toga Manufacturing Ltd.*,[84] the court denied the foreign representative of Canada relief "because, under the law of the main proceeding, a United States creditor and lien holder would have lost the secured status granted by United States law."[85] Although commentators have criticized it for requiring the foreign bankruptcy proceeding to be a "carbon copy"[86] of United States proceedings, *Toga Manufacturing* recognizes the problem that inevitably arises from the public policy exception: How similar does the foreign bankruptcy proceeding have to be to avoid violating public policy?

The current attitude of United States courts toward transnational insolvency seems to be one of territoriality at home, while advocating universal recognition of United States proceedings abroad.[87] One commentater stated:

> Almost invariably, each state's laws and policies dictate that "equal treatment" of creditors means that all creditors of a local debtor, whether the creditors are themselves local or not, should be treated in accordance with local law. Stated another way, most states would export their local laws to creditors and assets in other states but severely limit their recognition of foreign bankruptcy laws when the local creditors and local assets of a foreign debtor are involved.[88]

Thus, under the United States approach, a finding by a court that the public policy of the forum state is violated would be enough to limit severely the recognition of the foreign bankruptcy proceeding and to allow the adoption of a territoriality approach under the guise of comity.

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81. Laker Airways Ltd. v. Sabena, Belgian World Airlines, 731 F.2d 909, 931 (D.C. Cir. 1984).
82. 159 U.S. 113, 205-06 (1895).
83. *See supra* note 79.
84. 28 B.R. 165 (Bankr. E.D. Mich. 1983).
85. *See* Huber, *supra* note 40, at 754.
86. *Id.*
87. Honsberger, *supra* note 55, at 636.
88. Gitlin & Flaschen, *supra* note 31, at 308.

III. Instant Decision

In the instant decision, the Fifth Circuit Court of Appeals stated that "an inexpugnable public policy" exists in the United States that favors payment of lawfully owed federal taxes.[89] The court determined that this public policy would be violated if the taxes at issue were discharged in accordance with the foreign bankruptcy proceeding. The court concluded that comity does not allow one state to affect another's tax revenues and refused to recognize the Luxembourg bankruptcy proceeding.[90]

The Fifth Circuit began its analysis in the present case with a brief historical review of the principles of comity. The court noted that although the doctrine is "not a rule of law, but one of practice, convenience, and expediency,"[91] it should be withheld "only when its acceptance would be contrary or prejudicial to the interest of the nation called upon to give it effect."[92] The court then explored the doctrine of comity as applied to foreign bankruptcy proceedings. After a brief analysis of the universality[93] and territoriality[94] approaches, the court concluded that "comity is more likely to be accorded to foreign bankruptcy decrees when the foreign law is comparable to United States law."[95] Apparently adopting a territoriality approach to transnational insolvency, the court enunciated a policy whereby courts must "guard against forcing . . . [United States] creditors to participate in foreign proceedings in which their claims will be treated in some manner inimical to this country's policy of equality."[96]

89. *Overseas*, 911 F.2d at 1149 (quoting from the opinion of the district court, 685 F. Supp. at 972).

90. *Overseas*, 911 F.2d at 1149-50.

91. *Id.* at 1148 (quoting Somportex Ltd. v. Philadelphia Chewing Gum Corp., 453 F.2d 435, 440 (3rd Cir. 1971), *cert. denied*, 405 U.S. 1017 (1972)).

92. *Overseas*, 911 F.2d at 1148.

93. The court noted that the universality theory is considered to be the "modern trend" in recognizing transnational insolvencies—subjecting all of the debtor's assets to a single bankruptcy proceeding. *Id.* at 1149 n.5.

94. The court stated that the current movement is "away from the old 'territorial' approach," which failed to recognize bankruptcy judgments beyond the borders of the state that granted the decree. *Id.*

95. *Id.* at 1149. This seems to be a lower standard than previously required by other courts evaluating whether to accord comity to a foreign judgment. *See supra* note 37. Also, the Fifth Circuit failed to discuss the decisions of two other United States courts that granted comity to bankruptcy decrees from Luxembourg. *See supra* note 69.

96. *Overseas*, 911 F.2d at 1149 (quoting Banque de Financement, S.A. v. First Nat'l Bank of Boston, 568 F.2d 911, 921 (2nd Cir. 1977)). Although the Fifth Circuit did not explicitly adopt the territoriality doctrine, its holding and rhetoric are consistent with that approach. In contrast, the district court expressly declined to adopt either standard.

