International Creditors' Rights and Bankruptcy

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In the area of transnational insolvencies and creditors' rights there is little doubt that all parties have an interest in increasing predictability in commercial transactions, enhancing efficiency in administration of debtor's estates, and promoting fairness in claims adjudication. Similarly, experience suggests that increasing harmonization of transnational insolvency law and practice enhances the possibility of achieving these laudable goals. Three developments in 1996 reflect the range of approaches being taken to harmonize the law and practice in the area of transnational insolvency and creditors' rights.

I. UNCITRAL Model Legislative Provisions on Cross-Border Insolvency

In response to suggestions made by practitioners directly concerned with the area of transnational insolvencies, the United Nations Commission on International Trade Law (UNCITRAL) formed the Working Group on Cross-Border Insolvency to study the problems confronting debtors and creditors in transnational insolvency cases.[1] The Working Group has held three sessions devoted to the preparation of a draft "UNCITRAL Model Legislative Provisions on Cross-Border Insolvency," with the most recent session being held in Vienna in October 1996.[2] The U.S. Department of State, in conjunction with its Advisory Committee Study

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1. The most recent suggestions in this regard were made at the UNCITRAL Congress, "Uniform Commercial Law in the 21st Century," held in New York in conjunction with the twenty-fifth session of the Commission, in May 1992. In April 1994, the Commission held a Colloquium on Cross-Border Insolvency, in conjunction with the International Association of Insolvency Practioners (INSOL), to assess the desirability and feasibility of work in this area and to define the scope of the work to be undertaken. In March 1995, the Commission held the UNCITRAL-INSOL Judicial Colloquium on Cross-Border Insolvency to elicit the views of judges concerning the work of the Commission. The Commission's decision to undertake this project was taken at its twenty-eighth session and is further described in the *Official Records of the General Assembly*, 50th Sess., Supp. No. 17, ¶¶ 382-393, U.N. Doc. (A/50/17), as *cited in Report of the Working Group on Insolvency Law on the Work of Its Twentieth Session*, U.N. Doc. A/CN.9/433 (1996) at ¶ 1, n.1 [hereinafter *Report of the Working Group*].

2. This Summary of UNCITRAL's efforts is based on the *Report of the Working Group, supra* note 1.

Group on Cross-Border Insolvency, has been an active participant in the Working Group's efforts to harmonize transnational insolvency law and practice.

The Working Group has prepared a draft "UNCITRAL Model Legislative Provisons on Cross-Border Insolvency" (Model Legislation) that is intended (a) to further cooperation among courts and other competent authorities, (b) to promote the fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested parties without discrimination based on the nationality of creditors, (c) to facilitate the gathering of information about a debtor's assets and affairs and to protect and maximize the value of its assets, and (d) to facilitate the "rescue of financially troubled though viable businesses."[3] The Working Group believes that accomplishing these policy goals requires creation of a legal regime that reconciles three related concepts: recognition of foreign insolvency proceedings by a State that has enacted the Model Legislation (an Enacting State) being accomplished in an expeditious manner; access to judicial proceedings in the Enacting State for duly appointed foreign representatives; and availability of limited relief upon recognition that (a) protects the debtor's and creditor's interests in an orderly administration of the bankruptcy estate and the debtor's assets situated in the Enacting State and (b) promotes fairness for both local and foreign creditors in the claims adjudication process. Ultimately, UNCITRAL hopes the procedural mechanisms and relief embodied in the Model Legislation will be enacted into domestic law in various States and thereby increase harmonization of transnational insolvency law and practice.[4]

The next session of the Working Group is scheduled for January 1997, and the next plenary session of UNCITRAL will take place in May 1997.[5]

A. The Decision to Draft Model Legislation Instead of an International Convention

The Working Group's decision to draft model legislation, rather than propose an international convention, is based on three fundamental considerations. First, prior efforts to achieve harmonization in this area through international conventions repeatedly have failed. Accordingly, the Working Group believes that increasing harmonization is more likely to result from this first step which focuses on creating procedures enhancing judicial cooperation, establishing mechanisms for recognition of foreign proceedings and foreign representatives, and imposing limited restrictions on the administration of a debtor's local assets to protect the debtor's efforts to reorganize its business and the rights of both foreign and local creditors. Second, the Working Group believes the degree of uniformity in judicial cooperation that is necessary for the efficient administration of a transnational insolvency case, as well as to assure fairness for both foreign and local creditors in claims adjudication, can best be achieved by enacting revisions to domestic bankruptcy laws on a State-by-State basis. And, third, the Working Group recognizes that the concept of reciprocity poses a significant problem in creating the legal mechanisms for judicial cooperation. This problem arises from the fact that some States' laws require cooperation with

3. *Report of the Working Group, supra* note 1, at ¶¶ 21-28. Prior to October 1996, the Preamble included the underlying goal of encouraging a predictable environment for trade and investment in addition to purposes for the Model Legislation described in the text.

