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Creditor Equality in Transnational Bankruptcies: The United States Position

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I. INTRODUCTION

A. *The Problem*

In addition to giving a fresh start to the debtor,[1] a primary goal of bankruptcy law (at least of liquidation bankruptcy) is to distribute equally the debtor's assets to his creditors.[2] Although the Bankruptcy Reform Act of 1978[3] and its 1984 Amendments[4] (collectively "the Code") provide many ways of achieving this goal in domestic bankruptcies, these methods often prove to be of little help when a debtor's assets are located in more than one country.

Equality of creditors regardless of their origin, however, is considered

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1. *See* Burlingham v. Crouse, 228 U.S. 459 (1913); Traer v. Clews, 115 U.S. 528 (1885); *see also*, Given & Vilaplana, *Comity Revisited: Multinational Bankruptcy Cases Under Sec. 304 of the Bankruptcy Code*, 1983 ARIZ. ST. L.J. 325, 332.

2. *Burlingham*, 228 U.S. at 459; *Traer*, 115 U.S. at 528; Given & Vilaplana, *supra* note 1, at 332.

3. Pub. L. No. 95-598 (codified at 11 U.S.C., in scattered sections of 28 U.S.C. and in scattered sections of other titles) (1982) [hereinafter "the Code" or "the Bankruptcy Code"]. The Code repealed the Bankruptcy Act of 1898 (codified as amended at 11 U.S.C. §§ 1-1200 (1976)) [hereinafter "the Bankruptcy Act" or "the Act"].

4. Pub. L. No. 98-353 (codified at 11 U.S.C. (1984)).

essential for the development of international trade.[5] International trade has grown substantially, if not explosively, in recent decades. The issue of creditor equality has gained in importance because, along with the growth of international commerce, the number of transnational bankruptcies has increased. Because few treaties address this subject, primarily municipal law governs transnational bankruptcies.[6] Therefore, an analysis of United States municipal law regarding the equal treatment of creditors in bankruptcy cases crossing borders is appropriate.

This article contains two main parts (Sections II and III), which examine the issue of creditor equality from opposing points of view. Section II considers the Code's treatment of assets of a foreign debtor located within the United States and analyzes sections 304 through 306 of the Code. Section III discusses the problems arising when a United States debtor owns assets located abroad.

B. *Framing The Problem: Public International Law*

Two well-established principles of international law are: (1) a nation should legislate in a manner consistent with international law; and (2) courts should construe municipal law so as to ensure that its application will not violate international law.[7] Because this article examines bankruptcies on a transnational level, it is necessary to consider the restrictions which international law imposes on municipal bankruptcy law in its pursuit of transnational creditor equality. As the following discussion will show, jurisdiction is the primary restraint on this pursuit.

Jurisdiction concerns one aspect of the territorial sovereignty of a state: the state's right to regulate and to enforce its regulations.[8] Obviously, municipal law cannot define the scope of jurisdiction in international contexts. To avoid conflicts between sovereign states, rules of international law must restrict the state's jurisdiction. From the very beginning of the doctrine of jurisdiction, delimiting jurisdiction to the territory of a state has accomplished this restriction.[9] United States

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5. Note, *Sec. 304 of the Bankruptcy Code: Has it Fostered the Development of an "International Bankruptcy System"?*, 22 COLUM. J. TRANSNAT'L L. 541, 554 (1984).

6. *See* Nadelmann, *An International Bankruptcy Code: New Thoughts on an Old Idea*, 10 THE INT'L & COMP. L.Q. 70, 76 (1961); Nadelmann, *Codification of Conflicts Rules for Bankruptcy*, 30 SCHWEIZERISCHES JAHRBUCH FÜR INTERNATIONALES RECHT 57, 60 (1974).

7. *See* Commodity Futures Trading Comm'n v. Nahas, 738 F.2d 487, 493 (D.C. 1984).

8. Mann, *The Doctrine of Jurisdiction in International Law*, 111 (I) RECUEIL DES COURS DE L'ACADEMIE DE DROIT INTERNATIONAL DE LA HAYE 9, 13 (1964).

9. Nagan, *Conflicts Theory in Conflict: A Systematic Appraisal of Traditional and*

courts as well as the Restatement (Second) of Foreign Relations Law[10] accept this delimitation.[11] "[T]he principle of territoriality of jurisdiction is the cornerstone of the international system based on the nation-state."[12] Although the bonds between jurisdiction and territoriality have been loosened recently, especially by extraterritorial application of United States law and the effects-doctrine,[13] territoriality still is recognized as the major base of jurisdiction.[14]

Historically, international bankruptcy law, consisting mainly of municipal law governing transnational bankruptcies, has been torn between the doctrines of universality (or unity) and territoriality (or pluralism). Under the universality theory, international effect is given to a local adjudication in bankruptcy. In a straight application of the doctrine, the municipal law of the adjudicating country[15] extends to the foreign aspects of the bankruptcy case.[16] Under the universality doctrine, only one estate exists, which is administered by a trustee appointed by the authorities of the adjudicating country. The estate consists of all the debtor's assets, wherever located. Because every creditor's claim is subject to one body of law and is satisfied out of one estate, the universality doctrine equalizes creditors' rights.[17]

The territorial limitations of jurisdiction outlined above, however, prevent the unilateral application of the universality doctrine. Any unilateral application of one state's bankruptcy law in an extraterritorial manner would violate the "target-nation's" sovereignty.[18] Consequently,

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Contemporary Theories, 3 N.Y.L. SCH. J. INT'L & COMP. L. 343, 413-17 (1982).

10. RESTATEMENT (SECOND) FOREIGN RELATIONS LAW §§ 17-20 (1962).

11. Laker Airways v. Sabena, Belgian World Airlines, 731 F.2d 909, 921 (D.C. 1984).

12. Piciotto, *Jurisdictional Conflicts, International Law and the International State System*, 11 INT'L J. SOC. L. 11, 13 (1983).

13. United States courts claim that the effects-doctrine is within the doctrine of territoriality of jurisdiction (*see Laker*, 731 F.2d at 923), but one has to admit that basing jurisdiction on the mere effects of an act committed abroad within a nation's territory (which, summarily, is what the effects-doctrine says) has nothing to do anymore with the traditional concept of territoriality.

14. RESTATEMENT (SECOND) FOREIGN RELATIONS LAW (REVISED) § 402 comments a, b & c (Tent. Draft No. 6, 1986) [hereinafter RESTATEMENT (REVISED)].

15. This assumes the adjudicating country has proper jurisdiction over the debtor.

16. Note, *supra* note 5, at 560; Honsberger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W. RES. L. REV. 631, 633 (1981).

17. James, *International Bankruptcy: Limited Recognition in the New U.S. Bankruptcy Code*, 3 HOUS. J. INT'L L. 241, 242 n.9 (1981); Honsberger, *supra* note 16, at 633.

18. *Cf. supra* notes 208-21 and accompanying text.

universality is effective only when the countries of the interested parties have entered into a treaty allowing the adjudicating country's exercise of jurisdiction.[19] As mentioned above, however, treaties governing transnational bankruptcies are rare. Therefore, territoriality, the counterpart of universality, prevails. Under the concept of territoriality, protection of the local creditors' interests is the leading consideration. Basically, foreign bankruptcy adjudications are denied recognition and the debtor's properties outside the adjudicating country are not affected by the adjudication.[20]

Application of the territoriality doctrine has several effects which diminish creditor equality. The territoriality doctrine allows concurrent and competing proceedings in different jurisdictions, unnecessarily resulting in duplicative administrative expenses, which consequently reduce the funds available for distribution to the creditors. Moreover, a powerful creditor, who is more likely to be in a position to collect information regarding the debtor's various bankruptcy proceedings and to file claims in these jurisdictions, has a distinct advantage over less powerful creditors.[21]

No concurrent bankruptcy proceeding may be taking place in another country. The debtor then is free to dispose of his assets in that country to the disadvantage of creditors. The domestic trustee may have certain remedies to prevent this action by the debtor,[22] but these remedies may be of limited utility because they generally are not enforceable in a foreign jurisdiction due to the doctrine of territoriality. Moreover, the remedies may be rendered completely useless if the assets abroad are subject to attachments. Significantly, in recent cases of transnational bankruptcies the group of attaching creditors has not, or at least not exclusively, consisted of local creditors.[23] Once again, creditors are able to obtain preferences, and again the powerful creditors with the resources necessary to take part in international litigation gain preference over small creditors who are limited to participation in domestic procedures.

If territoriality means that bankruptcy adjudications generally are not given any effect outside the domestic jurisdiction, then the country where

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19. Note, *supra* note 5, at 560.

20. Honsberger, *supra* note 16, at 634; *In re* Toga Manufacturing Ltd., 28 Bankr. 165, 167 (E.D. Mich. 1983).

21. Even if filing a claim may be a very informal act, in most cases the creditor is required to retain counsel abroad, something a small creditor may be financially unable to do.

22. *Cf. supra* notes 228-37 and accompanying text.

23. *Cf.* the opposing parties in *In re* Culmer, 25 Bankr. 621 (S.D.N.Y. 1982) and Cunard Steamship Co. v. Salen Reefer Services, 49 Bankr. 614 (S.D.N.Y. 1985).

the assets are located has complete discretion[24] whether it will grant any effect to foreign adjudications in bankruptcy. Until the enactment of the Bankruptcy Code in 1979, the United States also followed this approach as a country of assets towards transnational bankruptcies. The following Part of this Article explores whether sections 304 through 306 of the Code have changed this attitude.

II. CREDITOR EQUALITY UNDER CODE SECTIONS 304 TO 306

A. *Purpose and Mechanism of Sections 304-306*

Although the Chandler Act[25] gave some authority to the courts to deal with foreign bankruptcies,[26] section 304 of the Bankruptcy Code[27] has no predecessor. To a certain degree section 304 extends to creditors in cross-frontier bankruptcies treatment equal to that afforded creditors in domestic cases by granting a foreign trustee[28] standing before United States courts[29] and by enabling a court to turn over United States assets of the debtor to these foreign representatives.[30]

That the Code has departed from pre-Code practice regarding foreign bankruptcies, or rather has taken into account the most recent practice, also is made evident by the language used in section 304 with respect to assets located in the United States. The fact that under subsection (b)(2) these assets may be turned over as "property of the estate" shows that the Code considers United States assets to be part of the foreign estate. The same implication may be drawn from subsection (b)(1), which refers to United States assets as "property involved in such foreign proceeding"[31] and as "property of such estate."[32] This terminology, combined with the absence of a statutory distinction between United States assets and the foreign estate, may be considered an implicit recognition by the Code of the concept of unity of the estate.[33] Indeed, such terminology leads to the conclusion that the Code's position regarding trans-

24. This discretion relates to international law. Under municipal law, this discretion may be governed by rules of recognition or by concepts like comity.

25. Act of June 22, 1938, c. 575, 52 Stat. 840.

26. *Id.*

27. 11 U.S.C. § 304 (1982).

28. In the terminology of the Code, which will be followed hereinafter, a foreign trustee is a "foreign representative." *See* 11 U.S.C. § 101(20) (1982).

29. 11 U.S.C. §§ 304(a), 306 (1982).

30. 11 U.S.C. § 304(b)(2).

31. 11 U.S.C. § 304(b)(1)(A)(1).

32. 11 U.S.C. § 304(b)(1)(B).

33. James, *supra* note 17, at 254.

national bankruptcies is based on the doctrine of universality.[34] Some courts even have praised section 304 for embodying the universality doctrine.[35]

The proceeding commenced by the foreign representative under section 304 is ancillary to the foreign bankruptcy proceeding.[36] It does not lead to liquidating procedures in the United States, but to the contrary, has the purpose of serving the main proceeding by enabling "the foreign trustee to protect the estate against dismemberment by local actions in this country without the necessity of commencing a bankruptcy or rehabilitation case under this Act."[37] This language illustrates that Congress' intent was based on the universality doctrine: only if one considers the assets located in the United States as part of the foreign estate does it make sense to look at section 304 as an instrument designed to protect the estate against dismemberment.

