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INTERNATIONAL ANCILLARY BANKRUPTCY PROCEEDINGS: IN SEARCH OF UNIFORMITY

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*All bankruptcies cause confusion. When a bankrupt company has assets and creditors strewn across several countries, confusion can become chaos. Farflung creditors lunge for the assets within their reach. The company's main liquidators try to lure them back home (airplanes in mid-flight have been instructed to turn back). Creditors may spend years in court resolving disputes created by clashing legal systems.*¹

The spectacular busts of the last year—BCCI,² Robert Maxwell's publishing empire, and Olympia & York—illustrate one of the unhappy downsides of the surging growth of transnational enterprises. Every commercially advanced nation has attempted, with varying degrees of sophistication and success, to grapple with the unique societal and economic problems that flow from the general default of domestic companies by adopting national bankruptcy or insolvency laws. Regrettably, similar attempts to fashion a transnational legal structure to cooperatively manage the consequences of cross-border defaults have in many respects failed.

For the most part, nations encountering a cross-border insolvency proceeding rely on the principle of territoriality, based on in rem jurisdiction, in which the courts of each national jurisdiction seize the property of the debtor physically within their control and distribute it according to local rules. In contrast, idealists and reformers champion the principle of universality, which would provide a single forum applying a single legal regime to all aspects of a debtor's affairs on a worldwide basis. The most common version of the universality idea consists of a primary proceeding in the debtor's home country, with "ancillary proceedings" in other jurisdictions where the presence of assets or other matters requires the primary court to seek local assistance. One key function of the ancillary courts is to assist the home-country administrator; i.e., to marshal and turn over local assets of the debtor to the home-country proceeding for distribution according to home-country rules.

*32 One bright spot in the otherwise dismal landscape of international insolvency is found in the U.S. Bankruptcy Code of 1978 (the Code),³ which has taken the first concrete step towards universalism. Generally, the Code permits a foreign representative of an insolvency proceeding to commence a full bankruptcy case against the debtor in the United States to commence an ancillary U.S. proceeding in aid of home-country proceedings, or to request the suspension or dismissal of ongoing U.S. bankruptcy proceedings involving the debtor.

The Foreign Creditor's Dilemma: A Hypothetical Example

The following brief example, which will be referred to throughout this article, illustrates the choices that a home-country administrator, who represents the interests of all of the creditors of the debtor, faces when he seeks to locate, marshal and repatriate assets located in the United States:

The insolvent debtor, MCorp, is a Swiss-incorporated bank that in the ordinary course of its business dealt in foreign currencies for its own account. Although its sole office is in Geneva, MCorp had engaged in currency trading with parties from all the major world financial centers, conducting its transactions using various European banks. MCorp's primary trading partner in

the United States was RCorp, a foreign currency dealer incorporated in New York. While most of their trading utilized a branch of Swiss Bank in New York, other sizable trades used branches in Miami, Chicago, Houston, and Los Angeles.

After discovering serious financial irregularities at MCorp's bank in Geneva, the Swiss Banking Commission revoked its license and commenced insolvency proceedings to wind up the company. At the time that the Swiss Banking Commission placed MCorp into liquidation, it had nearly \$7 U.S. million in various U.S. bank accounts recently delivered by RCorp for foreign currencies of comparable value not yet received. Similarly, RCorp was awaiting receipt from MCorp of \$4 U.S. million in exchange for foreign currencies that it had transferred the preceding day. There is in excess of \$12.5 U.S. million in RCorp's various accounts with Swiss Bank in the United States, which includes the deposits from many of MCorp's 400 creditors around the world.

Immediately upon placing MCorp into liquidation, the Swiss Banking Commission ordered Swiss Bank to block all MCorp accounts worldwide. Upon learning of MCorp's fate, RCorp immediately demanded the return *33 of its deposits from MCorp and Swiss Bank. MCorp was then informed that Swiss Bank would release the funds only when authorized by the Swiss government—appointed liquidator, KControl. Refusing to cooperate in the Swiss insolvency proceeding, RCorp the following day commenced actions against MCorp in the U.S. courts to recover its funds and also obtained a prejudgment attachment of all of MCorp's accounts in the United States.

If RCorp is successful in its action, it will likely be awarded \$11 million, which would represent 100% of its claim against MCorp. Creditors participating in the Swiss liquidation proceeding are likely to realize only about 50% of their claims—but will get significantly more if the American assets are turned over to the Swiss liquidator.

The objectives of the liquidator, KControl, are to repatriate the MCorp accounts located in the United States, end the litigation brought in the United States by RCorp, locate other MCorp assets in the United States through the use of discovery, and possibly to avoid fraudulent conveyances and preferences made by MCorp prior to entering insolvency.

What are KControl's options under U.S. law? Basically, a foreign administrator has three options:

- The use of remedies available under state law;⁴
- The commencement of a full bankruptcy case in the United States; or
- The commencement of an ancillary U.S. proceeding in aid of the foreign insolvency proceedings.

Nonbankruptcy Law Remedies

The first option involves the foreign representative either commencing an action in nonbankruptcy courts to request a transfer of assets within the jurisdiction or appearing in proceedings commenced by others to request the turnover of property. Thus, KControl could file an action in all of the different states where MCorp had assets—the five branches of Swiss Bank that it used in the United States. Alternatively, KControl could appear in the proceedings that RCorp had initiated against MCorp to seek relief. In either case, KControl would request the state courts (or the district federal court sitting in diversity jurisdiction using state law or the federal courts exercising jurisdiction under other constitutional clauses) to defer to the Swiss insolvency proceeding through a grant of comity.