The court next inquired into the United States policy favoring the payment of federal income taxes and stated that "[i]t is beyond peradventure that there is, in the United States, an inexpugnable public policy that favors payment of lawfully owed federal income taxes."[97] Quoting from the legislative history,[98] the court held that this strong public policy also applied to taxpayers in bankruptcy. Because the IRS would have been treated as a priority status creditor under the United States Bankruptcy Code,[99] the court concluded that the Luxembourg reorganization plan, which treated the IRS as a general unsecured creditor, unfairly prejudiced the United States.[100]

The Fifth Circuit thus concluded that because the doctrine of comity embodies a public policy requirement and because the United States public policy favors the payment of federal income taxes, it would not recognize the Luxembourg bankruptcy decree.[101] Therefore, the instant decision stands for the proposition that comity will not be accorded to foreign bankruptcy proceedings that discriminate against tax obligations owed to the United States government.

The district court stated that even under the universality theory the Luxembourg proceedings would not have been recognized due to the public policy exception to the comity doctrine. *Overseas*, 685 F. Supp. at 972.

97. *Overseas*, 911 F.2d at 1149 (quoting from the district court opinion, 685 F. Supp. at 972). Certainly public policy demands that taxes should be paid, but whether such policy is inexpugnable must be questioned. Indeed, our own statutes do not afford the IRS an unqualified right of priority in every conceivable circumstance. Under present law, the priority afforded to income taxes is for those taxes involving either a taxable year "for which a return, if required, is last due, including extensions, after three years" or assessed within 240 days, before the date of filing of the petition, 11 U.S.C. § 507(a)(7)(A). *See also* United States v. Energy Resources Co., Inc., 110 S. Ct. 2139 (1990) (holding that the government's ability to collect every dollar of the tax due must yield to the authority of the bankruptcy court when necessary for the success of the reorganization); *The Economics of Bankruptcy Reform: Discussion*, 41 LAW & CONTEMP. PROBS. Autumn 1977, at 123, 166 (1977) (remarks of Philip Shuchman, former Deputy Director, Commission on the Bankruptcy Laws of the United States, stating that the government was "intransigent about their right to be a priority claimant, and didn't want to hear any arguments").

98. *Overseas*, 911 F.2d at 1149 n.6.

99. 11 U.S.C. § 507(a)(7)(A). *See also supra* note 2 and accompanying text.

100. *Overseas*, 911 F.2d at 1150.

101. The court also rejected an alternative contention put forth by Overseas that because the IRS accepted the payments in accordance with the Luxembourg judgment, it was estopped from later seeking to collect the balance of the compromised tax liability. The court held that the acceptance was not an "acquiescence" in the judgment, but "an attempted compromise." Therefore, section 7122 of the Internal Revenue Code, Treas. Reg. § 301.7122-1, applied; because Overseas did not follow the procedures set out by that section, it cannot succeed on this alternative claim. *Overseas*, 911 F.2d at 1150.

IV. Comment

As the number of multi-national corporations increases and international trade expands, the probability that the bankruptcy proceedings of one state will affect other nations grows tremendously. As a result, the need for a consistent and reliable method for resolving transnational insolvencies increases.[102] The United States approach to foreign bankruptcy proceedings, however, traditionally has been hostile.[103] The courts have applied a double-standard, advocating universal recognition of United States proceedings abroad, while traditionally taking a territorial approach at home.[104] The instant decision follows this trend.

The *Overseas* court refused to accord comity to a Luxembourg bankruptcy decree, despite two United States courts having done so in similar cases.[105] This decision was based on the dissimilar treatment the United States government would have received under United States bankruptcy law, as well as the public policy exception embodied in the doctrine of comity. Because of the inherent bias toward favoring local creditors in bankruptcy, this decision presents an unworkable standard. The universality theory of bankruptcy, which encourages the extraterritorial recognition of foreign bankruptcy proceedings, never can be reconciled with the public policy exception in the comity doctrine, which protects the interests of local creditors.