The question, therefore, is not whether United States courts should allow assets located in the United States to become part of a foreign bankruptcy estate; the Code already so provides. Rather, the question is under what circumstances should the courts enable the trustee to collect these assets and to unite them with the estate for distribution in the main proceeding or to grant other relief. By incorporating subsection (c) into section 304, Congress has provided some guidelines to help the courts in answering this question. The following section of this article will analyze these guidelines and their interpretation by the courts.

B. *The Prerequisites of Section 304(c)*

1. The Function of Section 304(c)

The decision whether relief, as mentioned in section 304(b), should be granted and, if so, what relief, basically is left to the court's discretion, but unlike before the enactment of the Code, in an ancillary proceeding under section 304 the somewhat "nebulous concept of comity"[38] is no longer the sole guideline given the courts. According to the preamble of section 304(c), a court should render its decision so as to "best assure an

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34. Note, *supra* note 5, at 543.

35. *Toga*, 29 Bankr. at 167. A completely different question is whether the courts have in fact followed the Code's intention.

36. Hereinafter referred to as "the main proceeding."

37. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93rd Cong., 1st Sess. 71 (1973) [hereinafter COMMISSION REPORT].

38. Morales & Deutcsh, *Bankruptcy Code Sec. 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity*, 39 BUS. LAW. 1573, 1587 (1984).

economical and expeditious administration of such estate." This general principle favors the universal approach towards a transnational bankruptcy, because this objective hardly can be achieved by keeping the assets located in the United States separated from the foreign estate. Separation inevitably leads to an increase in time-consuming and costly litigation, as well as other negative effects on an "economical and expeditious" liquidation of the debtor's assets.[39] Although some decisions rendered under the Code analyze the principles mentioned in section 304(c) in a somewhat thorough fashion, most courts rarely mention the general principle stated in the preamble. Courts apparently take for granted that, once it has been established that the relief requested does not violate these principles, granting the relief better serves the general principle of the preamble.

Six principles of policy further guide the courts.[40] From these six principles come six different tests which a foreign proceeding has to pass before relief may be granted. The legislative history shows that these principles are intended to serve as guidelines and to give the court maximum flexibility when having to rule on a foreign representative's petition.[41] A review of the cases dealing with the principles[42] illustrates, however, that, contrary to the intent of Congress, courts have granted relief only in cases where the foreign proceeding passed all six tests of section 304(c).[43]

The problems involved with the application of the prerequisites, as these six factors shall be called, emerge from two extreme positions. First, the old notion of comity demanded that courts afford domestic creditors maximum protection. The opinion in *Toga*,[44] deriving support from cases dating back to 1809[45] and 1827,[46] shows that this notion is not completely extinct, although more recent cases rendered before the Code's enactment show a far more favorable attitude towards foreign

39. James, *supra* note 17, at 242, n.9.

40. *See* 11 U.S.C. § 304(c)(1)-(6).

41. H.R. REP. NO. 95-959, 95th Cong., 1st Sess., 324, 325 (1977) [hereinafter HOUSE REPORT]; S. REP. NO. 95-989, 95th Cong., 2d Sess. 35 (1978) [hereinafter SENATE REPORT].

42. *E.g., Culmer*, 25 Bankr. 621; *Toga*, 28 Bankr. 165; *In re* Gee, 53 Bankr. 891 (S.D.N.Y. 1985).

43. For example, one court has been criticized for allegedly not checking clearly the six factors point by point. Morales & Deutcsh, *supra* note 38, at 1593, regarding the *Culmer* court's emphasis on comity.

44. *Toga*, 28 Bankr. at 167.

45. Harrison v. Sterry, 9 U.S. (5 Cranch) 289 (1809).

46. Ogden v. Saunders, 25 U.S. (12 Wheat) 213 (1827).

bankruptcy proceedings.[47] Second, other courts having to decide on a petition of a foreign representative under section 304 clearly have favored the main proceeding, seeing in section 304 an instrument designed to bring about creditor equality in transnational bankruptcies. One court stated: "[T]he central examination which (the court) must undertake in order to comply with section 304(c) is whether the relief petitioners seek will afford equality of distribution of the available assets."[48]

2. Section 304(c)(1) and (c)(2): Equality v. Protection?

Subsection (c)(1) of section 304 requires the main proceeding to treat justly any "holder of claims against or interest in such estate." The subsection expresses a general requirement that all creditors be treated alike, notwithstanding their origin. This subsection is a derivative of international bankruptcy's primary principle of creditor equality and equal participation in the distribution of the debtor's assets. If relief grantable under section 304 will help to achieve this objective, then such creditor equality also has to be an objective of the law governing the main proceeding, or else the granting of relief would not make sense. Relief is designed to achieve creditor equality internationally, which is rendered impossible if the main proceeding discriminates against foreign claims.

A similar concept, although expressed differently from that in subsection (c)(1), is contained in section 304(c)(2). This subsection requires protection of claim holders in the United States against "prejudice and inconvenience in the processing of claims" in the main proceeding. Some commentators maintain that an irreconcilable difference exists between the requirement of section 304(c)(1) to treat all creditors alike and the requirement of section 304(c)(2) to protect the claims of United States creditors against prejudice and inconvenience.[49] Regarding prejudice, however, this seems not to be the case. The notion that protection of United States creditors against prejudice is contradictory to creditor equality results from a misunderstanding of the purpose of subsection (c)(2). Although a denial of relief may prevent equal treatment of creditors internationally, the protection of United States claim holders does not contradict section 304(c)(1), a test the main proceeding must pass. If prejudice exists as the *Finabank* court understood it, namely as the

47. *See* Banque de Financement v. First National Bank of Boston, 568 F.2d 911 (2d Cir. 1977); these decisions were rendered even though U.S. creditors would have fared better under the old interpretation of comity.

48. *Culmer*, 25 Bankr. at 628; *cf.* Cunard Steamship Co. v. Salen Reefer Services, 773 F.2d 452, 458 (1985); *Gee*, 53 Bankr. at 901.

49. Note, *supra* note 5, at 554.

treatment of claims of United States creditors "in some manner inimical to this country's policy of equality,"[50] then the main proceeding has not passed the first test; there is no just treatment of all claim holders and the request for relief may be denied as well under section 304(c)(1) as under subsection (c)(2).

Nevertheless, because the motive that led to the enactment of the sections dealing with ancillary proceedings undisputably was to achieve creditor equality in transnational bankruptcies,[51] section 304(c)(2) should be interpreted restrictively in order to comport with this objective, as suggested by commentators[52] and held by courts.[53] To tend toward a more protectionist approach and to afford United States creditors protection in cases is not dictated by an inimical attitude of the main proceeding towards them as described by the *Finabank* decision, [54] and means to unnecessarily reduce the applicability of ancillary proceedings. But a tendency to fall back to the pluralistic approach to transnational bankruptcies is hostile to the doctrine of universality, which led to the enactment of the Code's provisions discussed herein.[55]

One issue which section 304(c)(2) presents is whether creditors who have attached United States assets of a foreign debtor should be allowed to keep these assets for the satisfaction of their claims or whether under section 304(b) the trustee may avoid the attachments. This issue was paramount in *Culmer, Toga* and *Cunard* and also arose in *Gee.*[56] This issue should not be resolved on the basis of subsection (c)(2), but rather (c)(4) of section 304.[57] Section 304(c)(2), as explained above, is a protective device, limited to safeguarding United States creditors — and only United States creditors — against prejudice. Given this narrow interpretation, section 304(c)(2) never authorizes a judge to deny relief solely because the United States assets have been attached. The granting of relief, which may in fact result in the lifting of an attachment and the

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50. *Banque de Financement*, 568 F.2d at 921.

51. COMMISSION REPORT, *supra* note 37, at 71.

52. Klöcker, *Foreign Debtors and Creditors Under United States and West German Bankruptcy Laws: An Analysis and Comparison*, 20 TEX. INT'L L.J. 55, 87 (1985).

53. *Culmer*, 25 Bankr. at 628; *Gee*, 53 Bankr. at 901; *Cunard* is not representative here because no interests of U.S. claim holders were involved. *Cf. Cunard*, 49 Bankr. at 618.

54. *Banque de Financement*, 568 F.2d at 921.

55. Note, *supra* note 5, at 543; Riesenfeld, *The Status of Foreign Administrators of Insolvent Estates: A Comparative Survey*, 24 AM. J. COMP. L. 288, 296 (1976); *Gee*, 53 Bankr. at 901.

56. *Gee*, 53 Bankr. at 901.

57. Regarding § 304(c)(4), see *infra* notes 77-95 and accompanying text.

creditors' loss of the respective secured status, does not constitute prejudice in itself. Prejudice must be found in the rules governing the main proceeding, not in a shift of position caused by an act of a United States court in an ancillary proceeding. Furthermore, to turn section 304(c)(2) into an instrument preventing the turnover of attached assets goes beyond the scope of protection; it may prefer United States creditors over foreign claim holders, a concept completely irreconcilable with the ideas underlying section 304. The *Culmer* court realized this danger[58] and, accordingly, granted relief to avoid it.

More dangerous to creditor equality is the notion of inconvenience in section 304(c)(2). For example, in *In re Lineas Areas de Nicaragua*, the court found that the participation of a United States claim holder in a main proceeding abroad was "an alternative to be avoided if possible under section 304(c)(2)" and denied relief.[59] The decision has been criticized for its interpretation of the subsection.[60] Indeed, a holding that the inconvenience mentioned in this subsection consists of the mere fact that a claim holder has to pursue his rights abroad renders the instrument provided for by the Code ineffective in any case where a foreign debtor has United States creditors. Under such a holding courts could rarely grant relief because participation in a foreign proceeding always involves inconvenience to some extent.[61]

Fortunately, decisions rendered after *Lineas* have abandoned this interpretation of inconvenience. With respect to section 304(c)(2), the *Culmer* court carefully analyzed the main proceeding and concluded that there was neither prejudice against nor inconvenience to United States claimants in the proceeding itself which would merit protection of United States creditors.[62] The *Gee* court followed a similar analysis.[63] Neither decision considers the mere necessity to file a claim abroad a sufficient basis to deny relief. This conclusion complies with the language of section 304(c)(2), which asks for inconvenience "in the processing of claims in such foreign proceeding." This language implies that a court may find inconvenience only when a claim has been submitted.[64]

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58. *Culmer*, 25 Bankr. at 630.

59. *In re* Lineas Areas de Nicaragua, 13 Bankr. 779, 780 (S.D. Fla 1981).

60. Gallagher & Hartje, *The Effectiveness of Sec. 304 in Achieving Efficient and Economic Equity in Transnational Insolvency*, 1983 ANN. SURV. BANKR. L. 1, 18 (1983).

61. James, *supra* note 17, at 259.

62. *Culmer*, 25 Bankr. at 630.

63. *Gee*, 53 Bankr. at 903.

64. For example, if the foreign law requires the creditor to appear personally before the bankruptcy tribunal.

Furthermore, this narrower interpretation of section 304(c)(2) follows the drafters' intent to favor unity of the estate. As the *Gee* court stated, "Creditors of an insolvent foreign corporation may be required to assert their claims against a foreign bankrupt before a duly convened foreign tribunal."[65]

3. Preference and Fraud

The ability to avoid preferences and fraudulent transfers is of great importance to United States bankruptcy law and one of the main devices the Code provides to achieve creditor equality in domestic bankruptcies. Consequently, section 304(c)(3) requires the law governing the main proceeding to resolve issues concerning preferences and fraudulent transfers.