There are several drawbacks to this approach. If the assets are widely dispersed, the foreign administrator may be required to conduct a separate action in each state or federal court. This can be cumbersome, timeconsuming, *34 and expensive. Additionally, each state court is free to decide according to local law what, if any, type of cooperation will be extended to the foreign insolvency proceeding. A foreign representative should recognize that many U.S. courts will consider reciprocity as an

important factor in its calculus.⁵ Despite these drawbacks, one leading commentator has observed that complaints for relief to state or to federal courts not sitting in bankruptcy have become quite frequent.⁶

Full Bankruptcy Proceeding

The second option is for KControl to commence a full bankruptcy proceeding in the United States. The Bankruptcy Code provides for both voluntary⁷ and involuntary proceedings. Section 303(b)(4) permits a foreign representative of the debtor's estate in a foreign proceeding to commence an involuntary case. Such a filing constitutes a parallel proceeding, involving at least the assets located in the United States, and is aimed at liquidation according to the provisions of U.S. bankruptcy law. After filing, all creditors will be subject to the automatic stay provisions of the Code. This means that RCorp could be automatically enjoined from continuing its judicial actions against MCorp. The bankruptcy court could appoint a *35 trustee in bankruptcy,⁸ who is vested with broad powers to void fraudulent conveyances and preferences. Additionally, most litigation concerning assets will be centralized in one federal court.

The commencement of a full bankruptcy proceeding presents a number of disadvantages: the cases are complicated, time-consuming, and costly. Additionally, it is difficult to coordinate the administration of parallel insolvency proceedings. Moreover, the debtor could gain some measure of control of the proceedings by converting the involuntary case to a voluntary case. Nonetheless, one recent case, *In re Axona International Credit & Commerce, Ltd.*,⁹ illustrates the explosive potential of Section 303(b)(4). There, a foreign representative filed an involuntary case under Section 303(b)(4), used the powers of the trustee in bankruptcy to engage in judicial discovery, investigate potential sources of recovery, and commence an adversary proceeding to recover preferential payments. The avoidance action resulted in a negotiated settlement. The foreign trustee subsequently obtained dismissal of the U.S. proceeding and turned over the recoveries to the home-country proceeding in Hong Kong.

Although KControl may be lured by the potential upside of filing a Section 303(b)(4) petition, it probably would conclude that the relatively small recovery of \$12.5 million in assets would be severely depleted by the prohibitively high costs of a complex full-blown U.S. proceeding.

Section 304 Ancillary Proceeding

The rest of this article addresses the third option available to a foreign administrator: the commencement of an ancillary U.S. proceeding in aid of the home-country insolvency proceeding under Section 304 of the Code. This section permits U.S. bankruptcy courts to defer to foreign courts and to cooperate by halting U.S. lawsuits and attachments and turning over assets to the home-country court. At an initial glance, the limited scope of Section 304 should undoubtedly be appealing to KControl. The Swiss administrator can accomplish his primary objectives—the turnover of assets to the home-country proceeding and the enjoinder of RCorp's action—without depending on the vagaries of the law of local jurisdictions in nonbankruptcy law proceedings, or commencing an expensive and complex full bankruptcy action.

***36 Section 304 Procedural Issues**

Eligibility

A threshold issue for a Section 304 ancillary proceeding is eligibility. The first requirement for commencing an ancillary case is that a “foreign proceeding”¹⁰ was commenced against the debtor. A “foreign proceeding” is defined as a:

proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the

commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization.¹¹

The second requirement is that the petitioner is a “foreign representative”¹² entitled to file the action under Section 304. The Code defines a “foreign representative” to mean a “duly selected trustee, administrator, or other representative of an estate in a foreign proceeding.”¹³ These provisions indicate that there must be a “substantial connection” between the debtor and the foreign country in which the foreign representative has been appointed.¹⁴ KControl would clearly qualify as the “foreign representative” appointed in the “foreign proceeding” ordered by the Swiss Banking Commission.

The relative clarity of these statutory requirements for Section 304 eligibility has been unfortunately clouded by a number of questionable court decisions that have had the effect of imposing additional judicial prerequisites for ancillary relief. A line of cases has considered the issue of whether the foreign debtor must qualify as a “debtor” under Section 109¹⁵ of the *37 Code to be eligible for Section 304.¹⁶ A number of earlier decisions assumed that foreign debtors must meet all of the prerequisites of a debtor under U.S. bankruptcy law to qualify for a Section 304 proceeding. Thus, for example, since a foreign bank engaged in the banking business in the United States is ineligible to be a debtor, a foreign bank engaged in a home-country proceeding would also be ineligible for a Section 304 ancillary proceeding. Conversely, a foreign bank that did not engage in the banking business in the United States would be eligible under U.S. bankruptcy law and accordingly would qualify to commence a Section 304 action.¹⁷ Curiously, even though MCorp was in the banking business in Switzerland, it would be eligible for Section 304 since it engaged only in currency trading, and not the banking business in the United States. This much-criticized approach clearly limits the availability of Section 304 relief to foreign parties.¹⁸ Since Section 304 is a procedural device to permit cooperation with foreign proceedings, there is no compelling rationale why any debtor under administration in a foreign country should meet U.S. eligibility requirements.

The currently prevailing (and better) view is that a foreign debtor need only meet one of the general requirements of Section 109(a)—that is, either reside, have a domicile, a place of business, or property in the United States—to be eligible to commence a Section 304 proceeding.¹⁹ In the example *38 presented, since MCorp does have property in the US—the accounts at Swiss Bank—the foreign representative KControl could commence a Section 304 case.

