United States Recognition of Foreign Bankruptcies

As international trade increases and multinational corporations expand activities into more and more countries, the impact the bankruptcy of one of these institutions may have in other countries increases. As demonstrated by the fallout from the oil crisis of the early 1970s, the decline can be swift and devastating. Creditors may be faced with the prospect of concurrent insolvency proceedings in a multitude of jurisdictions. The United States has traditionally not treated foreign creditors favorably, especially when conflicting claims of United States creditors were involved. However, the enactment of the Bankruptcy Code of 1978 and the trend of recent case law reflects a more generous attitude toward their claims.

I. Bankruptcy Jurisdiction under International Law

The initial inquiry in any bankruptcy proceeding is to determine whether the court has jurisdiction over the debtor or the debtor's assets. Depending upon the country involved, this determination may significantly affect the manner in which those assets are distributed.

Under international law, bankruptcy jurisdiction may generally be established at the debtor's domicile or the principal place of a debtor's business.1 These standards have been adopted by the United States.2 In addition,
jurisdiction in the United States may be asserted on the basis of presence of property within the territory. As a general rule, when jurisdiction is asserted solely on the basis of property located within that jurisdiction, the proceeding is in rem, and any adjudication will be limited to the res, or the property located in that country. This derives from the general rule under international law that the acts of one state cannot affect property within the jurisdiction of another state.

A. INTERNATIONAL CONFLICT OF LAW RULES

The United States has adopted conflicting attitudes toward extraterritorial insolvencies, as evidenced by two international conflict of law rules. Under international law, the "universality" theory and the "territoriality" theory have developed to describe the different approaches countries may take in the international bankruptcy context. According to the universality theory, one bankruptcy adjudication over all the debtor's assets is held in the jurisdiction of the debtor's domicile to settle all claims against the debtor's estate. The trustee marshalls the debtor's assets, wherever located, to the jurisdiction of the debtor's domicile and all creditors must go to that jurisdiction to present their claims. The adjudication is to be recognized and enforced by every other jurisdiction.

The advantages to the universality approach are that it theoretically results in equitable disposition of the estate since all assets and creditors are

United States Code (hereinafter the Act or former Act). See also, Dalhuisen, supra note 1, § 204 [2] at 3-216 to 3-219. The Code removed the requirement that the place of business be the "principal" place of business.


4. Under the Bankruptcy Code as enacted in 1978, bankruptcy courts purportedly asserted exclusive jurisdiction over all property of the debtor, "wherever located." Former 11 U.S.C. § 241(a) provided that, "[t]he bankruptcy court in which a case under Title 11 is commenced shall have exclusive jurisdiction of all the property, wherever located, of the debtor, as of the commencement of such case." When jurisdiction was to be established solely on the basis of property located within the United States, this jurisdiction was not limited to the property of the debtor located within the jurisdiction, but extended to all assets of the debtor, "wherever located." This assertion of jurisdiction beyond the res attempted to convert in rem jurisdiction into in personam jurisdiction. This assertion was criticized as being "jurisdictionally improper" by Kurt Nadelmann, a well known scholar in the international bankruptcy field, in hearings before the House subcommittee considering the proposed 1978 Bankruptcy Code. See, Bankruptcy Act Revisions: Hearings on H.R. 31 and H.R. 32 Before the Subcommittee on Civil and Constitutional Rights of the House Committee of the Judiciary, 94th Congress, 2d Session, 1445 (1976) (Statement by Kurt H. Nadelmann). Although Professor Nadelmann's advice was not heeded when the Code was initially adopted, The Bankruptcy Amendments And Federal Judgeship Act of 1984 has corrected this jurisdictionally improper assertion by deleting § 241 in its entirety.


before one tribunal, and greater efficiency results since multiple adjudications in various jurisdictions are avoided. The disadvantage is that creditors may be inconvenienced by going to the debtor's domicile to assert their claims, and they may be subject to procedures which differ from those of their home countries. To be effective, all jurisdictions must adopt the universality theory and enforce foreign proceedings. In reality, most jurisdictions tend to protect local creditors when faced with the extraterritorial effect of a foreign bankruptcy proceeding over local assets. The universality theory has not been generally adopted, but may be effective with respect to some countries through bankruptcy treaties.