The question remains, then, how the foreign law must treat preferences and fraudulent transfers to meet the prerequisite of section 304(c)(3). In answering it, one has to keep in mind that the Code takes a rather negative attitude towards creditors. By application of sections 547 and 548 of the Code, courts have declared void transactions in which no fraud or preference is visible from the perspective of an observer from a foreign jurisdiction.[66]

Because a United States court is best acquainted with United States law, a certain risk[67] exists that the court will hold that foreign law governing the subject has to be substantially the same as United States law. However, because the extreme position in United States bankruptcy law of protecting the estate is unknown in many foreign bankruptcy laws, such interpretation will result regularly in a denial of relief, although foreign law may deal effectively, though differently, with the problem. The diversity of municipal bankruptcy laws is commonly known.[68] The drafters of the Code could not have intended foreign law to be a "mirror image" of United States law because such a strict prerequisite would render section 304 ineffective. Section 304(c)(3) reiterates the general policy inherent in sections 547 and 548 of the Code that preferences and

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65. *Gee*, 53 Bankr. at 901, (quoting *Cunard*, 773 F.2d at 458).

66. *Cf., e.g.*, Durett v. Washington National Ins. Co., 621 F.2d 201 (5th Cir. 1980).

67. This risk is similar to that contained in subsection (c)(4). *Cf. infra* notes 77-95 and accompanying text.

68. *See* 1 DALHUISEN ON INTERNATIONAL INSOLVENCY AND BANKRUPTCY § 1.08, p. 2-132.8. This variety and the nations' sticking to their solutions are the major obstacles to the conclusion of treaties on bankruptcy. Note, *supra* note 5, at 557; *see* Stevens, *The Interpenetration of Foreign Bankruptcy Laws in Domestic Proceedings Under H.R. 8200*, 52 AM. BANKR. L.J. 61, 73 (1978).

fraudulent transfers are inconsistent with the goals of United States bankruptcy law.[69] Consequently, and consistent with the favorable overall attitude of section 304 towards the main proceeding,[70] the prerequisite of subsection (c)(3) is met if the law governing the main proceeding provides for the prevention of fraud and preference, even if those provisions do not reach as far as do their United States counterparts.[71]

At least one court has completely misunderstood the function of ancillary proceedings in general and of section 304(c)(3) in particular.[72] In *Egeria II*, the issue was whether a preference action can be brought in an ancillary proceeding.[73] The court answered the question in the affirmative, basing its decision on section 304(c)(3) and writing that this provision "states that the [bankruptcy] Court shall act to prevent 'preferential or fraudulent dispositions of such estate.' "[74]

The prerequisites of section 304(c), however, are tests which the main proceeding must undergo. They are not a basis for the application of United States bankruptcy law to issues not related directly to the foreign representative's petition. Section 304(c)(3) authorizes the court to decide only whether the law of the main proceeding sufficiently protects the estate against preferences and fraudulent transfers. If this is the case, the court must grant relief,[75] regardless of whether transactions that resulted in either preference or fraudulent transfer actually exist. This issue has to be decided exclusively according to the law of the main proceeding and by the respective courts. To hold to the contrary and to allow parties in interest to dispute matters concerning substantive bankruptcy law would be to turn the ancillary proceeding into a separate bankruptcy case dealing with the United States assets, exactly what the drafters wanted to prevent through the addition of section 304.[76]

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69. Note, *supra* note 5, at 555.

70. COMMISSION REPORT, *supra* note 37, at 71; Powers & Mears, *Protecting a U.S. Debtor's Assets in International Bankruptcy: A Survey and Proposal for Reciprocity*, 10 N.C.J. INT'L L. & COMM. REG. 303, 341 (1985); *see infra* text accompanying note 214.

71. *Cf. Gee*, 53 Bankr. at 904.

72. *In re* Egeria Societa Per Azioni di Navigazione, 26 Bankr. 494 (E.D. Va. 1983).

73. *Id.* at 497.

74. *Id.*

75. Provided that the other requirements are satisfied, too.

76. Powers & Mears, *supra* note 70, at 341; text accompanying note 215, *supra*. Already the Commission Report suggests that, to avoid a transfer, a plenary case should be commenced, not a case under section 304. *See* COMMISSION REPORT, *supra* note 37, at 71.

4. Distribution of Proceeds

The order that the Code provides for the distribution of proceeds seems to have been of such fundamental importance to the Code's drafters that the test of section 304(c)(4) serves to establish that foreign law is substantially in accordance with United States law.[77] This requirement of similarity may be used as another device to protect the interests of United States claim holders.[78] Consequently, court decisions dealing with section 304(c)(4) and articles discussing that section illustrate that section 304(c)(4) can be a major obstacle to the foreign representative. If courts interpret the similarity prerequisite as requiring the foreign law to be a carbon copy of United States law, then all too often the substantial differences in municipal bankruptcy laws will prevent ancillary relief, evicerating section 304(b). As a review of the *Culmer* court's interpretation of section 304(c)(4) makes evident, "substantially" is on par with "fundamentally" or "basically,"[79] therefore allowing foreign law to differ from the order provided for by the Code, as long as the general principles underlying the order remain identical.

The court in *Gee* followed the reasoning of the *Culmer* court.[80] Between those two decisions, however, the *Toga* court rendered its opinion. The court denied the foreign representative 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. The court based the decision on section 304(c)(4).[81] *Toga* has been criticized for requiring the foreign distribution order to be a carbon copy of the provisions of the Code.[82] Several authors have compared *Culmer* and *Toga* and have found the decisions contradictory.[83] In both cases, the parties in interest who opposed the petition were creditors who either already had obtained or were in the course of obtaining attachments.[84] The differences in the courts' decisions, however, are based on the substantially differing facts of the cases.

In *Toga* a creditor had twice served garnishments on debtors of the

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77. 11 U.S.C. § 304(c)(4).

78. James, *supra* note 17, at 259-60.

79. *Culmer*, 25 Bankr. at 630-31.

80. *Gee*, 53 Bankr. at 904.

81. *Toga*, 28 Bankr. at 169.

82. Gallagher & Hartje, *supra* note 60, at 21.

83. Note, *supra* note 5, at 566-67; *see* Gallagher & Hartje, *supra* note 60, at 21; Klöcker, *supra* note 52, at 87; Powers & Mears, *supra* note 70, at 341-42.

84. In *Toga*, the court also had to resolve an issue regarding set-offs not to be addressed in this paper.

bankrupt long before the latter filed for bankruptcy in Canada and only after the creditor had obtained a judgment against the bankrupt. Under section 506 of the Code, the creditor would have been a holder of a secured claim. Four months passed between the serving of the second set of garnishments and the Canadian petition, and another two months passed before the foreign representative filed a petition for relief under section 304.[85] The court came to the conclusion that Canadian law would not recognize the creditor's secured status.[86]

A completely different factual situation was present in *Culmer*. This case is part of the litigation following the banking scandal and the breakup of the Italian Banco Ambrosiana S.P.A. and its affiliates, which led to the winding-up of Banco Ambrosiana Overseas (BAOL). BAOL was domiciled in the Bahamas and was the debtor in *Culmer*. The creditors involved were actually participating in a race for the courthouse which was not limited to the United States.[87] Significantly, this race began only after BAOL's banking license was suspended temporarily, which clearly indicated BAOL's financial troubles, and only shortly before the winding-up of BAOL was resolved in the Bahamas.[88] The court decided to grant relief despite the opposition of some of the secured creditors.

A comparison of the facts shows that quite different motives led the creditors to seek attachments in the two cases. Whereas in *Toga* the creditor had obtained a final judgment and served garnishments long before the debtor was adjudicated a bankrupt and was not competing with co-creditors, the situation present in *Culmer* was the result of each creditor seeking to outsmart its co-creditors and to grasp as much as possible of the debtor's assets, wherever located. This difference in facts calls for a different treatment under the law, for which the Code provides. The question when applying section 304(c)(4) is: Has the attaching creditor acquired a secured status that has become irrevocable? To answer this question, a recourse to United States bankruptcy law is inevitable. The answer is found in the Code's provisions dealing with the avoiding powers of the trustee, especially in section 547 of the Code.

The acquisition of a security interest by means of attachment is a "transfer" within section 547 of the Code because a transfer may be of

85. *Toga*, 28 Bankr. at 166-67.

86. *Id.* at 168-69.

87. For example, some of the creditors involved in the U.S. proceedings participated at the same time in the bankruptcy proceedings in the Bahamas and in attachment proceedings in Switzerland.

88. For detailed facts, see *Culmer*, 25 Bankr. at 623-27.

voluntary or involuntary nature.[89] Because an attachment always serves the purpose of securing an antecedent debt,[90] the crucial provision is section 547(b)(4) of the Code, making transfers avoidable if they fall within the 90-day preference period.[91]

A court asked to grant turnover, an act which in fact avoids existing attachments, must as a first step ascertain the status the attaching creditor would obtain in a United States case. Without doing so, this status could not be compared to the status granted to the creditor in the main proceeding, and whether the order for distribution of the main proceeding is similar to the order provided for by the Code could not be resolved. If the attachment is avoidable under section 547 of the Code, the creditor does not deserve protection of his attachment. The court may grant relief regardless of the attitude the law of the main proceeding takes towards domestic judicial liens.

The fact that under United States law the creditor's security interest cannot be defeated any longer, however, must not lead automatically to the conclusion that relief has to be denied. The task of the court then is to analyze the approach taken by the law governing the main proceeding. If the secured creditor obtains a position in the main proceeding similar to the one he would have taken in a United States case, the main proceeding has passed the test of section 304(c)(4). Consequently, the court may grant relief. If the main proceeding treats the attaching creditor as an unsecured creditor, relief should be denied.

Application of this solution to the *Toga* and *Culmer* holdings shows that both courts were correct. In *Toga*, six months had passed between the garnishments and the foreign representative's filing of a petition under section 304. Because the date of the filing of the petition generally begins the commencement of the 90-day preference period,[92] the creditor's position had become definitive before the petition was filed. Canadian law, however, would not have recognized his secured status.[93] The complete loss of a secured status contradicts section 304(c)(4) because such a shift of position constitutes a fundamental difference between the two orders of distribution and inevitably results in an often substantial diminution of the creditor's recovery. Therefore, the *Toga* court justifia-

89. 11 U.S.C. § 101(48).

90. 11 U.S.C. § 547(b)(1).

91. The question remains, naturally, whether the debtor was insolvent when the transfer occurred. The presumption of § 547(f) of the Code shifts the burden of proof for the contrary to the beneficiary of the transfer.

92. *See In re* Comstat Consulting Services Ltd., 10 Bankr. 134, 135 (S.D. Fla. 1981) (based on the definition of "petition" in § 101(31) of the Code).

93. *Toga*, 28 Bankr. at 168.

bly denied relief; it did not require the foreign law to mirror United States law. Instead, the court correctly applied section 304(c)(4). In *Culmer*, on the other hand, not more than a few weeks had passed between the attachment finally lifted by the decision and the order staying further action against the debtor issued under section 304.[94] In a United States case, the creditor would not have been able to keep the secured status because of section 547(b). Consequently, the court granted relief.[95]

5. The Role of Comity in Section 304(c)

When applying the doctrine of comity of nations to an act of a foreign sovereign, courts,[96] with the approval of commentators,[97] have repeatedly granted relief based on the doctrine's definition established in the leading case of *Hilton v. Guyot*:[98]

> '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 law.[99]

One has to recognize, however, that the doctrine, at least as far as its application to transnational bankruptcies is concerned, has undergone drastic changes, especially in the decade proceeding the enactment of the Code. The doctrine initially granted a considerable amount of discretion to the courts, who used it as a device to protect the interests of domestic

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94. The respective creditor, Arabank, had obtained an attachment on Aug. 8, 1982. Its action was stayed by the court due to the petition of the foreign representative on Sept. 8 and 10, 1982; *cf. Toga*, 28 Bankr. at 623-24.

95. This differentiation is in accordance with the legislative history. *See*, COMMISSION REPORT, *supra* note 37, at 70-71: "The section does not override the general American rule of conflicts of laws that foreign trustees may not defeat rights acquired by local creditors through levy on local assets." *Cf.* Honsberger, *supra* note 16, at 653; *contra* Gallagher & Hartje, *supra* note 60, at 13.