4. Although the Working Group expects to submit a draft of the Model Legislation for consideration by the Commission in 1997, the complexity of the issues involved makes the prognosis for its adoption uncertain. Finally, assuming the Commission adopts the Model Legislation, a second phase of this project will be necessary to further elaborate these initial rules and to explore substantive issues such as the discharge and priorities of claims.

5. *Report of the Working Group, supra* note 1, at ¶¶ 16-20.

foreign judicial authorities be subject to a requirement of reciprocity, but that national laws often embody distinct notions of reciprocity. Under these circumstances, the Working Group believes that these varying notions of reciprocity are more likely to be accommodated by permitting each State to enact legislation that is consistent with its concept of reciprocity. The Working Group, essentially, has concluded that reaching a consensus on either the meaning of reciprocity or its application would be necessary if an international convention were to be proposed and that such consensus is unlikely to occur.[6]

B. Recognition of Foreign Insolvency Proceedings and Access of Foreign Representative to Courts

1. *General*

Under the Model Legislation a foreign representative may apply directly to the appropriate court (the Recognizing Court) in an Enacting State for recognition of a foreign proceeding without ever having to apply through diplomatic or consular channels.[7] A foreign representative eligible to seek recognition of a foreign proceeding is "a person or body authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding."[8] A foreign proceeding that may be recognized in an Enacting State includes any "collective judicial or administrative proceeding pursuant to a law relating to insolvency in a foreign state in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court or other competent authority, for the purpose of reorganization or liquidation. . . ."[9]

Recognition of a foreign proceeding is not automatic under the Model Legislation. Instead, it can occur only after a foreign representative files a petition in the Enacting State that includes documentary proof that the foreign proceeding has been opened and that he has been properly appointed by the foreign court.[10] Significantly, there is no legalization requirement for these documents, thereby avoiding the time-consuming notarial or consular procedures that would frustrate the necessity to obtain timely relief in transnational insolvency situations.[11]

Once a foreign proceeding has been recognized, a limited stay arises that prohibits the commencement or continuation of individual actions by creditors and transfers by a debtor of interests in assets situated in the Recognizing State.[12] In addition, recognition of a foreign proceeding empowers the foreign representative to seek an order from the Recognizing Court

6. Model Legislation 6(b) cited in *Report of the Working Group, supra* note 1 [hereinafter Model Legislation]. According to the *Report of the Working Group, supra* note 1, at ¶ 51, this provision is intended to confer the narrow right of direct access to the court with the nature of the relief that may be granted being dealt with by other provisions.

7. Model Legislation art. 2(b).

8. *Id.* art. 6(a).

9. Article 7(1) of the Model Legislation currently requires that the foreign representative submit either a certified copy of the decision opening the foreign proceeding and appointing the foreign representative, a certificate of the foreign court evidencing these facts, or, in the absence of such proof, in any other manner required by the court. However, for ease of drafting and comprehension, the Working Group has agreed that these issues of proof should be included in Article 11, which deals with other aspects of recognition. *See Report of the Working Group, supra* note 1, at ¶¶ 60, 63.

10. *Report of the Working Group, supra* note 1, at ¶ 62.

11. Model Legislation art. 12(2)(a). *See Report of the Working Group, supra* note 1, at ¶¶ 115-26, and Part I. C. of this Summary for further discussion of the limited stay.

12. Model Legislation art. 12(5). *See Report of the Working Group, supra,* note 1, at ¶¶ 142-45, and Part I. D. of this Summary for further discussion of the available relief.

designed to protect the debtor's and creditors' interests in the assets within the jurisdiction of the Recognizing State.[13] Recognition also authorizes a foreign representative to request opening of an insolvency proceeding in the Enacting State if all requirements under that State's laws are satisfied.[14] Finally, recognition of a foreign proceeding constitutes rebuttable evidence that a debtor is insolvent for purposes of opening an insolvency proceeding.[15]

2. *Unresolved Issues Related to the Concept of Recognition*

Several issues related to the concept of recognition remain unresolved in the latest version of the Model Legislation. The first significant unresolved issue involves the distinction between a foreign main proceeding and a foreign nonmain proceeding. The Model Legislation provides that a foreign insolvency proceeding shall be recognized as a foreign main proceeding if the foreign court has jurisdiction based on a center of the debtor's main interests test, or as a foreign nonmain proceeding if the debtor only has an establishment in the foreign jurisdiction.[16] Neither of these terms are explicitly defined in the Model Legislation. However, it appears that a foreign main proceeding is one commenced in a jurisdiction in which a debtor has its "main interests," while a nonmain foreign proceeding is one commenced in a jurisdiction where a debtor has a "place of operations . . . and carries out a nontransitory economic activity with human means and goods" but does not have the center of its main interests.[17]

Distinguishing between main foreign proceedings and nonmain foreign proceedings is important because some members of the Working Group maintain that the relief afforded to foreign representatives of a nonmain proceeding should be more limited than the relief afforded foreign representatives in main proceedings. In this view, limiting the effect of recognition of a foreign nonmain proceedings to securing judicial cooperation only—rather than permitting a foreign representative to obtain any authority over a debtor's assets situated in the Recognizing State—reduces the likelihood that multiple nonmain proceedings will be opened in various States. This disincentive to opening multiple nonmain foreign proceedings, in turn, is intended to increase the likelihood that a debtor's assets will be administered in one main proceeding with ancillary proceedings being opened only for limited and specific purposes.[18]

13. Model Legislation art. 9.

14. It is unclear how this presumption would interact with local law on the issue of insolvency and this matter likely will be the subject of further discussion by the Working Group. *See* Model Legislation art. 16(2); *Report of the Working Group, supra* note 1, at ¶ 180.