Under the territoriality theory, bankruptcy proceedings may concurrently take place in each jurisdiction where the debtor or its assets are located, and no extraterritorial recognition is given to these proceedings by any other jurisdiction. The advantage to this system is that local creditors are not inconvenienced and may receive better treatment in their home countries. The disadvantages are that the debtor's property located in other countries is not part of the estate of the domestic jurisdiction and therefore may be simultaneously disposed of by the debtor or transferred for the benefit of preferred creditors. Creditors seeking these other assets must attach them in the various countries where they are located. This can lead to multiple, and possibly conflicting, bankruptcy proceedings and national preferences.

B. United States Approach

The United States has not formally adopted either the universality or territoriality theory to the exclusion of the other, but has adopted principles of both. The determination of which theory to apply in any given case largely depends on the circumstances of each situation. Prior to the enactment of the Bankruptcy Code, a lengthy, although not thoroughly developed, case law history reflected the de facto adoption of the territorial view by United States courts, at least when they were called upon to recognize the effectiveness of foreign proceedings over local assets. Courts did not automatically give full recognition to foreign proceedings with proper jurisdictional foundations, but generally allowed American creditors to satisfy their claims against assets located in the United States before turning over any remaining assets to the foreign trustee. Subsequent to the enactment of the Bankruptcy Code, both bankruptcy and non-bankruptcy courts have been more

7. Id.
8. Bankruptcy Act Revisions, supra note 4, at 1445.
10. Id.
11. See infra text accompanying notes 14 to 38.
inclined to recognize the effect of foreign proceedings over assets located in the United States when they have perceived that such recognition will enhance an orderly, efficient and single administration of a debtor's estate. Although courts still examine whether the interests of U.S. creditors will be protected and whether such recognition will violate public policy, the trend has been toward greater recognition of factors underlying the universality theory.\textsuperscript{12}

Prior to the enactment of the Code, little case law or statutory authority was available to guide courts faced with claims of foreign insolvency proceedings, although ample scholarly attention addressed those issues.\textsuperscript{13} A review of the evolution of case law prior to the enactment of the Bankruptcy Code in 1978 underscores the Code's significance in the development of this area of law, as well as the apparent change in U.S. policy toward greater international cooperation through increased recognition of foreign proceedings.

II. United States Recognition Prior to 1978

American courts have been faced with the issue of how much recognition to grant to foreign insolvency proceedings almost from the time the country was founded. Even though the problem is far from new, surprisingly few courts have actually adjudicated the issue. Courts have been forced to rely on very old cases, even in the most recent decisions, since so little guidance has developed in this area.

A. Early Treatment of Foreign Bankruptcy Proceedings

Initially, American courts were hostile to foreign proceedings which attempted to reach property located within the United States. This coolness was reflected in the early U.S. Supreme Court decision of Harrison v. Sterry.\textsuperscript{14} The case involved the bankruptcy of a partnership which did business in both the United States and Great Britain. Some of the assets located in the United States had been transferred in a preferential transfer, and some had been attached by both American and British creditors. The Court held that the share of the partnership located in the United States, approximately one-third, was to be adjudicated in accordance with American insolvency laws. The British attaching creditors were not entitled to void the preferential transfer or assert any claims to the American assets

\textsuperscript{12} See infra text accompanying notes 90 to 108 and 112 to 129.
\textsuperscript{13} See, e.g., Bankruptcy Act Revisions, supra note 4; Dalhuisen, supra note 1; Nadelmann, supra note 1; Reisenfeld, The Status of Foreign Administrations of Insolvent Estates: A Comparative Survey, 24 AM. J. COMP. L. 289 (1976).
\textsuperscript{14} 9 U.S. (3 Cranch) 289 (1809).
because the "bankruptcy law of a foreign country is incapable of operating a legal transfer of property in the United States." 15