96. *Cf.* Clarkson Co. Ltd. v. Shaheen, 544 F.2d 624, 629 (2d Cir. 1976); *In re* Colorado Corp., 531 F.2d 463, 468 (10th Cir. 1976); Cornfeld v. Investors Overseas Services Ltd., 471 F.Supp. 1255, 1259 (S.D.N.Y. 1979); *Culmer*, 25 Bankr. at 629; *Toga*, 28 Bankr. at 169; *Cunard*, 49 Bankr. at 617; *Cunard*, 773 F.2d at 456; *Gee*, 53 Bankr. at 901.

97. Morales & Deutcsh, *supra* note 38, at 1576; Honsberger, *supra* note 16, at 636; James, *supra* note 17, at 260.

98. 159 U.S. 113 (1895).

99. *Id.* at 163-64.

creditors[100] with only a few exceptions.[101] In the years just before the enactment of the Code, courts began to see creditor equality as the primary goal to be achieved in transnational bankruptcies.[102] In preferring equality of distribution of assets among creditors over absolute protection of domestic creditors' interests,[103] courts have limited the protection afforded United States creditors to cases in which their claims would have been treated "in some manner inimical to this country's policy of equality."[104] This trend has culminated in *Cornfeld*, which clearly confessed its adoption of the doctrine of universality by quoting a statement written by the *Gebhard* court more than one hundred years ago:[105] "What is needed is to bind those [creditors] who are abroad. Under these circumstances the true spirit of international comity requires that schemes of this character, legalized at home, should be recognized in other countries."[106]

Interestingly, since the Code has been in effect, the two positions outlined above have both found their way into opinions rendered by courts applying section 304(c)(5). Obviously hostile to the ideas incorporated in section 304, the *Toga* court denied relief based on section 304(c)(4) to a Canadian representative.[107] Before doing so, however, the court created a negative atmosphere by citing two antiquated cases which denied to a foreign adjudication any impact on assets located within the United States.[108] From these cases the court concluded that United States bankruptcy law historically had taken an attitude inimical towards claims of foreign representatives.[109] The court completely disregarded the development of the comity doctrine and opposed results reached in more recent

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100. Disconto Gesellschaft v. Umbreit, 208 U.S. 570 (1908); *In re* Berthoud, 231 F. 529 (S.D.N.Y. 1916).

101. *E.g.*, Canada Southern Railway Co. v. Gebhard, 109 U.S. 527 (1883).

102. Waxman v. Kealoha, 296 F. Supp. 1190 (D. Haw. 1969); Israel-British Bank (London) Ltd. v. Federal Deposit Insurance Corp., 536 F.2d 509 (2d Cir. 1976); *Banque de Financement*, 568 F.2d 911 (2d Cir. 1977); Clarkson Co. v. Shaheen, 544 F.2d 624 (2d Cir. 1976); *In re* Colorado Cornfeld v. Investors Overseas Services Ltd., 471 F. Supp. 1255 (S.D.N.Y. 1979).

103. *Israel-British Bank*, 536 F.2d at 513; *Banque de Financement*, 568 F.2d at 918-19.

104. *Banque de Financement*, 568 F.2d at 921.

105. *Cornfeld*, 471 F. Supp. at 1260.

106. *Gebhard*, 109 U.S. at 539.

107. *Toga*, 28 Bankr. at 168 and 169.

108. *Id.* at 167 (citing Harrison v. Sterry, 9 U.S. (5 Cranch) 289 (1809) and Ogden v. Saunders, 25 U.S. (12 Wheat) 213 (1827)).

109. *Toga*, 28 Bankr. at 167.

cases like *IBB, Finabank* and *Cornfeld.*[110] Though in *Toga* the application and interpretation of comity was not crucial because relief could (and had to) be denied on other grounds, a potential threat to creditor equality is inherent in an attitude like that of the *Toga* court. If courts regress to using comity as a protective device as courts used it at the turn of the century,[111] the other prerequisites will become meaningless: a court almost always will be able to deny relief because the old notion of comity affords protection to a creditor.

Fortunately, *Toga* has remained a minority approach. *Culmer* and the cases following represent the majority. *Culmer* limits the comity issues to whether a foreign court had competent jurisdiction[112] and whether that court's decision has violated the laws or the public policy of the United States.[113] Considering the context of section 304(c)(5), courts must interpret comity this narrowly. Subsections (c)(1), (2) and (4) of section 304 sufficiently protect the claims of United States creditors. Once a court has analyzed a case under those provisions there is no need to raise the same questions again in the light of comity and make the same mistake as the *Toga* court. Reliance on those old cases which afforded excessive protection to United States claim holders[114] is incompatible with the intent of section 304.

Culmer[115] followed the reasoning of *IBB, Finabank* and *Cornfeld.*[116] In accordance with congressional intent, the *Culmer* court based its interpretation of section 304(c) on creditor equality,[117] under which the Code and the doctrine of comity as applied in recent cases subordinates protection of local creditors.[118]

One issue which has arisen several times and remains unresolved is whether, because of section 304(c)(5), the granting of relief may be (or even must be) contingent on reciprocity. Section 304(c) does not refer expressly to reciprocity. However, courts traditionally have considered

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110. *See also,* Kenner Products Co. v. Société Foncière et Fiancière Agache-Willot, 532 F. Supp. 478, 479 (S.D.N.Y. 1982).

111. *See* cases cited *supra* note 100.

112. *See supra* notes 127-34 and acompanying text (discussing whether it is correct to consider jurisdiction here).

113. *Culmer,* 25 Bankr. at 629; *cf. Gee,* 53 Bankr. at 902.

114. *See Harrison,* 9 U.S. 289; *Ogden,* 25 U.S. 213 and cases cited *supra* note 100.

115. This decision was rendered before *Toga* and also was not taken into consideration by the *Toga* court.

116. *Culmer,* 25 Bankr. at 629.

117. *Id.* at 628.

118. *Cunard,* 773 F.2d at 458; *Gee,* 53 Bankr. at 901.

reciprocity to be part of the doctrine of comity.[119] Courts have stated and commentators have written that a court may deny relief under section 304(c)(5) if the foreign country would not react similarly in a reciprocal case.[120] Some writers have even suggested that United States courts should treat reciprocity as a prerequisite to granting relief in general.[121]

Although this suggestion is understandable from a United States point of view, such a prerequisite would contradict the intent underlying the Code's provision pertaining to ancillary proceedings. That the Code contains sections 304 through 306 indicates that Congress wanted to contribute unilaterally to creditor equality.[122] Conditioning relief on reciprocity diminishes the effectiveness of these sections to a level of insignificance.

Accordingly, courts have ceased to require reciprocity in connection with insolvency comity. Some decisions issued before the enactment of the Code briefly dealt with reciprocity, but in none of these cases did reciprocity play a decisive role.[123] Although decisions rendered after the enactment of the Code usually do not address the issue, the *Cunard* decision did.[124] The court quite clearly held that reciprocity is not a prerequisite to the granting of comity.[125]

In summary, the majority view opposes reciprocity.[126] If reciprocity is compared to the prerequisites of section 304(c), one also realizes that it would be the sole factor not connected with the actual case and would require an evaluation of foreign law under completely theoretical aspects. Furthermore, such a requirement eventually would punish the creditors in the case at bar for an approach taken by a foreign legislature or judiciary, which seems to be unfair to the parties involved. One hopes the tendency to disregard reciprocity will continue.

Finally, one is tempted to ask what the purpose of comity is in the context of section 304(c). The addition of comity (which occurred at a late stage of legislation)[127] to the other principles of this subsection has

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119. *Waxman*, 296 F. Supp. at 1194 (referring to *In re* Aktiebolaget Kreuger & Toll, 20 F. Supp. 964 (S.D.N.Y. 1937)).

120. *Waxman*, 296 F. Supp. at 1194; Honsberger, *supra* note 16, at 654; Klöcker, *supra* note 52, at 89.

121. Powers & Mears, *supra* note 70, at 349.

122. Commission Report, *supra* note 37, at 70.

123. *Waxman*, 296 F. Supp. at 1194; *In re* Colorado Corp., 531 F.2d at 468.

124. *Cunard*, 49 Bankr. at 617; *Cunard*, 773 F.2d at 460.

125. *Cunard*, 773 F.2d at 460.

126. *See* Morales & Deutcsh, *supra* note 38, at 1576 n.10 (referring to reciprocity as a "dead letter under U.S. law").

127. *Id.* at 1586-88.

confused the courts considering petitions of foreign representatives rather than aided them in this process. On one hand, *Toga* shows the risk of returning to the use of comity as a protective device preferring the interests of domestic creditors[128] and disregarding the recent development of the doctrine towards favoring recognition of foreign adjudications.[129] On the other hand, *Culmer* makes evident the risk that comity may drown the other principles and will be considered alone.[130]

If the intent of Congress was to express, through the addition of comity to the other prerequisites, that "the modern trend has been toward a more flexible approach which allows the assets to be distributed equitably in the foreign proceeding,"[131] the addition was superfluous. That the Code contains section 304 indicates the incorporation of this trend into the Code. Furthermore, comity is not necessary to the resolution of whether the foreign court has proper jurisdiction over the debtor,[132] as may be the case with questions of recognition and enforcement of other acts of foreign judiciares. This resolution must be founded on section 304(a), ignoring the principles of subsection (c) but guided by the definition of the term "foreign proceeding" in section 101(20) of the Code.[133] Accordingly, the scope of the applicability of section 304(c)(5) is reduced to the question whether the foreign adjudication in bankruptcy violated United States public policy.[134] If comity is limited to such a narrow field of application, it would be far better to replace the term in section 304(c)(5) and to define explicitly the requirement's range.

6. Discharge

Because of the nature of international trade, the debtor involved in a transnational bankruptcy most often will be a corporation and therefore not eligible to discharge under United States bankruptcy law in a liquidation bankruptcy.[135] Accordingly, section 304(c)(6) has not been an is-

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128. *See supra*, notes 80-95 and accompanying text.

129. Morales & Deutcsh, *supra* note 38, at 1587, suggest that the commission did not mention comity in the first drafts because it feared that comity would lead to granting of relief in too generous a manner.

130. *See supra* notes 40-48 and accompanying text.

131. *Gee*, 53 Bankr. at 901 (referring to *Cunard*, 773 F.2d at 458 (relying on *Banque de Financement*, 568 F.2d at 920-21)).

132. The *Culmer* court took this approach. *See Culmer*, 25 Bankr. at 629.

133. *See infra* notes 175-81 and accompanying text.

134. *Culmer*, 25 Bankr. at 629.

135. 11 U.S.C. § 727(a)(1) (1982). The situation differs with reorganization bankruptcy. 11 U.S.C. § 1141(d). However, discharge is inherent in the idea of reorganization and therefore should not give rise to problems in transnational cases.

sue in cases so far rendered. Nevertheless, the concern the United States has for a debtor's fresh start seems strange given the other guidelines of section 304(c). Subsection (c)(6) is the only prerequisite concerned with the position of the debtor rather than that of the creditors. In addition, Congress seems to have failed to realize that the requirement is of absolutely no help to the debtor. Denial of ancillary relief may lead to a separate bankruptcy in the United States[136] and to a discharge of the debtor, but the discharge may not prevent creditors whose claims have not been satisfied fully to seek recovery abroad, where a United States discharge may not be given any effect.[137]

Furthermore, section 304(c)(6) does not require foreign law to contain provisions discharging a debtor to the same extent as United States bankruptcy law does. Some commentators have equated this subsection with a prerequisite demanding discharge.[138] The language of section 304(c)(6), however, mentions only a "fresh start." If, once again, one does not require foreign law to mirror United States law, one has to acknowledge that other ways may exist to give a debtor an opportunity to begin anew. For example, in Switzerland, a bankrupt debtor receives no discharge for unsatisfied debts. Creditors holding claims related to pre-petition debts receive a certificate stating the amount unpaid.[139] The creditor, however, is stayed from collecting on the debt as long as the debtor has not been able to gain "new fortune."[140] The motive behind this concept is the same as that behind the United States concept of discharge: to give the debtor a fresh start.[141] In Swiss practice, the defense of not having gained "new fortune" effectively prevents creditors from collecting on their claims. This solution to the conflict between favoring unpaid creditors and allowing the debtor to recover financially and regain the social status lost due to his bankruptcy should pass the test of section 304(c)(6), although it is not as rigorous as a discharge under United States bankruptcy law.