15. Model Legislation arts. 11(1)(a), (b).

16. The quoted language is found in the definition of "establishment" currently contained in Article 2(e) of the Model Legislation. However, the Working Group has noted that this definition might be more usefully located in the article dealing with recognition, which currently is Article 11, or in Article 12, which deals with specific relief available upon recognition. *See Report of the Working Group, supra* note 1, at ¶¶ 34, 104, 147-55.

17. Resolving different views concerning the consequences of recognizing either or both of these foreign proceedings requires balancing the following fundamental principles: recognition of both main and nonmain proceedings is desired by some States; the availability of appropriate relief for both types of proceedings; the appropriate limits as the consequences of nonmain proceedings; and the necessity to coordinate between main and nonmain proceedings, particularly in light of the goal of diminishing the possibility that representatives of several foreign proceedings would seek relief in one or more States. *See Report of the Working Group, supra* note 1, at ¶ 150.

18. These members also stress that the term "recognition" has a broader meaning in the European Union Convention on Insolvency Proceedings than in the Model Legislation. Further, some members have suggested that recognition is not even necessary as a conceptual basis for granting the substantive relief envisioned by the legal regime created by the Model Legislation. Instead, they suggest that the relief to be afforded a foreign representative could simply be stated in the Model Legislation (subject to sufficient procedural safeguards) without using the term "recognition." *Report of the Working Group, supra* note 1, at ¶ 101-02.

The second significant unresolved issue relates to the meaning of the term "recognition" and its legal consequences under different States' laws. In some legal systems the term "recognition" means that a foreign judicial decision is given effect by another State's courts. Recognition, in this meaning of the term, signifies that a foreign court's judgment will be enforced pursuant to the jurisdiction of the court recognizing that foreign judgment. In contrast, the drafters of the Model Legislation intend the term "recognition" to have a more limited, and distinct, legal effect. Thus, recognition of a foreign insolvency proceeding only acknowledges the existence of a foreign insolvency proceeding, creates a limited stay on creditor and debtor actions, and confers standing on a foreign representative to obtain limited additional relief to protect a debtor's assets and to obtain judicial cooperation.[19]

The third significant unresolved issue relates to the tension between the Model Legislation's public policy exception to recognition of a foreign insolvency proceeding and the Model Legislation's express purpose to encourage and facilitate judicial cooperation. This public policy exception provides that an Enacting State may refuse recognition of a foreign proceeding (or to grant the special relief otherwise permitted under its provisions) if the effects of recognition or relief would be manifestly contrary to the Enacting State's public policy. Although the Working Group intends that this public policy exception should be interpreted strictly and should be invoked only in exceptional circumstances in which matters of fundamental importance to an Enacting State are implicated, this exception could pose a real threat to achieving a significant degree of harmonization in transnational insolvency law and practice.[20]

Finally, the types of foreign insolvency proceedings that are subject of being recognized under the Model Legislation remains unresolved. At this point in time, for example, the Working Group is undecided whether consumer bankruptcies should be included as foreign proceedings that can be recognized under the Model Legislation.[21]

C. Creation of a Limited Stay Upon Recognition

Perhaps the most remarkable provision of the Model Legislation is the automatic creation of a limited stay upon the commencement or continuation of individual actions by creditors and transfers by a debtor of interests in assets that arises only upon recognition of a foreign main proceeding. Although there is general agreement about the importance of this provision, several critical issues concerning the scope remain to be resolved in subsequent drafts of the Model Legislation.

First, this stay may not arise for some period of time after the foreign proceeding has been commenced and thus local creditors may be able to take advantage of any delay in the foreign representative's application for recognition of the foreign proceeding. Although timing of the

19. Model Legislation art. 13; *Report of the Working Group, supra* note 1, at ¶¶ 156-60.

20. Some members of the Working Group express concern that inclusion of consumer bankruptcies might reduce the willingness of some States to adopt the proposed Model Legislation. Other members suggest that States whose laws did not provide for consumer bankruptcies might exclude them from recognition under a public policy exception and these members suggest that excessive use of that exception in this area could lead to widespread use in other areas and thereby defeat the goal of encouraging recognition of foreign bankruptcies. *Report of the Working Group, supra* note 1, at ¶¶ 35-37.