This initial hostility was tempered somewhat by the development of the rule that foreign insolvency proceedings would be recognized in the United States as long as the rights of American creditors would not be prejudiced and no public policy would be violated. An early illustration of this rule can be found in the New York case of In re the Accounting of Waite. 16 The bankrupt, Pendle & Waite, was a firm which did business in both the United States and England. Pendle was an English citizen and was domiciled there. Waite was an American citizen who resided in New York. Pendle & Waite received an assignment from a New York firm, Haynes & Sanger. Pendle & Waite became insolvent and voluntarily petitioned the London Court of Bankruptcy for an arrangement with its creditors. 17 The arrangement failed and the firm was declared bankrupt and a trustee was appointed. Waite, in the meantime, had sold the assets received under the assignment and credited the proceeds to himself, without turning any over to either his partner or the trustee. Waite petitioned the New York court to settle his accounts under the assignment, and the trustee intervened to challenge the amounts retained by Waite, arguing that they were subject to the English bankruptcy and should be turned over to be included in that proceeding. All claims of U.S. creditors against the firm had previously been satisfied out of other assets.

The court held that the proceeds Waite received under the assignment were to be turned over to the British trustee. It reasoned that even though statutes of foreign countries were not automatically given effect in the U.S., comity allowed courts to recognize foreign bankruptcy trustees and enforce their claims to assets located in the U.S., provided that such recognition and enforcement could be accomplished "without injustice to our own citizens, and without prejudice to the rights of creditors pursuing their remedies here under our own statutes." 18 In addition, such recognition could not conflict with public policy, and the foreign bankruptcy court must have had proper jurisdiction over the debtors. The court found that the British proceeding had proper jurisdiction over Waite since he had voluntarily submitted to its jurisdiction, and that the trustee could reach the assets located in the United States since British law transferred title of all the debtor's personal property, wherever located, to the trustee. Since no American creditors would be damaged, the assets were turned over to the trustee in accordance with

15. Id. at 302.
17. Waite voluntarily submitted to the jurisdiction of the London court, which was recognized as a proper basis for jurisdiction by both the English and New York courts. Id. at 439.
18. Id. at 448, 2 N.E. 440, 450.
public policy to avoid assisting Waite in perpetrating a fraud against his partner and creditors.

The initial hostility toward foreign proceedings was tempered even further in the U.S. Supreme Court's decision in Canada Southern Railroad v. Gebhard in 1883. The Canadian Southern Railroad Co. was a Canadian corporation which had been created by the Canadian government to build and operate a railroad. Bonds had been issued to finance the enterprise, but the company found itself unable to meet its obligations under the bonds. A restructure of the debt was arranged by an arm of the Canadian government, and consented to by a majority of the bondholders. The restructure called for an exchange of outstanding bonds for new bonds, and a waiver of overdue interest payments. Disgruntled U.S. bondholders, who had not consented to the arrangement, sued the railroad company in the United States to require it to honor the terms of the original bonds, and to refuse the tender of the less attractive new bonds.

The Court dismissed the claims of the U.S. bondholders and held that the terms of the Canadian arrangement were binding on them. The Court based its decision on three grounds. First, the Court noted the quasi-governmental character of the railroad since it was specifically created for a public purpose, was subject to the exclusive legislative authority of the Canadian Parliament, and the reorganization had been structured and implemented by the government. These quasi-governmental actions commanded greater respect than if they had been accomplished by the private sector. Second, the Court indicated that the U.S. bondholders had impliedly consented to be bound by Canadian law by voluntarily contracting with the Canadian corporation. Third, the Court discussed the nature of reorganizations, and adopted a universality approach:

Unless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to have legalized, the scheme may fail. All home creditors

19. 109 U.S. 527 (1883).
20. The Court stated that, every person who deals with a foreign corporation impliedly subjects himself to such laws of the foreign government, affecting powers and obligations of the corporation with which he voluntarily contracts, as the known and established policy of that government authorizes. To all intents and purposes, he submits his contract with the corporation to such a policy of the foreign government, and whatever is done by that government in furtherance of that policy, which binds those in like situation with himself, who are subjects of the government, in respect to the operation and effect of their contracts with the corporation, will necessarily bind him. He is conclusively presumed to have contracted with a view to such laws of that government, because the corporation must of necessity be controlled by them, and it has no power to contract with a view to any other laws with which they are not in entire harmony. It follows, therefore, that anything done at the legal home of the corporation, under the authority of such laws, which discharges it from liability there, discharges it everywhere. Id. at 537-38. This rationale has been criticized because it cuts both ways. See infra text accompanying note 110.
can be bound. What is needed is to bind those who are abroad. Under these circumstances the true spirit of international comity requires that schemes of this character, legalized at home, should be recognized in other countries.21