C. *Relief Available Under Section 304(b)*

Section 304(b) basically governs the relief a court may grant under section 304. Depending on the circumstances of the particular case, a

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136. This is possible under 28 U.S.C. § 1472(1) (1983).

137. Honsberger, *supra* note 16, at 665-66.

138. James, *supra* note 17, at 261-62.

139. Bundesgesetz ueber Schuldbetreibung und Konkurs (Swiss Debt Collection and Bankruptcy Code, SchKG) art. 265 [hereinafter SchKG].

140. *Id.* art. 265, paras. 2, 3.

141. A. KURT, GRUNDRISS DES SCHULDBETREIBUNGS UND KONKURSRECHTES 365.

foreign representative submitting a petition also may have to consider the possibility of the court abstaining from or suspending pending United States proceeding[142] and his choice to demand a United States adjudication in bankruptcy.[143]

1. The Stay

With the filing of a petition in a United States proceeding, the automatic stay prevents creditors from further collecting on their claims outside these proceedings.[144] The automatic stay, however, does not become operational if a petition is filed under section 304.[145] Because the objective of section 304 is to enable the foreign representative to prevent the estate from dismemberment,[146] section 304(b) gives the bankruptcy judge the power to issue injunctions having essentially the same effect as that of the automatic stay.[147] Therefore, when filing a petition for ancillary relief, the foreign representative may request the court to issue a temporary injunction to preserve the status quo.[148] Although the language of section 304(b) suggests that a court may grant relief only if no opposing parties exist or only after a trial if there are opposing parties, the authority of the courts to grant preliminary relief has never been controverted by parties in interest. Such an attempt would be futile because, even if section 304(b) were interpreted as not allowing a preliminary injunction, little would prevent a court from issuing such order based on the broad powers of section 105(a).[149] The lack of a preliminary injunction may endanger the purpose of section 304 and complicate the relevant proceedings.[150] Such an order, therefore, would comply with section 105(a) of the Code. To prevent dismemberment of the estate, a court generally may restrain temporarily the attaching creditors from

142. 11 U.S.C. § 305(b) (1982).

143. 11 U.S.C. § 303(b)(4).

144. 11 U.S.C. § 362.

145. *See* 11 U.S.C. § 362(a). The application of § 362 of the Code clearly is limited to a "petition filed under section 301, 302 or 303 of this title." *Cf.* Powers & Mears, *supra* note 70, at 343.

146. COMMISSION REPORT, *supra* note 37, at 71; Honsberger, *supra* note 16, at 653.

147. 11 U.S.C. § 304(b)(1).

148. *Cf.*, *Culmer*, 25 Bankr. at 623.

149. "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a).

150. The debtor may be able to transfer assets; creditors may be able to obtain attachments.

pursuing their claims.[151]

If, after trial, the court decides to grant relief, the stay usually is confirmed,[152] enabling the trustee to do whatever the court authorizes. Obviously such a stay, especially if accompanied by an order for turnover,[153] has the same effect as the avoidance of existing attachments. One commentator has said that the Code's ambiguous language does not allow the conclusion that this is a legitimate use of the staying authority.[154] The question if and under what circumstances attachments should be avoided has been addressed above.[155] Nevertheless, the language of section 304(b) is sufficiently unequivocal and contains no ambiguities regarding this issue: the purpose of the judicial stay is to prevent the creation or enforcement of liens against the estate's property. As long as the main proceeding complies with the requirements of section 304(c), no reason exists why a court should not grant relief.

2. Turnover of the Assets

Section 304(b)(2) gives a court authority to order a turnover of assets to a petitioning representative. A turnover order is the ultimate objective of any foreign representative, and understandably, a foreign representative seeks a turnover quite frequently. A turnover enables a unification of the United States assets with the estate administered by the foreign representative and makes these assets available for distribution in the main proceeding. Local creditors, on the other hand, most vehemently oppose this kind of relief, especially if they are lienholders. For them it means the loss of control over the assets and the need to pursue their rights abroad. As explained above,[156] section 304 is a provision favoring creditor equality and section 304(c)(1) to (c)(6) contains the decisive standards. One also has to keep in mind that the court's decision should favor an "economical and expeditious administration"[157] of the estate. Clearly, this general guideline leads to a resolution of the conflict between the creditors' interests and those of the foreign representative in favor of the latter.

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151. James, *supra* note 17, at 264.
152. *See Culmer*, 25 Bankr. at 634.
153. *Cf. infra* notes 156-57 and accompanying text.
154. James, *supra* note 17, at 255.
155. *See supra* notes 78-95 and accompanying text.
156. *See supra* notes 47-48, 51 and accompanying text.
157. *See* 11 U.S.C. § 304(c) (preamble) (1982).

3. Other Appropriate Relief

Section 304(b)(3) authorizes the court to order "other appropriate relief." Because this provision grants a very broad authority to the court, it has repeatedly been labelled a catchall provision.[158] This provision enables the courts to deal with all aspects of a case and to grant relief as deemed just. It is consistent with the flexibility with which the legislature wanted to provide the judiciary in bankruptcy proceedings.[159] Accordingly, courts have given it a broad interpretation.[160]

This broad discretion in the judiciary poses a problem, however, if the relief finally granted is completely different from what the foreign representative initially requested. This situation was present in the *Lineas* cases. In *Lineas I*[161] the court formally granted the request for turnover, but conditioned the turnover on the foreign representative not removing the assets from the United States and using them primarily to satisfy claims of local creditors.[162] The effect of this condition was a denial of relief, because creditor equality, the underlying objective of section 304, was not achieved. The decision has been criticized for being excessively protective of domestic creditors.[163] More importantly, because the *Lineas II* court appointed a United States co-trustee,[164] the decision has led to United States administration of United States assets. Not only is this type of relief completely outside the ancillary nature of a proceeding under section 304,[165] but by tailoring the requested turnover a court also deprives the foreign representative of the choice between a petition under section 304 and a plenary bankruptcy case under section 303(b)(4) of the Code.[166] The Code, however, expressly authorizes the conversion of a case commenced under a certain chapter into another case.[167] No similar

158. Honsberger, *supra* note 16, at 653; Note, *supra* note 5, at 552.

159. HOUSE REPORT, *supra* note 41, at 325; SENATE REPORT, *supra* note 41, at 35.

160. *Culmer*, 25 Bankr. at 624. Courts repeatedly have used section 304(b)(3) to enable a foreign representative to gain information about assets of the estate allegedly located within the United States through discovery. Albert W. Angulo v. Kedzep Ltd., 29 Bankr. 417 (S.D. Tex. 1983); *Lineas*, 13 Bankr. at 780; *Gee*, 53 Bankr. at 897.

161. *In re* Lineas Aereas de Nicaragua, S.A., 10 Bankr. 790, 791 (1981).

162. *Id.*

163. Note, *supra* note 5, at 566. Others have suggested similar relief as being appropriate under § 304(b)(3); *cf.* James, *supra* note 17, at 257.

164. *Lineas*, 13 Bankr. at 781.

165. COMMISSION REPORT, *supra* note 37, at 71; Gallagher & Hartje, *supra* note 60, at 15.

166. Although the court did not really convert the case into a plenary case, the effects of the conditions applied equalled a conversion.

167. 11 U.S.C. §§ 706, 1112, 1307 (1976 & 1986 Supp.).

provision is mentioned regarding a case commenced under section 304. Therefore, the foreign representative must make the choice between sections 304 and 303(b)(4) of the Code. Although the authority granted to the judiciary to tailor the relief is undisputably broad, it should not be used to circumvent the choice of the foreign representative as happened in the *Lineas* case.

4. Abstention From or Suspension of a Domestic Case

Because of the very broad basis that section 109(a) provides for the commencement of a case against a debtor in the United States, and because under that provision the mere existence of assets within the United States is sufficient to make a debtor subject to plenary bankruptcy proceedings, a situation may arise in which a debtor has been adjudged a bankrupt both abroad and in the United States. Does the latter prevent the foreign representative from filing a petition under section 304? The answer to this question is clearly no. Under section 305(a)(2) of the Code, the court has the authority to either dismiss or sustain a domestic proceeding after a petition for ancillary relief has been filed. The foreign representative may request such dismissal or suspension under section 305(b) of the Code. Whereas under the Bankruptcy Act[168] a court had to consider all "relevant circumstances," the courts now only have to make reference to the principles of section 304(c).[169] If the main proceeding meets these guidelines, the court may dismiss or sustain a domestic proceeding in addition to granting relief as mentioned in section 304(b). An issue remains when the guidelines of section 304(c) "warrant"[170] dismissal or suspension. This issue was litigated in *Gee*.[171] Although the *Gee* court recognized that there may be cases that demand concurrent proceedings, it dismissed the domestic procedure holding that, if the ancillary proceeding is able to deal effectively with both United States creditors and United States assets, a competing United States proceeding should be dismissed.[172] This result is justified if one considers that the debtor was a foreign bankrupt corporation and the Chapter 11 proceedings probably were based on the debtor's having a place of business within the United States.[173] To prefer the foreign proceeding over the

168. Bankruptcy Act § 2a(22).

169. 11 U.S.C. § 305(a)(2)(B); Honsberger, *supra* note 16, at 657.

170. 11 U.S.C. § 305(a)(2)(B).

171. *Gee*, 53 Bankr. at 904-05.

172. *Id.* at 905.

173. 11 U.S.C. § 109(a); *cf. Gee*, 53 Bankr. at 892 (where a bankrupt company's management was located in New York).

domestic proceeding under those circumstances also seems to comport with the "terms of international fair play and justice."[174] Presumably, the result would have been to the contrary if a United States corporation had been adjudged bankrupt abroad based on a provision of foreign law similar to section 109(a) of the Code.

5. Plenary Case

Finally, the foreign representative may also opt for a plenary case under section 303(b)(4) of the Code. Because relief granted to a petition filed under section 304 is far more attractive to the foreign representative, this option constitutes a last resort. In a plenary case the foreign representative will lose control over the debtor's assets definitively; he therefore will file a petition under section 303(b)(4) only if it is obvious that a court will not grant relief under section 304. A petition for involuntary bankruptcy then may contribute to creditor equality by preventing attachments and subsequent consumption of the United States assets by the swiftest creditors and by enabling other creditors, especially foreign creditors, to participate in the distribution of the debtor's United States assets.

D. *Access of the Foreign Representative to United States Courts*

1. The Foreign Proceeding

Section 304(a) does not specify what constitutes a foreign proceeding. The Code definition of this term in section 101(20) contains two elements. First, the proceeding commenced abroad has to fulfill a purpose similar to that of a case under the Bankruptcy Code, namely liquidation, reorganization or debt adjustment. To say that "a bankruptcy case" has to be pending abroad, however, is misleading.[175] As long as one of the purposes mentioned above is satisfied, whether bankruptcy law governs the main proceeding is irrelevant.[176] Furthermore, the proceeding must have a judicial or an administrative nature,[177] thus excluding private debt restructuring negotiations from qualifying under section 304.[178]

Second, such a proceeding does not entitle one to file a petition under section 304 if the governing body (whether administrative or judicial) did

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174. *Waxman*, 296 F. Supp. at 1194.

175. Note, *supra* note 5, at 551-52; *see In re* Stuppel, 7 Bankr. 341, 342-43 (S.D. Fla. 1980); *Toga*, 28 Bankr. at 167.

176. 11 U.S.C. § 101(20) (Supp. 1986).