Jurisdiction and Venue

Other important Section 304 procedural issues include jurisdiction and venue. Assuming that the foreign representative can demonstrate eligibility under Section 304, the bankruptcy court will exercise subject matter jurisdiction since the petition arose expressly under the Code.²⁰ Some courts have added the blanket requirement that to invoke the bankruptcy court's jurisdiction, the foreign representative must allege that the debtor has assets within the judicial district where the Section 304 petition was filed.²¹ Since MCorp does have property in a number of U.S. jurisdictions, KControl can demonstrate subject matter jurisdiction.

The venue of Section 304 proceedings is likewise governed by statute.²² Generally, a case to enjoin a judicial action must be commenced in the district court in the jurisdiction where the proceeding is pending; a case to require the turnover of property must be commenced in the district where the property is located; and, a case to obtain other forms of relief must be commenced in the district where the principal place of business or principal assets of the debtor in the United States are located.

One potential drawback arising from the venue provisions is that a foreign representative will be required to commence multiple Section 304 proceedings if the debtor's assets or pending judicial actions are dispersed over several jurisdictions. KControl will be required to commence Section 304 proceedings in all jurisdictions in which it seeks assistance—New York, Miami,

Chicago, Houston, and Los Angeles. It is possible, however, to request a subsequent consolidation of the ancillary proceedings into a single federal district.²³ KControl would probably wish to consolidate all the cases in a single district, likely the New York federal court.

***39 Available Relief Under Section 304(b)**

Now that the foreign representative, KControl, has successfully negotiated the initial procedural hurdles, it can focus on the remedies available in a Section 304 ancillary proceeding. A Section 304 case is a limited one, designed to function in aid of a proceeding pending in a foreign court. Unlike a full-scale bankruptcy case, a debtor's estate is not created, an automatic stay is not triggered to prevent dismemberment of assets by diligent creditors, and the foreign representative is not vested with fiduciary powers to avoid preferential payments or fraudulent conveyances.²⁴ The court is, however, "free to broadly mold appropriate relief in near blank check fashion."²⁵ The remedial powers granted by statute to the court include the blockage of all collection efforts in the United States, the turnover of U.S. property of the estate to the foreign representative, and a general grant of discretionary authority to provide other appropriate relief.²⁶ In granting relief, the court is "guided by what will best assure an economical and expeditious administration of such estate," consistent with six enumerated factors.²⁷

Injunctive Relief

A foreign representative's first move frequently is to prevent local creditors from dismembering the estate of the insolvent debtor. To accomplish this, the foreign representative will need to obtain a court order enjoining a specific creditor or creditors. Fortunately, such sort of relief is available under Section 304(b), which grants the court broad powers to:

(1) enjoin the commencement or continuation of—

(A) any action against—

(i) a debtor with respect to property involved in such foreign proceeding; or

(ii) such property; or

(B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;²⁸

***40** Section 304(b)(1) injunctions are designed "to prevent individual American creditors from arrogating to themselves property belonging to the creditors as a group" and are "not unlike the injunction which is automatic in a chapter 7 or 11 case pursuant to § 362 of the Code."²⁹

In the MCorp example, the creditor RCorp had successfully attached all of the debtor's accounts in the United States and had commenced actions in the U.S. courts to recover what it considers to be its funds. Other of MCorp's creditors in the United States are likely to consider a similar course of action. Under Section 304(b)(1), KControl can request the court to enjoin the commencement or continuation of actions against MCorp with respect to the accounts, actions against the accounts, or the enforcement of judgments against MCorp involving the accounts.³⁰ The court may grant temporary and preliminary injunctive relief if the general standards for such relief are satisfied.³¹

Turnover of Property

The ultimate purpose of the Section 304 ancillary proceeding is to facilitate the marshalling and repatriation of the insolvent debtor's local assets to the home-country proceeding for equitable distribution. One commentator has observed that “[t]he ultimate test of [the] willingness to cooperate occurs when the court is asked to authorize a transfer of American assets so that they can be integrated with other assets in foreign proceedings.”³² Not surprisingly, the case law dealing with the turnover of property to a foreign proceeding reflects the tensions between the principles of territoriality and universality.

Section 304(b)(2) permits the court to “order turnover of the property of such estate, or the proceeds of such property to such foreign representative.” The deceptively simple language of this provision is complicated by the lack of a choice of law rule in Section 304. Before there can be a turnover of property to a foreign proceeding, a court must first determine *41 whether the property involved is indeed “property of [the debtor's] estate.” In the MCorp example, this would involve a determination of whether the bank accounts were property of MCorp's estate or were the property of some other party (remember RCorp claims \$11 million of the accounts). This determination raises two key questions: (1) what forum should decide whether the accounts are estate property (the U.S. court or the Swiss proceeding); and (2) what choice of law should the forum use to determine whether the accounts are estate property (U.S. law or Swiss law)?

Case law indicates that “[f]or purposes of Section 304, the estate of a foreign debtor is defined by the law of the jurisdiction in which the foreign proceeding is pending, with other applicable law serving to define the estate's interest in particular property.”³³ Accordingly, the estate of the foreign debtor RCorp will be defined by Swiss law. However, the estate's interest in particular property, the U.S. accounts, will be defined by other applicable law.

Recently, a federal circuit court in *In re Koreag, Controle et Revision*³⁴ addressed the Section 304(b)(2) choice of forum and choice of law questions. The *Koreag* court ruled that the U.S. bankruptcy court should apply applicable local law to determine the estate's interest in particular property.³⁵ Thus, the U.S. bankruptcy court must apply local law to determine whether MCorp has a valid ownership in the bank accounts. The *Koreag* court indicated that the bankruptcy court will use either local state or federal choice-of-law rules to further determine what substantive law will apply. After analyzing the interests of the local U.S. jurisdiction and the foreign jurisdiction involved, the circuit court concluded that local law will define the estate's interest in the property. Since *Koreag* and the MCorp example are based on similar fact patterns, it is probable that the bankruptcy court would use local state law, not Swiss law, to determine the interests of RCorp and MCorp in the disputed accounts.