A universal approach to transnational insolvencies allows the court in which the bankruptcy is proceeding to administer all of the debtor's assets in a single adjudication and requires other nations to recognize the judgment.[106] This approach, however, is at odds with the public policy exception of comity. The moment a court begins to examine whether its own policies are prejudiced by a foreign court's bankruptcy decree, the universality theory is abandoned and the "overt nationalistic bias favor-

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102. The need for such a method was noted as far back as 1888, when John Lowell wrote:

> It is obvious that, in the present state of commerce and 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.

John Lowell, *Conflict of Laws as Applied to Assignments for Creditors*, 1 HARV. L. REV. 259, 264 (1888).

103. *See supra* note 47 and accompanying text.

104. Honsberger, *supra* note 55, at 636.

105. *See supra* note 69.

106. *See supra* note 41 and accompanying text.

ing . . . [United States] creditors"[107] takes over. Indeed, the *Overseas* court applied an even lower standard of the public policy doctrine, stating that "[United States] courts have declined to accord comity to such decrees when it would prejudice . . . [United States] interests or policies."[108] The court also stated that "comity is more likely to be accorded foreign bankruptcy decrees when the foreign law is comparable to United States law."[109] This standard is much lower than the "inherently vicious, wicked or immoral, and shocking to the prevailing moral sense" standard applied by some courts, as well as the strong public policy standard that Justice Cardozo pronounced for withholding comity.[110] Furthermore, the court seemed to ignore the fact that two other United States courts had found the Luxembourg bankruptcy system comparable enough to the United States system to accord comity.[111] Once again, these discrepancies exemplify the inconsistencies that result under the territoriality theory.

Under the *Overseas* approach, a court can deny comity to a foreign bankruptcy proceeding in nearly every instance, for inevitably either United States interests or policies will be prejudiced by the foreign proceeding or the foreign bankruptcy system will not be comparable to that of the United States. In the present case, the court found the single fact that the Luxembourg judgment accorded the IRS a lesser priority than it would have been granted in a United States court sufficient to deny enforcement of the Luxembourg judgment on public policy grounds. The mere fact that the laws of a foreign state differ from United States law should not support the withholding of comity. Under such a policy, seldom, if ever, would a foreign judgment be recognized. Yet the instant decision has this potential effect.

The *Overseas* case can be interpreted in the future either broadly or narrowly. In a broad sense, the case stands for the proposition that no foreign bankruptcy decree that discharges tax obligations owed to the United States government will be accorded comity because public policy dictates against this result. In contrast, if the decision is interpreted narrowly, then foreign bankruptcy decrees that discharge tax debts will be

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107. Morales & Deutcsh, *supra* note 33, at 1579 (discussing the past trend of United States case law on transnational insolvency).

108. Overseas, 911 F.2d at 1149.

109. *Id.* Although not elaborated on by the Fifth Circuit, the district court expressly declined to say the extent to which the relief afforded the IRS in the Luxembourg court would have to approximate the relief available in the United States to warrant according comity to the Luxembourg decree. *Overseas*, 685 F. Supp. at 975 n.22.

110. *See supra* note 37.

111. *See supra* note 69.

recognized, provided the decrees accord the government treatment comparable to that provided under the United States Bankruptcy Code. The problem with both interpretations is that they impose United States standards on foreign judgments and do not allow the foreign court to administer the debtor's assets in accordance with its own laws. When multiple states are involved in the proceeding, the successful reorganization of a multinational corporation virtually will be impossible because of the competing national policies.[112]

In sum, the *Overseas* decision presents an unworkable standard for United States courts if they are ever to move toward a universal system of recognizing foreign bankruptcy proceedings. To take a universal approach to transnational insolvency and to advocate simultaneously the protection of United States interests and public policy are theoretically impossible. United States courts have no right to require foreign states to have laws identical to their own. Next time, the United States may be the state in Luxembourg's position, desiring to have its proceedings recognized abroad. If the foreign tribunal takes an approach similar to that of the *Overseas* court, the decision probably will not be accorded comity.

Michael P. Bigelow

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112. Another possible consequence of the *Overseas* standard is that the uncertainty resulting from a territorialistic approach may dissuade United States businesses from dealing in international trade. This problem was noted in a recent article on transnational insolvency:

> Larger still than the problem of striking a balance between the competing policy interests favoring protection of U.S. nationals versus promotion of international cooperation and centralization of bankruptcy administration is the chilling effect that such uncertainty has on the broader need for continued investment by U.S. creditors abroad to foster international trade and development.

Morales & Deutcsh, *supra* note 33, at 1595 (footnote omitted).