B. Comity Equated with the Protection of Local Creditors

If Gebhard indicated a trend toward greater recognition of foreign proceedings, that trend was curbed with the renowned U.S. Supreme Court case of Hilton v. Guyot in 1895.22 The defendants in Hilton were American merchants who conducted business in France, and who were sued there for overdue payment obligations. The Americans removed all their assets from France before a judgment was rendered against them. Unable to enforce the judgment in France, the French parties sued the Americans in the United States to enforce their judgment.

Hilton is significant because it firmly established the rule that U.S. courts are to look to the principle of comity to determine whether foreign proceedings or judgments should be recognized or enforced in the United States. The Court noted the rule of international law that "[n]o law has any effect, of its own force, beyond the limits of the sovereignty from which its authority is derived."23 The extent to which any country gives effect to the laws of another country is based on the principle of comity. According to the Court,

"Comity," in the legal sense, is neither a matter of absolute obligation on the one hand, nor of mere courtesy and good will upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.24 Under this rule of comity, courts are allowed, but not required, to recognize foreign laws, judgments or proceedings, depending on the circumstances of each case.25

In Hilton, the Court examined the American defendants' argument that the Court should decline to enforce the foreign judgment since the differences in procedures between American and French law were so great that basic principles of fairness would be violated if the French proceeding was enforced. They pointed out that in the French proceeding no oath was required of the witnesses, no cross-examination was allowed, and documents and other evidence which would have been inadmissible under American law were admitted. The Court rejected the claim that these differences

21. 109 U.S. at 539.
22. 159 U.S. 113 (1895).
23. Id. at 163.
24. Id. at 164.
25. As a prerequisite it is assumed that each proceeding or judgment sought to be recognized or enforced is jurisdictionally proper. Id. at 166.

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in and of themselves were sufficient to impeach the foreign judgment since it was conceded that the proceeding had been conducted in accordance with French law. The Court did not specifically consider whether the claims of U.S. citizens would be impaired if the French judgment was recognized because it found an independent basis for denying recognition under the principle of comity: the "want of reciprocity, on the part of France, as to the effect to be given to the judgments of this and other foreign countries." Although not specifically discussed in Hilton, several comity considerations may be examined in balancing the interests between international duty and the protection of local citizens. Factors which weigh in favor of granting extraterritorial effect to foreign laws include increased international cooperation through reciprocal recognition, economic and efficient use of judicial resources, and avoidance of multiple proceedings against the same debtor. Factors which weigh against recognition of foreign proceedings include the desire to protect local creditors, the inconvenience U.S. creditors would suffer in being forced to assert their claims abroad, and differences in bankruptcy laws which may violate basic principles of fairness according to U.S. standards. These factors, among others, must be weighed in light of the facts of each case to determine whether foreign proceedings should be recognized under the principles of comity.

After Hilton, courts generally adopted the rule initially set forth in Gebhard, that comity would be balanced to recognize foreign proceedings as long as local citizens' interests were not prejudiced and no public policy would be violated. For instance, in Disconto Gesellschaft v. Umbreit, the U.S. Supreme Court affirmed the ability of a state to satisfy the claims of local creditors before assets would be turned over to a foreign trustee, even though the trustee had a prior attachment to those assets. In Disconto Gesellschaft, a German citizen, Gerhard Terlinden, moved to Wisconsin and deposited $6,420 in a Wisconsin bank. A month later he was found to be a "fugitive from justice" and was extradited to Germany. Disconto Gesellschaft, a German banking corporation in Berlin, garnished the deposit in the Wisconsin bank and commenced an action there to include the garnished funds in a bankruptcy proceeding against Terlinden in Germany. Augustus Umbreit, a resident of Wisconsin, intervened to have the deposit turned over to him to satisfy a bill for services rendered to Terlinden while he was in