The court, guided by the six considerations of Section 304(c), must next decide whether to turn over the property of the debtor in the United States to the home-country proceeding. It is difficult to make concrete generalizations about the trend of decisions, except to note that the cases reflect the inherent conflict between the territorialist bent to protect local creditors and the universalist impulse to defer to the home-country proceeding on the grounds of comity.³⁶

*42 One leading case following the traditional territorial approach refused turnover on the grounds that a secured U.S. creditor would not receive a similar high priority for its claim in a Canadian proceeding.³⁷ In a second decision, the court granted a turnover of assets to a foreign representative, but attached a number of restrictions on the transferability of the assets designed to protect the interests of U.S. creditors.³⁸ In contrast, some courts have taken significant, albeit small and cautious steps towards the ideal of universality in property turnover litigation. The court in *In re Culmer*,³⁹ impressed by the close substantive similarities between U.S. and Bahamian bankruptcy law, ordered the turnover of U.S. assets to the foreign representative. And in perhaps the most promising example of international cooperation, *In re Axona*, the court permitted the turnover of U.S. assets to a Hong Kong insolvency proceeding.⁴⁰

So what are the Swiss liquidator KControl's prospects of repatriating the funds in the accounts to Switzerland? In defining the property, or granting turnover relief under the statute, a court must consider six statutory factors provided in Section 304(c). It is frequently difficult to predict how a given court will balance these factors, treated in greater detail below, to arrive at a decision.

Other Appropriate Relief

Section 304(b)(3) authorizes the court to “order other appropriate relief.”⁴¹ This provision is intended to provide the court with the “maximum flexibility in handling ancillary cases”⁴² under Section 304. Courts have used this section to require persons and entities to submit to discovery by foreign representatives, appoint a co-trustee with responsibility for the debtor's assets in the United States, and to order that entitlements under foreign laws to assets claimed by foreign debtors be determined in foreign proceedings.⁴³ KControl might wish to use this provision to engage in discovery against the U.S. creditors of MCorp to locate additional assets or to investigate possible improper financial dealings on the part of MCorp officials. A foreign representative should be guided in his decision by the *43 knowledge that the bankruptcy courts have generally used the “blank check” grant of authority of Section 304(b)(3) in an aggressive and creative fashion.⁴⁴

Six Criteria for Relief

The foreign representative of the home-country proceeding, confident that he meets all of the procedural prerequisites to commence a Section 304 case, must now confront one remaining fundamental question (frequently asked of him long distance by the creditors in the home-country proceeding): What is the likelihood of success? According to the leading U.S. authority on the Code, recent cases dealing with Section 304 and related provisions indicate that U.S. courts are continuing the practice “of deferring, on the grounds of international comity, to foreign bankruptcy proceedings unless particular circumstances suggest such deference is inappropriate.”⁴⁵ The ability to predict outcomes in Section 304 cases must begin with an understanding of the tensions between the territorialist agenda of protecting the interests of local creditors and interest and the universalist ideals of global equality of distribution and international comity—tensions evident in Section 304(c).

Thus, the final hurdle for a foreign representative to contend with is Section 304(c), which provides “a shopping list of factors for the court to consider in determining what, if any, relief to give in deference to the foreign proceeding.”⁴⁶ Section 304(c) provides that:

In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—

- (1) just treatment of all holders of claims against or interests in such estate;
- (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
- (3) prevention of preferential or fraudulent dispositions of property of such estate;
- (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
- (5) comity; and
- (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.⁴⁷

*44 Recognizing the risk of oversimplification that accompanies broad generalizations, the decisions applying the Section 304(c) framework can be essentially lumped into two categories. In the first category of cases, the courts focus on concerns for international comity and equality of creditor treatment and defer to the foreign proceeding. In the second category, courts are concerned with the protection of local creditors and potential outcome differences between the foreign proceedings and U.S. proceedings, and deny relief. With this background in mind, it is possible to consider the Section 304(c) factors.

Comity

Although listed as the fifth factor, comity⁴⁸ is obviously a central issue in a transnational bankruptcy proceeding.⁴⁹ Comity is a complex and elusive concept, and bankruptcy courts will rely on a long and rich line of U.S. case law to guide their decision whether to defer to a foreign court. The relative emphasis on comity, however, will depend on whether the court styles itself (or is characterized by other courts) as taking a modern⁵⁰ or a protectionist⁵¹ approach.

For those courts using a Section 304(c) analysis that have deferred to foreign proceedings, the general rule can be stated as follows: “Comity is to be accorded a decision of a foreign court as long as that court is of competent jurisdiction and as long as the laws and public policy of the forum state are not violated.”⁵² This approach clearly tends to favor deference to foreign proceedings, especially when there is substantial similarity between the U.S. and home-country legal and bankruptcy systems. Following this *45 logic, U.S. courts have deferred to foreign insolvency proceedings in the Bahamas, Bermuda, Canada, the Cayman Islands, Hong Kong, and Sweden after finding the foreign law was similar or provided fundamental standards of procedural fairness.⁵³ The courts consider, but do not require, reciprocity as a prerequisite to a grant of comity.⁵⁴

Predictably, those decisions which did not defer to foreign proceedings did not take such an expansive view of comity and were troubled by the differences in outcomes that can be encountered by U.S. participants in foreign proceedings. A typical example is *In re Papeleras*, where the court held that comity is to be accorded no greater weight than the other Section 304(c) factors. The *Papeleras* court refused to defer to a Spanish proceeding on the grounds that a U.S. lien creditor would not be afforded just treatment under Spanish law.⁵⁵