177. *Id.*

178. *Cf.* Honsberger, *supra* note 16, at 652.

not have jurisdiction over the debtor within the meaning of United States law. The standard applied to a foreign proceeding with respect to jurisdiction is stricter than the one applied to main proceedings commenced within the United States. Whereas under section 109(a) of the Code anyone who has residence or domicile, a place of business or assets in the United States may be a debtor, foreign jurisdiction over the debtor is recognized only if the debtor has his principal place of business or his principal assets in that country.[179] Although creditor equality would be served better if the less strict standard also applied to ancillary cases, the stricter one may prevent a dispute between foreign representatives in United States courts in cases in which a debtor has been adjudicated a bankrupt in more than one country and, consequently, more than one foreign representative may file a petition under section 304.[180]

Proof that a "foreign proceeding" is pending and that the petitioner is the duly elected representative of the debtor's estate is a prerequisite to the court acting on the petition. Such proof must be submitted with the petition. Duly authenticated copies of the relevant documents should suffice, as a hearing will take place only if parties in interest oppose the petition.[181] In practice this prerequisite rarely gives rise to disputes.

2. Jurisdiction

The Code does not contain a special provision governing jurisdiction in ancillary proceedings. Consequently, section 109(a) of the Code is decisive. According to this section the debtor must have either residence or domicile, a place of business or property in the United States.[182] For the

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179. 11 U.S.C. § 101(20) (Supp. 1986).

180. It is not clear, however, what the reaction of U.S. law is in a case in which the principal place of business and the principal assets of a debtor are not located in the same country and the debtor is adjudged a bankrupt in both.

181. 11 U.S.C. § 304(b) (preamble); Given & Vilaplan, *supra* note 1, at 336; Gallagher & Hartje, *supra* note 60, at 3-4.

182. In *In re* Stuppel, 17 Bankr. 413, 415 (S.D. Fla. 1981), the district court obviously misinterpreted § 304 by deriving from this section a "requirement of property 'involved in' the foreign proceeding" to invoke jurisdiction. Section 304(b)(1)(A)(i) only limits a restraining order against the foreign debtor to cases concerned with property "involved in such foreign proceeding," but is not a jurisdictional prerequisite. The latter is contained in § 109(a) of the Code, which demands that the debtor have property within the United States. The difference in the language of the two provisions is remarkable. Whereas in most cases the "property involved" may be property of the debtor, the *Stuppel* cases show that this does not necessarily have to be so. It is submitted that, had the court applied § 109(a) of the Code instead of § 304(b)(1)(A)(i), the result would not have been the same. The piece of real estate which belonged to the debtor's former spouse, although it was involved in the case, was not an asset of the debtor. The debtor

most part, the basis for jurisdiction is the location of assets.[183] This basis, however, poses a certain problem if the ancillary relief requested is discovery. In *Angulo* the relief consisted of an authorization for the foreign representative to proceed with discovery and it was clear that the debtor owned assets within the United States.[184] In *Gee*, however, the existence of assets was only alleged.[185] The court held that such allegations were sufficient to invoke jurisdiction if the relief requested was "discovery to ascertain the existence and location of the debtor's assets."[186] The court admitted that an allegation of existing assets would not be sufficient in a case where the requested relief consisted of a turnover.[187] It overlooked the fact that granting discovery based on a mere allegation may have the same effect. If, as a result of the discovery, the foreign representative finds assets, he may amend his petition and request turnover.[188]

Finally, in *Gee* the court unnecessarily widened the jurisdictional basis provided by section 109(a) of the Code. The debtor admitted that it had a place of business, even its principal place of business, in the United States.[189] The *Gee* court could have rejected the debtor's argument that the presence of assets is always a prerequisite for a case under section 304 by simply stating that the presence of assets is only an alternative requirement to the debtor having a place of business in the United States. The debtor doubtlessly met the latter.

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therefore had no property in the U.S. on which jurisdiction could have been based.

183. *Toga*, 28 Bankr. at 167; *Angulo*, 29 Bankr. at 418.

184. *Angulo*, 29 Bankr. at 418.

185. *Gee*, 53 Bankr. at 894.

186. *Id.* at 899.

187. *Id.* at 898. The court held, "Stuppel is distinguishable on its facts because of the nature of the ancillary relief sought." *Id.*

188. Both *Gee, id.* at 899 ("Bank accounts here which were closed less than two years ago"), and *Stuppel*, 17 Bankr. at 415, hold that a fraudulent transfer of assets also satisfies the jurisdictional requirement of assets within the U.S. This finding is completely unwarranted and raises more questions than it solves. The courts seem to assume that on the question of whether a fraudulent transfer occured, U.S. law applies. As discussed in the text, this is not true. Furthermore, the court moves in a vicious circle if, to establish jurisdiction, it presumes that there was a transfer and that the transfer was fraudulent and then decides on the issue of avoidability to decide whether it can grant the turnover.

Furthermore, *Gee* sets aside *Angulo* by finding that the *Angulo* court "did not hold that the presence of assets was mandatory." 53 Bankr. at 898. The language of *Angulo*, 29 Bankr. at 418, is unambiguous. Clearly, the *Angulo* court understood the compliance with § 109(a) of the Code to be mandatory.

189. *Gee*, 53 Bankr. at 899.

3. Venue

The final hurdle the foreign representative must overcome is the choice of venue. Venue in an ancillary case is governed by 28 U.S.C. § 1410,[190] which gives the foreign representative three options. First, if the representative's objective is an injunction of either an action or an enforcement of a judgment,[191] he must file the petition with the court in which the relevant action is pending.[192] The language of section 1410 is not completely clear on the venue for a future action or enforcement procedure.[193] Presumably the venue would be the district court where the proceeding to be enjoined would have to be brought. Second, if the foreign representative seeks turnover of assets,[194] he must file his petition in the court of the district within which the property is located.[195] The language of this section indicates that the venue of the court is limited to property located within its district and results in the foreign trustee having to file several petitions if the assets are dispersed across districts.[196] Finally, other appropriate relief[197] must be sought in the court of the district of either the principal United States place of business or the location of the principal United States assets.[198]

Although in several cases the relief sought consisted of each element falling under a different subsection of section 1410,[199] the foreign representative did not have to file different petitions in any of these cases. The reason for this is that very often the proceedings about which the foreign representative is most concerned, and therefore wishes enjoined, are the in rem proceedings against the debtor's assets (such as attachments and garnishments) which must be brought in the district where these assets are located. Therefore, the first two venues provided for in section 1410 often coincide.[200] Consequently, though the venue provisions of section 1410 on their face seem to complicate ancillary proceedings, this has not proven to be true in practice.

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190. Formerly, 28 U.S.C. § 1474, *repealed by* 1984 Amendments to the Bankruptcy Code, Pub. L. No. 98-353.

191. 11 U.S.C. § 304(b)(1) (1982).

192. 28 U.S.C. § 1410(a) (Supp. 1986).

193. The word "commencement" in § 1410(a) indicates that this subsection also governs future proceedings of the kind.

194. 11 U.S.C. § 304(b)(2) (1982).

195. 28 U.S.C. § 1410(b) (Supp. 1986).

196. James, *supra* note 17, at 273 n.211.

197. 11 U.S.C. § 304(b)(3) (1982).

198. 28 U.S.C. § 1410(c) (Supp. 1986).

199. *See Culmer*, 25 Bankr. 621; *Gee*, 53 Bankr. 891; *Toga*, 28 Bankr. 165.

200. *Culmer*, 25 Bankr. at 624-25; *Toga*, 28 Bankr. at 167.

E. *Conclusion*

That the Bankruptcy Code intended to improve creditor equality in transnational cases is widely acknowledged.[201] The design of section 304 to recognize foreign bankruptcies and to support them unilaterally without requesting reciprocity[202] indicates that municipal bankruptcy law is able to reject the doctrine of territoriality and follow the universality doctrine.

Understandably, however, no country will give away control over assets which could satisfy its domestic creditors without being assured that the law governing the main proceeding will treat the claim of domestic creditors fairly and justly. Therefore, as a counterbalance to the available relief, the territoriality doctrine is present in section 304(c) and requires the main proceeding to pass certain tests before relief will be granted. These tests provide the United States creditors with the guarantee that their claims will not be treated differently from United States claims.

Whereas a review of decisions rendered shortly after the enactment of the Code shows a certain unfamiliarity with and reluctance to follow the concept of section 304,[203] more recently courts[204] have been guided by this concept: their prime objective is the realization of creditor equality in transnational bankruptcies, restricted only by the prerequisites of section 304(c). Accordingly, in these cases the requirements of section 304(c) have been interpreted restrictively, because if the design of section 304 is followed, protection of local creditors[205] must be subordinated to creditor equality.[206]

III. A UNITED STATES DEBTOR'S ASSETS LOCATED ABROAD

The discussion in this part is based on a situation in which a debtor has been adjudicated a bankrupt in the United States, but owns assets located abroad. The part concentrates on situations in which the debtor's

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201. Paskay, *Impact of the Bankruptcy Reform Act of 1978 on Foreign Debtors and Creditors*, 12 STETSON L. REV. 321, 341 (1983).

202. This design is expressed especially in § 304(b), which describes the relief available.

203. This is especially true for *Toga*.

204. This is particularly true for *Gee*, 53 Bankr. 891, and to a certain extent for *Cunard I*, 49 Bankr. 614, although *Cunard* is a case outside § 304 and deals with the section only peripherally.

205. This protection applies to the extent that it tries to achieve more than preventing local creditors from having to submit their claims to a proceeding in which they are faced with discrimination.

206. *Gee*, 53 Bankr. at 901; *cf. Culmer*, 25 Bankr. at 628.

assets abroad have been attached, making it impossible for the debtor to transfer them to the United States. As discussed,[207] in the absence of treaties the law of the country in which these assets are located decides whether to recognize the United States adjudication. The objective of this part is to discuss the extent to which United States law takes countermeasures to offset the effects of nonrecognition of United States bankruptcies abroad and to ascertain the compatibility of these countermeasures with public international law.

A. *Jurisdictional Aspects*

1. The Estate: Jurisdiction Over Assets

Section 541(a) of the Code defines the composition of the estate of a debtor in a United States case. Of interest is the preamble of subsection (a), which states that the estate is comprised of the property enumerated in section 541, "wherever located." This wording raises the question whether the estate is limited to the debtor's assets within the United States or whether, according to United States law, it includes assets abroad. Secondary sources, as far as they deal with the problem, unanimously agree that the latter is correct.[208] This position is reinforced by 28 U.S.C. § 1334(d), according to which a district court in which a bankruptcy case has been commenced has "exclusive jurisdiction of all the property, wherever located, of the debtor. . . ." The predecessor of this provision has been interpreted to grant the respective court jurisdiction also over assets located abroad.[209]

The conclusion is that United States law clearly takes a position based on the universality doctrine regarding the international effects of a United States bankruptcy.[210] This attempt to give United States bankruptcy law extraterritorial effect, however, conflicts with the territorial limitation of jurisdiction,[211] according to which universality cannot be made effective by a unilateral act of a state. The United States trustee will encounter rejection not only when the United States case is based on secondary jurisdiction (such as the mere presence of assets within the United States),[212] but he also may face refusal in cases in which he is

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207. *See supra* notes 15-24 and accompanying text.

208. Honsberger, *supra* note 16, at 636, 648; James, *supra* note 17, at 269-70; Powers & Mears, *supra* note 70, at 305; 1 DALHUISEN, *supra* note 68, § 2.02(1)-(2), at pp. 3-157 to 3-158; Klöcker, *supra* note 52, at 60 n.24.

209. Klöcker, *supra* note 52, at 59-60 (regarding 28 U.S.C. § 1471(e)).

210. Honsberger, *supra* note 16, at 636.

211. *See supra* notes 15-24 and accompanying text.