26. Id. at 204–205.
27. Id. at 210. The reciprocity requirement has been criticized as counterproductive to the goal of obtaining increased recognition of U.S. judgments abroad, and appears to no longer be persuasive in the United States. See, e.g., Fotochrome, Inc. v. Copal Co., 517 F.2d 512, 516 (2d Cir. 1975); Cunard Steamship Co. v. Salen Reefer Services, 49 BANKR. 614. (RWS), Slip op. (S.D.N.Y. May 2, 1985); Morales & Deutch, Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity, 39 BUS. LAW. 1573, n. 10 (1984).
Wisconsin. The conflict was brought before the Wisconsin Supreme Court, which held that claims of the Wisconsin citizen were to be satisfied before any funds could be transferred to foreign creditors.

The U.S. Supreme Court affirmed, citing *Hilton*, and noting that whether a state should allow property to be removed from its jurisdiction to satisfy foreign claims was not a matter of absolute right for the foreign creditors, even though their garnishments were made prior to those of local creditors, but that such turnover could be granted as a matter of comity. According to the "well-recognized rule between states and nations which permits a country to first protect the rights of its own citizens in local property before permitting it to be taken out of the jurisdiction for administration in favor of those residing beyond their borders," each state could determine as its own public policy how much recognition it would grant to foreign proceedings. Wisconsin's decision to favor its local creditors was therefore affirmed.

This interpretation of comity was also persuasive in *In re Stoddard and Norsk Lloyd Insurance Company, Limited*. The debtor was a Norwegian insurance company which had deposited funds with the New York Superintendent of Insurance as security in order to establish its business in New York. When the insurance company became insolvent, the superintendent took possession of the funds and petitioned the court to determine how the funds were to be allocated. Three types of claims to the funds were asserted: first, claims under policies issued to U.S. residents by agencies of the insurance company doing business in the United States, second, claims under policies issued to U.S. residents by agencies operating outside the United States, and third, claims under policies issued to nonresidents by agencies operating outside the United States.

The court held that the receiver of the insurance company was entitled to transfer the funds to Norway after the claims of the first class, *i.e.* claims by U.S. residents under policies issued by agencies of the insurance company doing business in the United States, had been fully paid. Claims asserted under the second and third classes were not to be paid out of any remaining funds; those funds were to be transferred to the Norwegian receiver. The court found that claims under policies which had been issued by agencies operating outside the United States were not intended to be covered by the fund, since its creation was directly related to the establishment of agencies operating within the United States. Nevertheless, even though the claims of the local policyholders under the second class were not to be paid out of the fund, the court protected their interests by holding that their claims could be proven in ancillary proceedings in the United States to avoid the expense and inconvenience of being forced to go to Norway to present their claims.

29. *Id.* at 582.
This interpretation of comity was also looked to in *Fincham v. Income From Certain Trust Funds*. The court held that a British trustee, who had acquired title to assets of a United States trust under a British insolvency proceeding, was entitled to transfer those assets to be included in the British proceeding since no injustice to U.S. creditors would result.

Rules of comity were not dispositive in every claim made by a foreign insolvency proceeding to assets located in the United States. For example, if a U.S. court was presented with claims asserting jurisdiction over real property located in the United States, the court did not apply the principles of comity. It is a recognized principle of international law that one country cannot affect rights to real property located in another jurisdiction. This rule was applied in *In re Delahanty's Estate*, in which the Arizona Supreme Court held that British trustees in bankruptcy with an assignment from the bankrupt of his rights to real and personal property in Arizona was ineffective as a transfer of title to the real property. Similarly, if a foreign proceeding violated basic principles of justice and fairness as applied by U.S. laws, the foreign proceeding would not be recognized.

C. Continued Protection of Local Creditors during the Decade Preceding the Enactment of the Code

More recent cases prior to the enactment of the Code continued to apply this interpretation of comity in deciding whether to recognize foreign proceedings. For instance, in *Waxman v. Kealoa*, the plaintiff was the trustee in a Canadian bankruptcy proceeding against a Hawaiian corporation, and the defendants, who were residents of Hawaii, were the incorporators and shareholders of the corporation. The trustee instituted suit in Hawaii to recover unpaid stock subscriptions the defendants owed to the corporation. The court rejected the defendants' challenges to its jurisdiction and held that, in accordance with the principles of comity, it would recognize the claims under the foreign proceeding unless the claims of local creditors would be impaired by such recognition. Since the defendants were unable to show that any local creditors would be prejudiced by extending comity to the Canadian proceeding, it was recognized and the defendants' motion to dismiss was denied.