Just Treatment of All Holders of Claims

The factor of “just treatment of all holders of claims against or interest in such estate” favors the universalist principle of a centralized home-country distribution to all creditors.⁵⁶ In weighing this requirement, courts generally conduct perfunctory analyses of foreign insolvency law to ensure that it “provides a comprehensive procedure for the orderly and just treatment of all [the insolvent's] creditors.”⁵⁷ One court has observed that “just treatment” does not require that the creditor's claim be treated the same under foreign law as U.S. law.⁵⁸

Prejudice and Inconvenience

Another factor to be considered is the protection of U.S. claimholders against prejudice and inconvenience in the processing of claims in the foreign proceeding. In contrast to the prior two factors which expressed universalist concerns, Section 304(c)(2) squarely addresses the territorialist agenda of protecting local creditors. This factor requires a balancing of the prejudice and inconvenience that a local creditor encounters when required *46 to participate in foreign proceedings against the goal of an economical and expeditious administration of the insolvent debtor's estate.

Courts often examine the procedural aspects of foreign proceedings: notice, time limits for filing claims, processing costs, and rules permitting appeal of rejected claims. Exactly how much procedural protection a U.S. claimholder is due is not a settled question. In a recent controversial decision, *Interpool, Ltd. v. Certain Freights*,⁵⁹ the court refused to defer to an Australian insolvency proceeding, one of the stated grounds being procedural unfairness to U.S. creditors. The procedural unfairness cited by the court was that Australian law permitted an ex parte settlement of an important dispute with a third-party insider by the liquidator of the insolvent company, without notice and the opportunity for the U.S. creditors to be heard on the matter.

The *Interpool* decision is criticized as protectionist by those who argue that as sophisticated commercial parties, U.S. creditors assume the risks of the home-country legal system when they make the decision to do business with a foreign company.⁶⁰ On this view, local creditors impliedly subject themselves to the laws of the foreign government—including the insolvency laws—when they deal with a foreign corporation. Accordingly, the *Interpool* creditors should have been well aware of the possibility of an ex parte settlement and the lack of a notice requirement under Australian law: “[o]ne who invests in a foreign corporation subjects his investment to foreign law and may not seek to obtain greater rights than his co-creditors by suing in American court.”⁶¹

This controversy neatly illustrates the dispute between those courts that are influenced by universalist ideals and those courts concerned about disparate outcomes that result from differences in laws between U.S. and foreign insolvency proceedings—even when the two systems are substantially similar.

Prevention of Fraudulent Transfers

The third factor listed in Section 304(c) is the “prevention of preferential or fraudulent dispositions of property of such estate.” This factor should only come into play when the foreign system lacks meaningful avoidance powers.⁶² For example, although there are important differences between the U.S. and British laws regarding preferential payments to creditors, *47 these possible differences in outcome would not generally be thought to justify denying Section 304 relief.

Substantial Similarity in Distribution

Section 304(c)(4) requires that the distribution provisions of the home-country proceeding be in substantial accordance with the order prescribed by the Code. One approach used by courts looks generally for substantial similarity in U.S. and foreign priority systems, including the absence of discriminatory distribution schemes (for example, the absence of national treatment for foreign creditors or distribution to creditors on a first-come, first-served basis). A contrasting line of decisions, however, has refused to defer to home-country proceedings where differences between U.S. law and foreign law would have resulted in local creditors receiving a lower priority under the foreign insolvency regime.⁶³ Once again, the conflict in judicial approach demonstrates the differences between the modern approach, which looks for rough similarity, and the protectionist approach, which is concerned about outcome differences.

Future Trends

After enduring a detailed discussion of the sometimes perplexing and not entirely coherent body of U.S. transnational bankruptcy law, the reader is entitled to some thoughts about the future. On a pragmatic level, one result of the international cooperation among U.S. and foreign bankruptcy courts in the spectacular international mega-busts of recent years should be the breakdown of the mutual mistrust and suspicion that fosters parochialism. One would expect that as bankruptcy courts and attorneys become more familiar with the workings of foreign insolvency systems, an increased willingness to defer to foreign proceedings will result.

More ambitious proposals to advance the universalist goal of international cooperation in insolvency matters take the form of model uniform laws and bilateral and multilateral treaties. The International Bankruptcy Committee of the International Bar association has recently proposed the Model International Insolvency Cooperation Act (MIICA), which has been described as follows:

The basic idea behind MIICA is adoption by a number of countries of a statute that directs each country's courts to cooperate with a foreign bankruptcy proceeding, acting ancillary to and in aid of that foreign jurisdiction. Section 304 of the U.S. Bankruptcy Code is the inspiration for MIICA, but its provisions differ from Section 304 in several important ways. The most important difference is that MIICA adopts a

universalist choice of law rule that requires the local court to apply the substantive law of the foreign court, albeit with some discretion to apply local law where it feels it must.⁶⁴

*48 The leading example of an attempt to fashion an international treaty for international cooperation in insolvency matters is the Strasbourg Convention, currently being discussed by the nations of the Council of Europe.⁶⁵ Some commentators, however, question the utility of treaties as a vehicle for international cooperation in bankruptcy.⁶⁶ In any event, these proposals remain just that—proposals—for now.