212. 11 U.S.C. § 109(a); in such cases assumption of jurisdiction over assets abroad

representing a genuine United States debtor. This rejection may occur because the country of assets wishes to prefer domestic creditors or because it allows attachments of the assets and does not recognize a mechanism which would make it possible to avoid these attachments and to recognize the foreign trustee's claim.[213] Prima facie, the inclusion of foreign assets in the United States estate appears to be of little importance. As will become evident, however, this inclusion may be of help to the trustee in dealing with the creditors.

2. Jurisdiction Over Creditors

Bankruptcy proceedings are considered to be essentially in rem.[214] The in rem nature of the procedure especially affects the determination of insolvency, powers of management, disposition of assets, and distribution of proceeds.[215] In these respects, the bankruptcy court's orders are deemed to bind everyone. But in other respects, creditors not involved in the actual case are not bound by the legal consequences of the bankruptcy. In these circumstances, bankruptcy procedures are considered to be in personam.[216]

In transnational cases, a further distinction must be made. As a result of territoriality of jurisdiction, domestic creditors and foreign creditors cannot be treated the same in every respect. Whereas municipal law may subject a domestic creditor to the jurisdiction of a bankruptcy court even if he does not participate in the proceedings,[217] and an internationally recognized jurisdictional basis exists for the foreign creditor participating locally,[218] no such basis exists for the foreign creditor who abstains from

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definitely is exorbitant and will not be recognized abroad. Nadelmann, *Bankruptcy Jurisdiction: News From the Common Market and a Reflection for Home Consumption*, 56 AM. BANKR. L.J. 65, 69 (1982).

213. The latter is the case in Switzerland. In favor of creditor equality, in a full bankruptcy proceeding in Switzerland attaching creditors would lose their secured status according to SchKG, art. 199. But absent a domestic bankruptcy the claim of attaching creditors would prevail over the claim of a foreign trustee. The creditor, under Swiss law, is collecting on an obligation of the debtor. The trustee, on the other hand, is deemed to represent the debtor. Therefore, first the attaching creditors would be fully satisfied. The trustee is entitled only to assets that remain after satisfaction of the attaching creditors, namely to equity. *Cf.* Honsberger, *supra* note 16, at 660.

214. Note, *supra* note 5, at 547.

215. 1 DALHUISEN, *supra* note 68, § 2.01(1), at p. 3-103.

216. *Id.*

217. 11 U.S.C. §§ 105, 362.

218. *Cf.* RESTATEMENT (REVISED), *supra* note 14, § 421(g). The participation in the domestic proceeding is deemed to constitute a consent to jurisdiction.

participation in the United States case.[219] He is clearly outside the reach of United States jurisdiction. This leads to the distinction between three classes of creditors in a United States transnational bankruptcy case:[220] domestic creditors,[221] foreign creditors subject to United States jurisdiction and foreign creditors who cannot be reached by United States courts.

B. *Sections of the Code with Impact on Transnational Cases*

1. The Marshalling Provision: Section 508(a)

Section 508(a) of the Code prevents the participation of a creditor in the distribution of the debtor's assets in a United States bankruptcy if the creditor's claim has been satisfied in a foreign proceeding. If a claim was partially satisfied, the respective creditor cannot receive any payments until other creditors have received an amount equal to what the creditor received abroad. This mechanism, which is called the "marshalling of assets,"[222] certainly intends to achieve creditor equality in cases in which the debtor's assets located abroad cannot be included in the estate created by the United States adjudication. The marshalling provision, however, suffers from three important limitations. First, it applies only to participating creditors. The provision does not provide the trustee with a device that enables him to equalize the payments to creditors who participated in a foreign proceeding and creditors who participated solely in local proceedings if the former refuse to take part in the local bankruptcy. Second, and more important, even if a creditor participating locally has obtained partial satisfaction of his claim abroad, section 508(a) of the Code applies to him only if this satisfaction derived from a foreign proceeding as defined in section 101(20) of the Code. The distribution that the respective creditor received must have been obtained in a proceeding related to either liquidation of an estate, debt adjustment or reorganization.[223] The case in which a United States debtor is adjudged a bankrupt

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219. For an exception, see RESTATEMENT (REVISED), *supra* note 14, § 421(h) (regular conduct of business in the U.S. is deemed to be sufficient to invoke jurisdiction).

220. The distinction is based upon whether the U.S. has jurisdiction over a certain type of creditor.

221. This class includes domestic creditors, whether participating or not.

222. *Cf.* Nadelmann, *The National Bankruptcy Act and the Conflict of Laws*, 59 HARV. L. REV. 1025, 1049-51 (1945/46); James, *supra* note 17, at 272 n. 206.

223. *See supra* notes 175-81 and accompanying text. This foreign proceeding must have the characteristics of a bankruptcy proceeding. 3 COLLIER ON BANKRUPTCY § 508.02, at p. 508-3 (15th ed. 1985).

both in the United States and abroad, however, is unusual.[224] More often, the debtor's assets abroad will be subject to attachments, but the proceedings following attachments lack the character of a bankruptcy proceeding. These proceedings restrict the satisfaction of the claims of the attaching creditor or creditors to the attached assets, whereas any of the proceedings enumerated in section 101(20) of the Code give access to the generality of creditors and affect all assets of the debtor.[225] Section 508(a) is therefore of no help to the trustee if a creditor who participates in the United States proceedings obtained partial satisfaction of his claim by attaching foreign assets. On the creditor's proof of his claim,[226] the claim will be reduced to the amount outstanding, but on this amount he will receive the same payment as his co-creditors who have not yet received anything. Finally, the section does not oblige a participating creditor to turn over a surplus if he already has received more abroad than his co-creditors will receive locally. In summary, section 508(a) of the Code is of very little help in achieiving creditor equality in transnational cases because it addresses the wrong problem;[227] it is unenforceable against any nonparticipating creditor and it is a passive device only.

2. Avoiding Powers of the Trustee

If the United States claims jurisdiction over all the debtor's assets, even if located abroad, then the transfer of an interest in property located outside of the United States may fall within the Code's provisions regarding voidable transfers. Except with respect to the enforceability of judgments against nonparticipating foreign creditors,[228] voluntary transfers of assets abroad do not require treatment different from those involving domestic assets.

If property of the debtor is attached abroad, a security interest is cre-

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224. Few countries have as broad a basis for jurisdiction as the U.S. has with § 109(a) of the Code. Generally, the mere presence of assets will not constitute a sufficient basis for an adjudication in bankruptcy. Nadelmann, *supra* note 212, at 69.

225. In *In re* Polmann, 156 F. 221 (S.D.N.Y. 1907), a German creditor of a U.S. debtor was denied the right to file a claim after he had attached property of the debtor in Germany and received the respective proceeds. However, this case cannot be a precedent today: at the time it was decided § 65d of the Bankruptcy Act, which was the predecessor of today's § 508(a), was not yet in force. The case concerned whether the attachment constituted a fraudulent transfer.

226. 11 U.S.C. § 501.

227. Section 308(a) addresses double adjudication instead of attachment of foreign assets.

228. If this is the case, voluntary transfers have to be treated the same as involuntary ones.

ated that may be preferential, because according to section 101(48) of the Code the term "transfer" as used in section 547(b) includes involuntary transactions. The two relevant provisions are subsections 547(b)(3) and (b)(4)(A) of the Code.[229] With respect to these two provisions, attachments of the debtor's foreign assets lead to a conflict of laws. United States law must answer the question of insolvency[230] when a United States debtor is the bankrupt[231] and a United States plenary case raises the issue of voidability. The contrary is true for the central issue in section 547 of the Code, namely the question of when the transfer occurred.[232] According to section 547(e)(2), the date of perfection of the security is decisive. Because the attachment is obtained in a foreign procedure, United States law lacks the basis to determine this question. The law governing the foreign procedure must decide the moment of perfection. United States law then decides whether perfection occurred within the periods mentioned in section 547(b)(4).

According to section 548 of the Code a trustee may avoid a fraudulent transfer if it occurred within one year before the filing of the petition. A United States trustee therefore might wish to attack transfers relating to assets located abroad based on this section rather than on section 547. With respect to involuntary transfers, however, an analysis of section 548 illustrates that this section is not applicable at all. First, actual fraud as described in section 548(a)(1) may be ruled out. The debtor is not involved in the attachment proceeding, thus there is no actual intent to hinder, delay or defraud as required for actual fraud.[233] Second, section 548(e)(2)(A) prevents application of the section governing constructive fraud. The antecedent debt is considered to be value under section 548(a)(2)(A); as long as the property attached by a creditor is not worth more than the debtor owes him, no fraudulent transfer has occurred.

Section 502(d) of the Code contains a mechanism designed to put some pressure on a creditor who obtained preferential treatment of his claim; claims of such a creditor are disallowed under section 502(d) unless the creditor turns over what he received from the debtor to the trustee.[234] At

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229. *See supra*, notes 80-95 and accompanying text.

230. 11 U.S.C. § 547(b)(3).

231. That is, at least if the secondary jurisdiction of presence of assets was not the basis for the adjudication.

232. 11 U.S.C. § 547(b)(4).

233. The situation might differ, however, if the debtor does not take part in the debt collection process or the litigation following the attachment. This behavior might result in a default judgment against the debtor that could have been prevented by controverting the action taken by the attaching creditor.

234. *Cf.* Note, *The Lure in "International Bankruptcies" of Assets Located*

first glance, this device seems to suffer from disadvantages similar to those of the marshalling provision. As will be shown, however, section 502(d) of the Code helps to achieve creditor equality at least to some extent in cases in which the trustee cannot force foreign creditors to turn over the preferences obtained.

Obviously, there is no problem of actually recovering the preferences from domestic creditors in accordance with section 550(a) of the Code. United States creditors are subject to the jurisdiction of United States courts and a court order may require them to turn over their preferences. The same is not true of foreign creditors. The trustee is helpless against nonparticipating creditors, especially if they do not conduct business regularly within the United States. Attaching the assets of a United States debtor is probably considered a legal act in the country where the assets are located. To demand a United States court to order the foreign creditor to turn over the foreign assets would be futile. The courts in the country where the assets are located would neither recognize nor enforce the order.[235]

From a factual, though not legal point of view, a situation quite similar to the one just described may confront the United States trustee even if the foreign creditor is participating in the United States bankruptcy. Although jurisdiction over the foreign creditor may exist, the fact that neither the creditor nor any of his assets are present in the United States may prevent enforcement of an order to turn over. Section 502(d) of the Code may help in these cases. If the dividend expected in the United States case is larger than the proceeds of the attached assets,[236] the attaching creditors may be willing to turn over the latter in order to receive the dividend. If this is not the case, this section at least prevents these creditors from getting an additional share of the debtor's assets.[237]

3. The Automatic Stay

Section 362 of the Code provides for an automatic stay which temporarily prevents creditors from proceeding to recover on pre-petition

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Abroad, 33 INT'L & COMP. L.Q. 431, 435 (1984).

235. The situation might differ if the country of assets generally recognizes foreign bankruptcies, but the trustee did not claim the assets in the attachment proceedings. Even then the country of assets probably would refuse to force the creditor to turn over; failure to contest the creditor's claim in the attachment proceedings or in subsequent litigation constitutes a waiver of the debtor's rights in the assets.

236. This may be the case if the foreign assets are attached by a plurality of creditors that have to share the proceeds.

237. In this respect § 502(d) differs from § 508(a).

claims against the debtor. In particular, subsection (a)(4) of this provision prohibits the creation, perfection or enforcement of liens "against property of the estate." United States bankruptcy law also takes the position that the debtor's foreign assets are part of the estate.[238] Thus, the automatic stay theoretically prevents attachment of the debtor's assets located abroad. If the stay applies to these assets, once the debtor has filed the petition, attaching creditors have to abandon imperfect attachments and abate subsequent litigation, and they cannot obtain any new attachments.

In a domestic case the stay does not necessarily require an act of enforcement because actions taken in violation of the stay are void.[239] The country where the assets are located, however, may consider attachment of the debtor's assets to be perfectly legal. If in that country the creditor prevails over the debtor, the trustee and the United States bankruptcy will not be given any effect abroad,[240] the stay will be disregarded by the authorities and will have no effect at all.