21. The stay provided for in the Model Legislation is far less protective of a debtor's assets than the automatic stay created upon the commencement of a bankruptcy case under the U.S. Bankruptcy Code. Nonetheless, its inclusion represents a significant step towards facilitating the reorganization of a debtor having transnational business activities. The availability of relief to protect the assets in the Enacting State pending a decision whether to grant the application for recognition is discussed in detail at Part I. D., below.

filing of an application is within the control of a foreign representative, the Model Legislation does not impose a deadline by which the court must act on the application. Therefore, creditor actions may be taken in an Enacting State while an application for recognition is pending unless the Enacting State grants a request by the foreign representative for provisional relief to protect the local estate.[22]

Second, whether this limited stay will arise will be subject to any exceptions or limitations imposed by the law of the Enacting State to domestic proceedings that are comparable to the foreign main proceeding. Although still unresolved, it appears likely that the Model Legislation will provide that this limited stay is subject to applicable local law.[23]

Third, extending any stay to actions against the debtor's assets may not be possible in some legal systems because judicial acts can only be brought against persons. Similarly, the effect of extending the stay to actions against the debtor is not wholly certain because some legal systems exclude from any stay in insolvency proceedings certain actions (such as civil status, alimony, and certain administrative or criminal actions).[24]

Fourth, the stay may be too narrow to accomplish its intended purpose of covering all actions that might affect a debtor's assets or increase a debtor's liabilities. For example, the use of the term "actions" in describing the scope of the stay might be interpreted as not reaching nonjudicial, self-help remedies available to secured creditors in some jurisdictions. Likewise, concern has been expressed that the term "creditors" may limit the ability of a stay to reach all actions that may affect a debtor's assets in jurisdictions where a person's or entity's status as a creditor may be in dispute or may not be established by a final judgment. In response to these concerns, it appears likely that the Working Group will adopt a stay that covers "actions or proceedings concerning the debtor's assets, rights, obligations or liabilities."[25]

Fifth, because a general stay of actions against a debtor is not ordinarily provided in some jurisdictions (and may be permitted only under special conditions), courts in these jurisdictions might require proof by a foreign representative of imminent danger to the debtor's assets that would result from the continuation of individual action. Similarly, even in jurisdictions in which a stay is available but the standards under local law are very high, a concern has been expressed that these higher standards would have to be observed by a foreign representative if he is to be afforded the national treatment that is the essence of the nondiscrimination rule which underpins the Model Legislation.[26]

Finally, questions have been raised whether the automatic stay on the transfer of a debtor's assets should extend to transfers made in the ordinary course of business or whether it should only extend to transfers of an irregular nature. The consensus of the Working Group seems to be that defining regular transfers (*i.e.*, those made in the ordinary course of business) would be excessively complex and that these types of situations would better be treated as an "exception or limitation."[27]

22. Model Legislation art. 12(2)(a). Alternatively, the Model Legislation likely will permit Enacting States to provide that the applicable law is the law of the foreign main proceeding.

23. *Report of the Working Group, supra* note 1, at ¶¶ 115-18.

24. *Id.* at ¶¶ 119-26.

25. *Id.* at ¶ 122.

26. *Id.* at ¶ 123.

27. Model Legislation art. 12(2)(b)(I)-(v); *Report of the Working Group, supra* note 1, at ¶¶ 127-34. Although the Working Group acknowledged that it is unlikely an Enacting State would grant relief only permitted under foreign law, it believed that it was useful to permit this option in Article 12(2)(b)(v).

D. Relief Available to Foreign Representatives Upon Recognition

In addition to the existence of the limited stay intended to protect the debtor's and creditors' interests in the assets situated in an Enacting State, the Model Legislation affords foreign representatives access to an Enacting State's courts in order to seek judicial assistance in protecting a debtor's estate from dismemberment and distribution in favor of local creditors to the detriment of foreign creditors or a debtor's opportunity to reorganize is affairs. Several aspects of this right to access and right to seek judicial assistance merit emphasis.

First, the Model Legislation authorizes a foreign representative to request the Recognizing Court to grant appropriate relief necessary to protect the assets of the debtor and creditors' interests. Specifically, the foreign representative may request the Recognizing Court enter an order (i) staying actions not otherwise stayed or extending the automatic stay, (ii) extending any provisional relief granted pending a decision on recognition that protects a debtor's assets or creditors' interests, (iii) compelling testimony or delivery of information concerning the assets and liabilities of a debtor, (iv) permitting the foreign representative (or other person appointed under local law) to preserve and manage a debtor's assets, and (v) granting other relief available under the laws of the foreign proceeding or the laws of the Enacting State.[28] In reaching a decision whether to grant any relief, the Recognizing Court must consider whether the creditors collectively and the debtor are protected against undue prejudice and given a fair opportunity to assert their claims and defenses before granting any relief.[29] Additionally, the court may condition any relief on compliance by the foreign representative with orders of the court.[30] After recognition of a foreign proceeding is granted, the foreign representative is required to give notice of any relief granted, as well as recognition of the foreign proceeding and existence of the stay.[31]