Conclusion

What then, finally, are KControl's prospects for obtaining relief under Section 304? A bankruptcy court,⁶⁷ considering a similar case involving the Swiss insolvency proceedings of a Swiss bank that engaged in currency dealings in the United States ordered the turnover of the funds in a Swiss Bank account in the United States to the foreign representative. On appeal, however, the U.S. creditor was able to block the turnover until a threshold determination was made in a U.S. court using local law to determine the debtor's interest in the property.⁶⁸ After this determination is made, the funds in the Swiss Bank account that are found to be the property of the debtor will be subject to turnover to the Swiss proceeding under Section 304(b)(2).⁶⁹

The MCorp example illustrates the dilemma that the foreign creditors of an insolvent multinational debtor face when confronting the U.S. legal system. Perhaps the best solution to this dilemma will be found in harmonizing national insolvency laws or adopting an international insolvency treaty. In the meantime, a participant in home-country insolvency proceedings that is considering seeking the assistance of the U.S. courts does have a number of powerful options. The purpose of this report has been to introduce these options, particularly that of the Section 304 ancillary proceeding. The Section 304 ancillary case should be especially attractive to a foreign representative that seeks to marshal a significant amount of U.S. assets of the insolvent debtor to the home-country proceeding without undergoing the expensive, complex, and time-consuming process of a full-blown U.S. bankruptcy case. The Section 304 procedure is a relatively young innovation, and has experienced its share of growing pains. Although Section 304 has resulted in only about two dozen reported cases, this body of law is rapidly maturing and the U.S. courts are becoming increasingly sophisticated in its application.

Footnotes

- a1 Partners, Curtis, Mallet-Prevost, Colt & Mosle, New York, New York. The extended assistance of Mark R. Hageman, J.D. Candidate, Harvard Law School, 1993, is appreciated.
- 1 "Sharing the World's Corporate Carrion," *The Economist*, Jan. 4, 1992, at 67.
- 2 For a bankruptcy case related to the BCCI criminal settlement in the United States, see *In re* Petition of Smouha, 136 BR 921 (SDNY 1992).
- 3 11 USCA §§ 101-1330 (1979 & West Supp. 1992). The provisions of the Code that concern transnational insolvency cases are Section 303(b)(4), which permits a foreign representative of a foreign proceeding to commence an involuntary case; Section 304, which governs U.S. cases ancillary to foreign proceedings; and Sections 305(a)(2) & 305(b), which permit a foreign representative to seek dismissal or suspension of a U.S. proceeding in deference to a foreign proceeding. Section 306 allows a foreign representative to make a limited appearance in a bankruptcy court without submitting to the jurisdiction of U.S. courts for other purposes.
- 4 In certain circumstances, e.g., admiralty cases, the remedy would be obtained under federal nonbankruptcy law in the federal courts. An action in the federal court system based on the diverse citizenship of the parties will apply state law, including state choice of law rules. See *Erie RR Co. v. Tompkins*, 304 US 64 (1938); *Klaxon v Stentor Elec. Mfg. Co.*, 313 US 487 (1941).

- 5 U.S. courts will also entertain motions to vacate stays imposed in favor of foreign liquidation proceedings. See *Drexel Burnham Lambert Group, Inc. v. A.W. Galadari*, 134 BR 719 (SDNY 1991) (court finds that foreign proceeding conducted with great delay and unfairness and orders that creditors' claims go forward in U.S. courts).
- 6 Stefan A. Riesenfeld, *Transnational Bankruptcies in the Late Eighties: A Tale of Evolution and Activism, in Comparative and Private International Law: Essays in Honor of John Henry Merryman on His Seventieth Birthday* 409, 419 (1990).
- 7 Unlike Section 303(b)(4) involuntary cases, which are commenced by the foreign representative of the debtor's estate in a foreign proceeding, a voluntary bankruptcy petition is filed by the debtor itself—prior to or often simultaneously with a foreign insolvency petition. In one famous preCode case, the Israel-British Bank (London) Ltd. was in financial distress and commenced voluntary bankruptcy proceedings in the United States and also petitioned in England for a voluntary winding up. The objective of the U.S. bankruptcy proceedings, where it had assets but did no banking business, was to deprive U.S. creditors of the advantage they had gained by attaching bank assets. *Israel-British Bank (London) Ltd v. Fed. Deposit Ins. Corp.*, 536 F2d 509 (2d Cir. 1976). More recently, multinational debtors have engaged in parallel voluntary filings for strategic business reasons. One primary objective appears to be to take advantage of the Code's Chapter 11 provisions that facilitate the reorganization of distressed companies. The leading examples are the Olympia & York case, where the U.S. Chapter 11 petition preceded a Canadian filing by hours, and the Maxwell Communication Corporation commencement of U.S. reorganization proceedings one day prior to its British filing. See “Reichmanns' Bankruptcy Move: Seeking the Best of Two Legal Systems,” *New York Times*, May 16, 1992, at 39.
- 8 A foreign representative would be eligible to be appointed as the trustee in bankruptcy if he met the statutory requirements, which includes residing or maintaining an office in the judicial district (or adjacent district) where the case is pending. 11 USCA § 321 (West Supp. 1992).
- 9 88 BR 597 (Bankr. SDNY 1988), aff'd 115 BR 442 (Bankr. SDNY 1990), appeal dismissed, 924 F2d 31 (2d Cir. 1991) (hereinafter *In re Axona*). The Hong Kong liquidators chose the Section 303(b)(4) full bankruptcy case over an ancillary proceeding for the strategic purpose of utilizing the trustee's avoiding powers—powers that are generally not available in a Section 304 proceeding. 88 BR at 601.
- 10 11 USCA § 304(a) (1979).
- 11 11 USCA § 101(23) (West Supp. 1992).
- 12 11 USCA § 304(a) (1979).
- 13 11 USCA § 101(24) (West Supp. 1992).
- 14 Lawrence P. King, 2 *Collier on Bankruptcy* ¶ 304.02 (15th ed. 1988) (hereinafter *Colliers*) (referring to legislative history). One commentator doubts that place of incorporation alone is sufficient to qualify as “domicile.” Jay L. Westbrook, “Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum,” 65 *Am. Bankr. LJ* 457, 473 n. 58 (1991).
- 15 The relevant portions of 11 USCA § 109 are:
(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality may be a debtor under this title.
(b) A person may be a debtor under Chapter 7 of this title only if such person is not—
(1) a railroad;
(2) a domestic insurance company, bank, savings bank, savings and loan association, building and loan association, homestead association, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(H)); or
(3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, homestead association, or credit union, engaged in such business in the United States.
(d) Only a person that may be a debtor under chapter 7 of this title, except a stockbroker or a commodity broker, and a railroad may be a debtor under chapter 11 of this title.
11 USCA §§ 109(a), 109(b), 109(d) (West Supp. 1992).
- 16 See, e.g., *In re Culmer*, 25 BR 621 (Bankr. SDNY 1982); *Angulo v. Kedzep, Ltd.*, 29 BR 417 (SD Tex. 1983).