United States creditors are clearly subject to the stay. A United States court has the power to proscribe the conduct of its nationals, even if this conduct does not occur within its borders.[241] A bankruptcy court therefore may hold a United States creditor in contempt of court if he pursues foreign proceedings in violation of section 362 of the Code.[242]

Personal jurisdiction of the United States over the creditor conflicts, however, with the jurisdiction of the country of assets to regulate litigation before its courts.[243] The United States prohibition against its nationals litigating abroad may restrict this latter jurisdiction.[244] Enjoining one's nationals from litigating abroad has been held to be a last resort.[245] But here other remedies are not available. As long as all attaching creditors are within the reach of United States jurisdiction and there is a good chance that enforcement of the stay will enable a transfer of the debtor's foreign assets to the United States,[246] creditors should be forced to give

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238. *Cf. supra* notes 208-13 and accompanying text.

239. 2 COLLIER, *supra* note 223, § 362.11, at p. 362-66.

240. This is the case in Switzerland. *Cf. supra* note 224.

241. *Cf.* RESTATEMENT (REVISED), *supra* note 14, § 402(2); *Laker*, 731 F.2d at 922; United States v. Davis, 767 F.2d 1025, 1036 (2d Cir. 1985).

242. Regarding a contempt citation as a remedy in case of a violation of the stay in general, see Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REF. 177, 259-60; 2 COLLIER, *supra* note 223, §§ 105.03, at p. 105-10, 362.11, at p. 362-67.

243. *Davis*, 767 F.2d at 1036.

244. *Id.* at 1038; *Laker*, 731 F.2d at 927.

245. *Davis*, 767 F.2d at 1038; *Laker*, 731 F.2d at 933 n.81.

246. This is not the case if creditors have also attached these assets that are not

up imperfect attachments in favor of creditor equality.[247]

With respect to foreign creditors it is necessary to differentiate between those subject to United States jurisdiction and those who are not. Participation in the United States case or other sufficient minimal contact may subject a foreign creditor to United States in personam jurisdiction and therefore subject him to the automatic stay.[248] Enforcing the stay (for example, by means of an injunction),[249] however, might not be that easy. An attempt to enforce might fail because neither the creditor nor assets belonging to him are present in the United States.

As *Fotochrome, Inc. v. Copal Company, Ltd.*[250] illustrates, the situation is even worse with respect to foreign creditors who are beyond the jurisdiction of United States courts. In *Fotochrome* the United States debtor had become involved in a Japanese arbitration with Copal, its Japanese contract partner, before filing for relief under Chapter XI of the Bankruptcy Act. The Act did not contain a provision comparable to section 362 of the Code, but the bankruptcy court issued a restraining order having an effect similar to the stay. The order enjoined creditors from commencing or continuing actions, suits or arbitrations and from enforcing claims against the debtor.[251] The Japanese arbitration continued despite this order and a judgment was entered against the debtor. Copal filed a claim based on that judgment in the United States bankruptcy proceeding. The *Fotochrome* court had to resolve, among other issues, the question of jurisdiction.[252] It affirmed the lower court's finding that a bankruptcy court lacks jurisdiction over a foreign creditor unless such creditor has minimal contacts with the United States.[253] The court added that, absent personal jurisdiction over the respective creditor,

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subject to U.S. jurisdiction.

247. If the attachments are already perfected according to U.S. law, the effect of the stay is limited to litigation subsequent to the attachment procedure (usually an action taken to obtain a final judgment with respect to the claim underlying the attachment). A creditor should not be forced to transfer such action to the U.S. bankruptcy court if this would result in a loss of the security. This may be the case if the law governing the attachment demands verification of the claim locally. It would indirectly lead to an avoidance of a security when this security has become definitive even under U.S. law.

248. *Cf.* Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 MINN. L. REV. 595, 601 n. 31 (1983).

249. *Id.*

250. 517 F.2d 512 (2d Cir. 1975).

251. *Id.* at 514.

252. The issue arose because the debtor challenged the creditor's claim and requested a hearing on the merits of the claim. For an analysis of this main issue, see Westbrook, *supra* note 248.

253. *In re* Fotochrome, Inc., 377 F. Supp. 26, 29 (E.D.N.Y. 1974).

a stay issued in a United States bankruptcy proceeding cannot be enforced with respect to an action before a foreign tribunal.[254]

In *Fotochrome* the creditor was not able to attach the debtor's assets located abroad. Copal had to file a claim in the United States. As Westbrook suggests, certain remedies are available once the creditor files a claim,[255] but the same is not true if a creditor obtains a judgment that can be enforced against the debtor's foreign assets. The creditor can obtain at least partial satisfaction of his claim without interference from the ongoing United States bankruptcy. The attached foreign assets are definitely lost for the United States estate.[256] Obviously, the extension of the automatic stay on the debtor's foreign assets places the United States creditors at a severe disadvantage. Even if these assets clearly will never become part of the United States estate, the result of such extension is to prevent domestic creditors from participating in the distribution of the respective proceeds. The extension thus creates a prerogative of the foreign creditors over the debtor's assets located abroad. Although intended to help achieve creditor equality, the automatic stay may very well have the opposite effect. The stay indirectly favors foreign creditors who do not participate in the United States bankruptcy. It is therefore highly disputable whether the stay should be enforced against United States creditors if it is uncertain whether the enforcement will guarantee the transfer of the debtor's foreign assets or the proceeds to the United States.

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254. *Fotochrome*, 517 F.2d at 516.

255. Westbrook, *supra* note 248, at 604 *passim*, discusses the so-called nullification rule which would allow the trustee to reargue cases in which a judgment was entered abroad despite the fact that a stay was in effect. The author overlooks that, because bankruptcy (especially Chapter 11 bankruptcy) is a very popular debt restructing device in the United States, such a rule unnecessarily overshadows the reliability necessary in international transactions. Westbrook argues that the rule should apply to litigation "to which the estate's representative is not a party." *Id.* at 605. If this is his major concern, then it should suffice that the foreign court recognizes that the trustee is the successor of the debtor, and the litigation should be continued on that basis. There is no need to require the foreign creditor to secure the permission of a U.S. court to do so. This is especially true for Chapter 11 cases, where the debtor generally is not replaced by a trustee. The nullification rule definitely should not apply in these cases as long as the principles of due process are respected in the foreign proceeding, as certainly was the case in the *Fotochrome* arbitration. The facts of this arbitration, as far as they are published, strongly suggest that one of the debtor's major reasons for filing in bankruptcy was to get rid of litigation which had become an unbearable burden. On an international level, such behavior is not acceptable.

256. In many cases a creditor will prefer to limit recovery to proceeds of the attached assets. This is especially true if he is an unsecured creditor with slim chances to obtain anything at all in the U.S. case.

Finally, both *Fotochrome* and its discussion by Westbrook impart a lesson debtors should follow, especially in cases where foreign creditors attach the debtor's assets located abroad. Westbrook wants to apply the nullification rule to judgments obtained abroad against the bankrupt debtor to prevent creditors from collecting on unwarranted or overblown claims,[257] but the nullification rule is not available if the creditor has no intention of taking part in the United States case and decides to limit satisfaction of his claim to proceeds of attachments abroad. Simply waiting for the creditor to file a claim in the United States case, therefore, is not a solution for the debtor or trustee. Withdrawal from or abandonment of the foreign litigation, which often follows the attachment procedure to verify the underlying claim, will not be accepted by the foreign court. Such behavior will result in a default judgment against the debtor. Especially if good chances exist to contest or at least to reduce the claim before the foreign tribunal and if at the same time the attachment covers substantial assets of the debtor, the debtor or the trustee should continue to take part in the foreign litigation to prevent the creditor from collecting more than what he is entitled to.

4. Orders Under Section 105(a) of the Code

Finally, section 105(a) of the Code may have limited application in transnational cases. An order issued under section 105(a) of the Code may help the United States trustee obtain the debtor's foreign assets as long as attachments have not yet blocked them.

According to section 521(1) of the Code, the debtor has to file a list of assets. What happens if some of these assets are located abroad? The trustee likely will not be recognized as a representative of the debtor because of the nonrecognition of foreign bankruptcies in the country where the assets are located. For the trustee, however, it is essential that the assets be transferred to the United States as fast as possible to protect them against attachments, whereas for the debtor this may not be a very urgent issue.[258]

Section 105(a) of the Code contains very broad language.[259] It is widely recognized that a court with in personam jurisdiction may issue

257. Westbrook, *supra* note 248, at 606-07; *cf. In re* Paramount Publix Corp., 85 F.2d 42, 44 (2d Cir. 1936).

258. This is true at least if he filed for liquidation bankruptcy. If he intends to reorganize, he probably will react differently, because the foreign assets will be of use to him to comply with the plan and to make the respective payments.

259. *See* 2 COLLIER, *supra* note 223, § 105.01, at p. 105-1.

orders directing the person's conduct abroad,[260] and courts have applied this principle in bankruptcy cases.[261] The bankruptcy court which has jurisdiction over the debtor therefore could order the debtor to transfer his foreign assets to the United States for unification with the estate under section 105(a).[262] A court took this approach in *In re Lloyd, Carr & Company*,[263] a case decided under the Bankruptcy Act. The debtor was held in contempt of court for failing to cooperate in transferring his foreign assets to the United States.[264]

In re Holzer also was decided under the Act[265] and reached a similar result by directing the debtor to execute for the trustee certain powers of attorney "so as to enable him to investigate foreign bank accounts and other assets located outside the United States as listed on the bankrupt's Schedules."[266]

C. *Conclusion*

The analysis of those sections of the Bankruptcy Code that have a possible impact on transnational cases illustrates that there is very little the United States actually can do to achieve creditor equality with respect to assets of the debtor located abroad. Besides disallowing the claims of foreign creditors who, in a manner unacceptable to the United States, gained control of these assets, the devices applied on purely do-

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260. *Cf.* RESTATEMENT (REVISED), *supra* note 14, § 402(2); *supra* notes 241-47 and accompanying text.

261. *In re* Feit & Drexler, Inc., Nos. 83-B-10921—83-B-10923 (S.D.N.Y. July 19, 1984). The case was not a transnational one; the property the defendant Violet Drexler was ordered to turn over, however, was outside the court's jurisdiction.

262. Against an individual debtor a more powerful threat is contained in § 727(a) of the Code: non-cooperation may result in a denial of discharge. As long as mere non-cooperation does not reach the level required in subsection (a)(6), it may not suffice to deny a discharge. But, as time is crucial, the debtor's behavior may lead to a complete loss of the foreign assets due to attachments.

263. 617 F.2d 882 (1st Cir. 1980).

264. *Id.* at 884.

265. *In re* Holzer, 22 Bankr. 326 (S.D.N.Y. 1982).

266. *Id.* at 327. One has to be aware that the trustee might get into difficulties in Switzerland and other countries with similar legislation if he acts without proper authorization. Schweizerisches Strafgesetzbuch (Swiss Criminal Code, StGB) Art. 271 prohibits anyone to act without permit on behalf of a foreign state or a foreign party or another foreign organization if such acts are reserved to an authority or an official. As the debtor is forced to issue a power of attorney to the trustee, the latter would not be recognized as the debtor's representative, but would be looked at as an investigator from the U.S. estate. His activity would therefore be subject to prior approval. The problem cannot be avoided by authorizing a local attorney, because he is subject to the provision as well.

mestic cases are virtually useless because the respective orders cannot be enforced abroad. As exemplified by the automatic stay, these devices may even place United States claim holders at a disadvantage compared to their foreign co-creditors.

In light of the vast foreign assets of United States-domiciled multinational corporations, the cooperation of United States trading partners in transnational bankruptcies may be of the essence. It therefore is important that United States and its partners enter into negotiations on the subject and try to reach an agreement. Only treaties will be able to provide the necessary basis to do justice to creditors of a bankrupt irrespective of their nationality or domicile.