Second, "from the time of an application for recognition until recognition is granted or refused, and where necessary to protect the assets of the debtor or the interests of the creditor . . . and upon the request of the foreign representative," the court may grant the provisional relief to protect the debtor's assets and creditors' interests. The consensus of the Working Group is that access to an Enacting State's courts by a foreign representative is not available without filing an application for recognition (unless such relief otherwise would be available to a foreign representative under the Enacting State's laws regardless of any recognition of a foreign insolvency proceeding). Once the Recognizing Court grants the relief requested, the foreign representative must give notice of this provisional relief as prescribed by the Enacting State's law. This provisional relief does not extend beyond the date recognition is granted or denied unless extended by the court after recognition.[32]

Third, the Model Legislation provides that a foreign representative appointed in a foreign proceeding is entitled to request opening of an insolvency proceeding in an Enacting State if requirements for opening a proceeding under its laws are satisfied. This right of a foreign

28. In contrast, Article 12(4) of the draft of the Model Legislation reviewed by the Working Group in October 1996 included a requirement that the court must be satisfied that creditors collectively are protected against prejudice and will be given a fair opportunity to assert their claims against the debtor.

29. Model Legislation art. 12(6); *Report of the Working Group, supra* note 1, at ¶ 146. It is anticipated that revised language bearing on this issue may be considered by the Working Group.

30. Model Legislation art. 12(2)(c).

31. *Id.* art. 12(1). Although not finally resolved, it appears that the Model Legislation is likely to be revised to clarify that access to an Enacting State's courts also will be available for interim or provisional "foreign representatives." *Report of the Working Group, supra* note 1, ¶¶ 38, 110-12.

32. Model Legislation art. 9; *Report of the Working Group, supra* note 1, at ¶¶ 71-75.

representative is independent of the right of creditors to request opening of a proceeding. However, this right is not intended to extend to opening a proceeding against a subsidiary of a debtor in the Enacting State unless that authority is conferred by the law of the Enacting State.[33]

Fourth, the general consensus is that availability of relief to a foreign representative affects neither the availability of remedies to other interested persons under local law nor the court's authority to appoint a person other than a foreign representative to preserve, administer, and manage a debtor's assets.[34]

Fifth, the Model Legislation provides that a court may deny, modify, or terminate any relief granted, including the automatic stay created as a consequence of recognition of the foreign insolvency proceeding.[35]

Several important issues regarding the relief available to a foreign representative remain outstanding. First, the intent of the Model Legislation's provision for a Recognizing Court to grant a turnover order is uncertain. As the Working Group acknowledges, a debtor's assets rarely will be physically turned over to a foreign representative. Instead, it is the administration of the debtor's assets that is to be entrusted to the foreign representative.[36]

Second, how the Model Legislation should handle the right of a foreign representative to file avoidance actions (so-called Paulist actions) is unresolved. There seems to be a consensus among that a foreign representative should have this right but that the issues raised by such actions do not lend themselves to simple and harmonized solutions. Therefore, it appears likely that avoidance actions will be eliminated as one alternative form of relief available under the next draft of the Model Legislation.[37]

Finally, when relief granted under this provision should terminate also is unresolved. It appears that the Model Legislation will provide that termination of the relief granted to a foreign representative after recognition of a foreign proceeding will be determined under local law. Until this issue is resolved, significant uncertainty and unpredictability will remain in transnational insolvency cases administered under this legal regime.[38]

E. Access of Foreign Creditors to Insolvency Proceedings in an Enacting State

The Model Legislation establishes a clear "nondiscrimination rule on treatment of foreign creditors" so that foreign creditors are treated like local creditors in all respects.[39] Several fundamental issues pertaining to this nondiscrimination rule remain. First, it remains unsettled whether foreign creditors are to be admitted to the same or equivalent class as local creditors. This issue is complicated by the fact that establishing equal treatment between foreign and

33. This latter point addresses the concern that in some States an exclusive system of licensed insolvency practioners exists and a foreign representative might not be able to be appointed to administer a debtor's assets under these local laws. *Report of the Working Group, supra* note, 1 at ¶¶ 128-32.

34. Model Legislation art. 12(5); *Report of the Working Group, supra* note 1, at ¶¶ 142-45. It is anticipated that revised language may be considered by the Working Group.

35. Model Legislation art. 12(2)(c). The Working Group likely will consider whether the Model Legislation can be revised to use a term other than "turnover" in describing the potential authority that may be granted to a foreign representative. *Report of the Working Group, supra* note 1, at ¶ 134.

36. Nonetheless, the commentary to the Model Legislation reiterates that some limited aspects of such avoidance powers might be included in a separate article under the Model Legislation in the future.

37. *Report of the Working Group, supra* note 1, at ¶¶ 136-37.