- 17 See *In re Culmer*, 25 BR 621, 624 (Bankr. SDNY 1982). The court denied motion to dismiss the § 304 petition on finding that the debtor, a foreign bank, “was not engaged in the banking business in the United States.”
- 18 See, e.g., Douglass G. Boshkoff, “United States Judicial Assistance in Cross-Border Insolvencies,” 36 Int. Comp. LQ 729, 739-741 (1987).
- 19 See, e.g., *In re Brierley*, 23 BCD 429 (CRR) (Bankr. SDNY 1992); *In re Gee*, 53 BR 891, 899-900 (Bankr. SDNY 1985); *In re Lines*, 81 BR 267 (Bankr. SDNY 1988); *In re Banco de Descuento*, 78 BR 337 (Bankr. SD Fla. 1987). See also Richard A. Gitlin & Evan D. Flaschen, “The International Void in the Law of Multinational Bankruptcies,” 42 Bus. Law. 307, 319 (1987) (Section 304 relief should be available if the prerequisites of Section 109(a) have been met). One federal circuit court has gone further and permitted a foreign representative to commence a Section 304 petition even though the debtor did not qualify as a debtor under Section 109(a). Instead, the debtor must “only be properly subject, under applicable foreign law, to a proceeding, commenced for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization.” *In re Goerg*, 844 F2d 1562, 1568 (11th Cir. 1988), cert. denied, 488 US 1034, 109 S. Ct. 850 (1989).
- 20 28 USCA §§ 157, 1334 (West Supp. 1992). See, e.g., *In re Kingscroft Ins. Co. Ltd.*, 138 BR 121, 123 (Bankr. SD Fla. 1992) (hereinafter *In re Kingscroft*).
- 21 See, e.g., *In re Koreag, Controle et Revision SA*, 130 BR 705, 711 (Bankr. SDNY 1991), vacated and remanded, 961 F2d 341 (2d Cir. 1992), cert. denied, 1992 US LEXIS 5308 (1992) (hereinafter *In re Koreag*). The overbroad requirement of property in the jurisdiction overlooks those occasions when a foreign representative might seek other relief, e.g. discovery, rather than a turnover of assets, or injunctive relief to protect property. Courts have allowed such relief even though there was no property of the debtor in the jurisdiction. See, e.g., *In re Gee*, 53 BR at 898-899 (granting discovery to locate assets); *In re Kingscroft*, 138 BR at 126 (enjoining legal action although no assets in district); *Colliers* at ¶ 304.05.
- 22 28 USCA § 1410 (West Supp. 1992). See also Lawrence P. King, 1 *Collier on Bankruptcy* ¶ 3.02[3] (15th ed. 1988).
- 23 28 USCA § 1412 (West Supp. 1992).
- 24 See, e.g., *In re Axona*, 88 BR at 606.
- 25 *In re Culmer*, 25 BR at 624.
- 26 11 USCA § 304(b) (1979).
- 27 11 USCA § 304(c) (1979). The six factors listed in §§ 304(c)(1)- 304(c)(6) are discussed *infra*. These factors are likewise considered in the decision of a court to order suspension or dismissal of a U.S. proceeding in deference to a foreign proceeding. 11 USCA § 305(a)(2)(B) (1979).
- 28 11 USCA § 304(b)(1) (1979).
- 29 *In re Banco Nacional de Obras y Servicios Publicos, SNC*, 91 BR 661, 664 (Bankr. SDNY 1988).
- 30 Since the literal language of § 304(b)(1) grants the court the power to enjoin action against a debtor “with respect to property involved in such foreign proceeding,” (emphasis added) and the bank accounts in the United States are clearly “involved” in the Swiss proceeding, the court does not need to make an initial determination if the accounts belong to MCorp or RCorp prior to issuing the injunction. See *In re Koreag*, 961 F2d 348 (2d Cir. 1992). This distinction will become significant when considering the turnover of property, see *infra* at 33-35, and accompanying text.
- 31 *Colliers* ¶ 304.03. The general standards for such relief are prima facie showings of irreparable harm, no alternative remedy at law, probability of ultimate success, and a balancing of the equities in favor of the applicant. The premature disposal of property involved in foreign proceedings has been held to be irreparable injury. *Id.*
- 32 Boshkoff, *supra* note 18, at 745.
- 33 See, e.g., *In re Lines*, 81 BR 267, 271 (Bankr. SDNY 1988).