38. Model Legislation art. 10(1); *Report of the Working Group, supra* note 1, at ¶¶ 77-78.

39. *Report of the Working Group, supra* note 1, at ¶¶ 77-80.

local creditors "of the same priority" is difficult because the definitions and classes of priority of creditors vary greatly from country to country. At least some members of the Working Group believe that a rule of nondiscrimination should be understood as a rule of national treatment and the courts of each Enacting State should determine under its domestic law what priority, if any, should be afforded foreign creditors. In contrast, other members believe that a minimum standard for the treatment of foreign claims should be established to avoid an Enacting State from determining that its laws permitted exclusion of all foreign claims.[40]

Second, the status of claims asserted by foreign tax and social security authorities has presented fundamental problems. One view is that governmental claims should not be referred to explicitly in the text because it will precipitate objections from States that traditionally do not accord foreign tax and other governmental claims status equal to that accorded local tax and other fiscal authorities. Other states favor inclusion of optional language in the text permitting States to afford claims under public law (such as foreign tax and social security claims) status as general, non-priority claims and to make clear that such foreign claims are not to be treated "equally" with local claims in all respects.[41]

Third, issues pertaining to the notice that must be given to foreign creditors by the court of the commencement of a bankruptcy proceeding remain unresolved. For example, it is unresolved whether foreign creditors should be given precisely the same notice as local creditors or whether they should be given some form of special notice (such as individual notice even if publication notice is all that is required under domestic law). Similarly, if the Model Legislation requires that special notice be given to foreign creditors, one might contend that special treatment designed to meet the needs of foreign creditors (such as the language or text of the notice) violates the concept of national treatment as that term generally is understood. Concerns about the cost of providing individual notice to foreign creditors has caused some members of the Working Group to suggest that the Recognizing Court be authorized to dispense with such requirements or to order different notice appropriate under the circumstances.[42]

F. Authorization of Judicial Cooperation—Concurrent Proceedings

The third fundamental aspect of the Model Legislation is its provision for judicial cooperation in transnational insolvency cases. The Model Legislation provides that the "courts of the enacting State . . . shall cooperate to the maximum extent possible with foreign courts or competent authorities and with foreign representatives." In this regard, the Recognizing Court may request

40. *Id.* at ¶¶ 79, 82. As of October 1996, this matter was referred back to the drafting group to prepare text permitting Enacting States to have this option and thereby to clarify whether foreign tax and social security claims are to receive "equal" treatment or not under the form of the Model Legislation actually enacted.

41. The severity of this problem might be reduced if a centralized, electronic legal registry were to be established and the Model Legislation required posting notice on that registry. The Working Group also has not reached an agreement whether the Model Legislation should mandate the language that should be used in any notice to foreign creditors. Similarly, the Working Group has not decided whether all notices served on local creditors must be served on foreign creditors or whether foreign creditors should be given merely notice of the "opening of a proceeding" (whatever that means under domestic law in each Enacting State). Model Legislation art. 10(2); *Report of the Working Group, supra* note 1, at ¶¶ 86-93.

42. Although administrators are subject to court supervision in many States, the degree of control varies widely; therefore the Model Legislation likely will provide for cooperation with administrators separately from cooperation between courts. Model Legislation art. 15(1); *Report of the Working Group, supra* note 1, at ¶ 166.

information or assistance directly from the foreign court or competent authority in any matter relating to the insolvency proceeding.[43]

Although a consensus exists that multiple proceedings in a transnational insolvency case should be limited, the more effective means to accomplish that result remains the subject of debate. The Model Legislation provides that where an insolvency proceeding has been opened in a foreign jurisdiction in which the debtor has its center of main interests, the courts of an Enacting State shall have jurisdiction to open an insolvency proceeding only if the debtor has either an establishment (*i.e.*, it is doing business) or assets in the Enacting State. There was no agreement, however, whether the effect of this second proceeding should be restricted to the establishment or the assets of the debtor situated in the Enacting State.[44]

Finally, to assure fairness to all creditors in claims adjudication, the Model Legislation provides that a creditor who has received partial payment on its claim in an insolvency proceeding opened in another State may not receive payment for the same claim in an insolvency proceeding opened in the Enacting State so long as the payment to other creditors in the same class in that Enacting State is proportionately less than the payment the creditor already has received. This provision is not intended to prejudice the rights of creditors holding secured claims or in rem rights. The meaning of the term "same class" of claims may vary in different legal systems and the Working Group will seek to resolve issues related to this provision.[45]

II. The Transnational Insolvency Project of the American Law Institute

The Transnational Insolvency Project of the American Law Institute (ALI) "aims to facilitate administration of business insolvency proceedings that have transborder effects involving" the United States of America, Canada, and Mexico and to provide a "comparative delineation of bankruptcy law and practice for business insolvencies" in all three countries.[46]

This project is based on three fundamental premises. First, "that neither harmonization of the insolvency laws of the three countries nor adoption of a comprehensive treaty concerning insolvency is likely to be achievable in the near future."[47] Second, that "the Project should be limited to commercial matters and to legal entities (like corporations and partnerships), because the achievement of agreement with respect to the insolvency of natural persons implicates too many fundamental social and political issues to represent a practical goal at the present time."[48] And, third, "that the primary emphasis should be on approaches that can be implemented by private parties and by courts without the need for legislation, to the extent possible."[49]

The Transnational Insolvency Project is consistent with ALI's mission to "provide a description and analysis, both useful to practitioners and in conformity with scholarly standards," of the existing law.[50] However, although the statements of the domestic laws of all three NAFTA

43. Suggestions that the Model Legislation go further and declare a rule of international jurisdiction for insolvency cases was rejected by the Working Group because of the complexity involved and the possibility that acceptability of the Model Legislation would be reduced. *See* Model Legislation art. 16(1); *Report of the Working Group, supra* note 1, at ¶¶ 174-80.

44. Model Legislation art. 17; *Report of the Working Group, supra* note 1, at ¶ 183.

45. Geoffrey C. Hazard, Jr., *Foreword* to AMERICAN LAW INSTITUTE, TRANSNATIONAL INSOLVENCY PROJECT, INTERNATIONAL STATEMENT OF UNITED STATES BANKRUPTCY LAW, DISCUSSION DRAFT, xiii (1996) [hereinafter ALI TRANSNATIONAL INSOLVENCY PROJECT].

46. *Introduction to* ALI TRANSNATIONAL INSOLVENCY PROJECT, *supra* note 46, at 1.

47. *Id.* at 1-2.

48. *Id.* at 2.

49. Hazard, *supra* note 46, at xiii.

50. *Id.*

countries are intended to be used by lawyers and businesspersons from the other countries, they do not presuppose "familiarity with the basic domestic *corpus juris* and with the political and cultural presuppositions on which each country's laws and procedure rest."[51] This Project seeks to advance the law and practice in the area of transnational insolvencies by developing "suggested forms and protocols through which legal proceedings in one country can interface with those in the other countries."[52] Ultimately, the Project is intended "to achieve a higher level of cooperation and to reduce both the transaction costs and the risk of working at cross purposes when an insolvency has transborder effects."[53] Inherent in ALI's approach is the expectation that development of practical procedures by courts and other insolvency professionals in transnational insolvency cases will result in *de facto* harmonization of insolvency laws and practices among the NAFTA countries.[54]

In December 1996, the tentative drafts of the statements of the United States bankruptcy laws and the Canadian bankruptcy laws were endorsed by the ALI Council. Both of these draft statements will be considered for approval by the ALI members in May 1997 at the ALI Annual Meeting. The draft statement of the Mexican insolvency law currently is being prepared and the ALI expects that this preliminary draft will be considered by members of the ALI Transnational Insolvency Project at their meeting in April 1997.[55]

III. *In re* Maxwell Communication Corp.

In a case of fundamental importance to practitioners involved in structuring international commercial transactions and in handling transnational insolvencies, the Second Circuit Court of Appeals held in *In re Maxwell Communication Corp., plc,* that the doctrine of international comity precluded the application of U.S. bankruptcy laws relating to the avoidance of preferential transfers by a debtor to its creditors.[56] In doing so the court carved out a role for the judiciary to fill a void in transnational bankruptcy law and noted that "[a]lthough comity analysis does not yield the commercial predictability that might eventually be achieved through uniform rules, it permits the courts to reach workable solutions and to overcome some of the problems of a disordered international system."[57] The *Maxwell Communication* case is the most recent example vindicating the view of the ALI Transnational Insolvency Project that courts will be able to develop *de facto* rules for responding to commercial needs and realities more efficiently because they are not constrained by domestic and political considerations to the same degree or in the same manner as national legislatures.

In re Maxwell Communication involved the transnational insolvency of Maxwell Communica-

51. *Id.* at xiv.

52. *Id.*

53. Extending this *de facto* harmonization approach to its logical end admits the possibility that a "common law of transnational insolvency law and practice" will be created and that, eventually, this body of law and practice may constitute customary international law in the area. In this regard, the Project is aligned with the pragmatic approach taken by the Second Circuit Court of Appeals in *In re Maxwell Communication Corp.*, which is discussed in the following section of this Review.

54. Copies of the draft International Statement of United States Bankruptcy Law and the International Statement of Canadian Bankruptcy Law are available from the American Law Institute, 4025 Chestnut Street, Philadelphia, PA 19104-3099.

55. *In re* Maxwell Communication Corp., 93 F.3d 1036 (2d Cir. 1996). While the court also discussed other issues, including the binding effect of the confirmation order and the standard for review for appeal, this summary addresses only the comity issue.

56. *Id.* at 1053.

57. *Id.* at 1042.

tion Corporation plc (MCC), an English holding company with a majority of its assets held in the United States. On December 16, 1996, MCC filed a petition for relief under the reorganization provisions of Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. On December 17, 1996, MCC petitioned the High Court of Justice in London for an order of administration.