- 34 961 F2d 341 (2d Cir. Apr. 9, 1992).
- 35 *Id.* at 348.
- 36 Some commentators are less optimistic and feel recent cases involving § 304 turnovers reflect a trend away from international cooperation. See Boshkoff, *supra* note 18, at 747; Elizabeth Warren & Jay Westbrook, *The Law of Debtors and Creditors* 856 (2d ed. 1991).
- 37 *In re Toga Mfg. Co.*, 28 BR 165 (Bankr. ED Mich. 1983).
- 38 *In re Lineas Areas de Nicaragua, SA* 10 BR 790 (Bankr. SD Fla. 1981).
- 39 25 BR 621 (Bankr. SDNY 1982).
- 40 *In re Axona*, discussed *supra*, note 9, and accompanying text, was a § 303(b)(4) involuntary liquidation in which the court granted the joint application of the U.S. and Hong Kong trustees to suspend the U.S. proceeding and turn over the recovered assets to the Hong Kong proceeding. The decision to suspend a U.S. bankruptcy case under Section 305(b), like the decision to grant relief under § 304(b), is guided by a consideration of the Section 304(c) factors.
- 41 11 USCA § 304(b)(3) (1979).
- 42 *Colliers* ¶ 304.03 (citing legislative history).
- 43 *Id.* (citing collected cases).
- 44 See, e.g., *In re Gercke*, 122 BR 621, 626 (Bankr. DDC 1991) (court issues preliminary injunction to enjoin further litigation under authority of § 304(b)(3)).
- 45 *Colliers* ¶ 304.04.
- 46 Westbrook, *supra* note 14, at 472. Westbrook describes the six factors as an “enumeration of defenses against deference.” *Id.*
- 47 11 USC 304(c) (1979). The sixth factor, 304(c)(6), which considers the “fresh start” for an individual debtor, will not be considered in this article which is concerned with multinational corporate entities.
- 48 The classic U.S. judicial definition of comity 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 citizens, or of other persons who are under the protection of its laws.
Hilton v. Guyot, 159 US 113 (1895).
- 49 There is something of a judicial debate whether comity is of paramount concern and given superior weight in the Section 304(c) determination, or if comity is given only equal weight with the other factors. It is probably fair to conclude that the relative weighting of comity reflects a predisposition towards either the universalist or the territorialist position. Compare *In re Koreag*, 130 BR at 712 with *In re Papeleras Reunidas, SA*, 92 BR 584, 594 (Bankr. EDNY 1988) (hereinafter *In re Papeleras*). See also *In re Axona*, 88 BR at 611 (criticizing *In re Toga* as “out of line with the modern need for flexibility in the construction of comity”).
- 50 *In re Axona*, 88 BR at 611 (emphasizing a modern need for flexibility in the construction of comity).
- 51 See *In re Koreag*, 130 BR at 714 (characterizing *Toga* and *In re Papeleras* as examples of protectionism).
- 52 *In re Culmer*, 25 BR at 629. Bankruptcy courts in the Southern District of New York go even further in narrowly construing the exceptions to comity, declaring: “[F]oreign-based rights should be enforced unless the judicial enforcement of such a [right] would be the approval of a transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense.” *Id.* (quoting *Intercontinental Hotels Corp. v. Golden*, 15 NY2d 9, 13, 254 NYS2d 527, 529, 203 NE2d 210, 212 (1964)).

- 53 See, e.g., *In re Culmer* (Bahamas); *In re Kingscroft* (Bermuda); *Caddel v. Clairton Corp.*, 105 BR 366 (ND Tex. 1989) (Canada); *In re Gee* (Cayman Islands); *In re Axona* (Hong Kong); *Cunard SS Co. v. Salen Reefer Services AB*, 773 F2d 452 (2d Cir. 1985) (Sweden); *Victrix SS Co., SA v. Salen Dry Cargo, AB*, 825 F2d 709, 714 (2d Cir. 1987) (Sweden).
- 54 *Cunard SS v. Salen Reefer Serv. AB*, 773 F2d at 460. For a discussion of a recent English decision that withheld deference for a perceived lack of reciprocity by U.S. courts, *Felixstowe Dock & Ry. Co. v. US Lines, Ltd.*, [1987] 2 Lloyd's Rep. 76, see Westbrook, *supra* note 14, at 478-483.
- 55 *In re Papeleras*, 92 BR at 590. The modern courts do not accept the view that a local creditor must enjoy the same status under foreign law as it would have in the United States. See *In re Koreag*, 130 BR at 714.
- 56 *Colliers* § 304.04
- 57 *In re Axona*, 88 BR at 612.
- 58 *In re Koreag*, 130 BR at 714.
- 59 102 BR 373 (DNJ 1988).
- 60 See, e.g., Westbrook, *supra* note 14, at 475-477. See generally *Canada S. Ry. v. Gebhard*, 109 US 527, 537 (1883).
- 61 *In re Culmer*, 25 BR at 632. There is an obvious distinction between a sophisticated commercial investor and an unsophisticated (and involuntary) local creditor, e.g., a tort victim. But see *In re Kingscroft*, 138 BR at 126 (plaintiff with medical malpractice claim motion to dismiss insolvent insurer's Section 304 petition denied).
- 62 See Westbrook, *supra* note 14, at 474-475. Westbrook further criticizes a second rationale of the Interpool decision, which found that the lack of a remedy under Australian law for insider manipulations equivalent to the U.S. doctrine of "equitable subordination" amounted to a substantial difference between U.S. and Australian law and justified refusing the Section 304 petition. *Id.*
- 63 See notes 34 & 35, *supra*, and accompanying discussion.
- 64 Westbrook, *supra* note 14, at 483 (footnotes omitted).
- 65 See Westbrook, *supra* note 14, at 485-487, for an overview of the proposed treaties.
- 66 See, e.g., Jan H. Dalhuisen, *1 International Insolvency and Bankruptcy*, Part III, ¶ 2.05[7].
- 67 The example is generally based on *In re Koreag*, *supra* note 21, which represents a cutting edge Section 304 case. Certain variations were introduced to make the example more illustrative of the various factors a foreign party should consider.
- 68 *In re Koreag*, 961 F2d at 348.
- 69 *Id.* at 358.