The English court appointed members of Price Waterhouse as administrators to manage MCC's affairs and property. The U.S. Bankruptcy Court appointed an examiner pursuant to 11 U.S.C. § 1140(c) with the authority to investigate MCC's condition and to act as a mediator with the goal of harmonizing the U.S. and the English procedures, to maximize benefits to the creditors and shareholders of MCC, and to promote rehabilitation of MCC.[58] The U.S. Examiner and the English administrators then entered into an unprecedented agreement for coordinating the cases, referred to as the "Protocol." The parties worked together to harmonize the proceedings where possible and to create a common system for administering and reorganizing MCC and for maximizing the return for creditors.[59]

While this unprecedented coordination resulted in a high level of cooperation and organization, it did not resolve all issues such as choice of law with respect to disputes among creditors. In particular, it did not resolve the applicability of the preference laws under the United States Bankruptcy Code which permit avoidance of any transfer of an interest in property of a debtor if the transfer was made to a creditor during the 90 days preceding commencement of the case, on account of an antecedent debt, while the debtor was insolvent and that enables the creditor to receive more than he would be entitled to upon liquidation of the debtor.[60] In contrast, although English insolvency statutes permit avoidance of preferential transfers, they require a showing that the debtor actually intended to place one creditor in a better position than it otherwise would have been absent the transfer.

In *In re Maxwell Communication*, MCC repaid loans to three foreign banks which had extended lines of credit to MCC during the 90 days preceding filing of the Chapter 11 petition in the U.S. Bankruptcy Court. Accordingly, the U.S. Examiner filed a complaint against the three banks in the U.S. Bankruptcy Court seeking to avoid these payments as preferences under Section 547(b). The U.S. Bankruptcy Court dismissed the complaint on the ground that Section 547 could not be given extraterritorial effect to govern transfers made abroad, and the U.S. District Court affirmed that decision on appeal.

On appeal, without addressing the extraterritoriality issue, the Second Circuit Court of Appeals affirmed the lower courts' decisions on the grounds that application of the doctrine of international comity requires U.S. courts to decline jurisdiction. In reaching that result, the Second Circuit rejected the plaintiff's contention that application of international comity was inappropriate in the context of the Bankruptcy Code. The court concluded that ". . . absent a contrary legislative direction the doctrine may properly be used to interpret any statute."[61] Indeed, the court noted that

> [c]omity is especially important in the content of the Bankruptcy Code for two reasons. First, deference to foreign insolvency proceedings will, in many cases, facilitate "equitable, orderly, and systematic" distribution of the debtor's assets. [citation omitted] Second, Congress explicitly

58. *Id.*
59. *See* 11 U.S.C. § 547(b).
60. *In re* Maxwell Communication Corp., 93 F.3d at 1036, 1048 (2d Cir. 1996).
61. *Id. citing* 11 U.S.C. § 304.

recognized the importance of the principles of international comity in transnational insolvency situations when it revised the bankruptcy laws.[62]

The Second Circuit also rejected the plaintiff's contention that use of the comity doctrine was improper because there was no true conflict between U.S. law and English law regarding preferences. In reaching that decision, the court emphasized that "a conflict between two avoidance rules exists if it is impossible to distribute the debtor's assets in a manner consistent with both rules." And, in this instance, the parties "have assumed that the 'intent' requirement in the English law would dictate a different distributional outcome than would United States law. Consequently, it is not possible to comply with the rules of both forums and the threshold requirement of a true conflict exists for purposes of comity analysis."[63]

In determining whether to apply the comity doctrine in *In re Maxwell Communication*, the Second Circuit considered the following factors: (1) the link between the regulating state and the relevant activity; (2) the connection between that state and the person responsible for the activity; (3) the nature of the activity and its importance to the regulating state; (4) the effect of the regulation on justified expectations; (5) the significance of the regulation to the international system; and (6) the extent of other states' interests, and the likelihood of conflict with other states' regulations.[64] The Second Circuit applied these elements and found that circumstances in this case supported application of the doctrine of comity; specifically, (1) the prime contacts were clearly with England and not the United States as the debtor was constituted, governed, and managed primarily in England and the creditors were mainly English, (2) there was an expectation that English law would apply, (3) the United States does not, under these specific circumstances, have a significant interest in imposing its own avoidance law, and (4) with respect to this debtor, the United States and England have crafted a unique system to harmonize two different insolvency procedures which is worth preserving.[65] In reaching its decision, the Second Circuit emphasized that "[i]t should be remembered that the interest of the system as a whole—that of promoting 'a friendly intercourse between sovereignties, (citation omitted)—also furthers American self-interest, especially where the workings of international trade and commerce are concerned."[66]

Finally, mirroring the sentiments behind the ALI Transnational Insolvency Project, the Second Circuit emphasized that:

> We recognize that forbearance and goodwill in the conduct of international bankruptcies is an ideal not easily achieved in the near-term. Many commentators advocate centralized administration of each insolvency under one country's laws, which could require a multi-lateral treaty or, even, a greater degree of harmonization of the commercial laws throughout the world. (Citation omitted). In the meanwhile, bankruptcy courts may best be able to effectuate the purposes of the bankruptcy law by cooperating with foreign courts on a case-by-case basis. . . . Although comity analysis admittedly does not yield the commercial predictability that might eventually be achieved through uniform rules, it permits the courts to reach workable solutions and to overcome some of the problems of a disordered international system."[67]

62. *Id.* at 1050.
63. *Id.*
64. *Id.* at 1048 *citing* RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 403(2) (1986).
65. *Id.* at 1053.
66. *Id.*
67. *Id.*