Similarly, in *In re Colorado Corp.*, the Tenth Circuit found that since no

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32. 11 Ariz. 366, 95 P. 109 (1908).
35. 531 F.2d 463 (10th Cir. 1976).
prejudice to local creditors could arise by allowing foreign creditors to participate in voting for a trustee in a U.S. proceeding when that trustee would subsequently be subject to U.S. law, those foreign creditors would be allowed to participate.

In a recent case involving a Canadian trustee, the Second Circuit recognized the close relationship between the United States and Canada as sister common law jurisdictions as an additional factor to be weighed when balancing comity considerations. In *Clarkson Co. v. Shaheen* a duly appointed Canadian trustee sought to recover records from two New York offices of the bankrupt Canadian corporation. The defendants, officers of the bankrupt corporation, opposed the Canadian order requiring them to turn over the records on the ground that the Canadian order had been fraudulently obtained. The Second Circuit recited the rule of comity that foreign proceedings are to be recognized unless they would prejudice the rights of local creditors or violate public policy, and held that "[t]hese exceptions to the rule of comity are construed especially narrowly when the alien jurisdiction is, like Canada, a sister common law jurisdiction with procedures akin to our own." The court rejected the fraud claims on the ground that they were mere allegations and had not been adequately proven. Absent any convincing proof of fraud or prejudice to U.S. citizens, the Canadian proceedings were recognized and enforced.

These cases and the rules they established were the guidelines for courts faced with the extraterritorial assertion of foreign bankruptcy proceedings in the early 1970s. Comity is still the guideline for non-bankruptcy courts today. This slow and intermittent development of case law established a general rule, but no unifying federal bankruptcy law addressed these issues. Foreign bankruptcy trustees were forced to seek recognition in state or federal courts and were faced with the prospect that each state could establish its own rules under its particular interpretation of comity. This was the status of the law when the Herstatt affair shook the international banking and legal communities in 1974.

III. Herstatt: The Catalyst for Change

The Herstatt affair highlighted the underdeveloped status of United States law respecting foreign insolvency proceedings. The inability to address the issues presented by the Herstatt affair has been greatly remedied by the enactment of the Bankruptcy Code of 1978. To understand the significant impact the Herstatt affair and two similarly significant cases had on the Code, the events should be reviewed.

36. 544 F.2d 624 (2d Cir. 1976).
37. Id. at 629–630.
38. See infra text accompanying notes 112 to 129.
Bankhaus I.D. Herstatt K.G.a.A. (Herstatt), one of Germany's largest commercial banks, was engaged in the speculative foreign exchange market. Although Herstatt did not do business in New York in that it did not have an agency, branch or office there or anywhere else in the United States, it did use Chase Manhattan Bank, N.A. (Chase) in New York as its principal clearinghouse for foreign exchange transactions. Herstatt suffered extensive losses on its exchange transactions, and on June 26, 1974, it was closed by German banking authorities. Although the bank was closed at the end of the banking day in Germany, the day had just begun in New York. When Chase heard of Herstatt's closing, it decided to "freeze" its accounts, i.e., it refused to honor approximately $620 million in payment orders for exchange transactions, but continued to accept credits to the account. Herstatt's creditors from around the world quickly became aware of the account held by Chase, and raced to attach it. The account was assumed to be large and, in fact, held more than $150 million. Within days attachments exceeded $200 million.

In the meantime, a liquidator and receiver for Herstatt had been appointed by the Cologne District Court under the German Arrangements Law. The liquidator cabled a demand on Chase to return the funds to Germany to be included in the German proceedings. To determine the rights of the liquidator and the attaching creditors, including its own claim for five million dollars, Chase filed an interpleader action in the federal district court in Manhattan. The claimants all filed papers describing their claims, with the noticeable exception of the German liquidator. On the advice of counsel, the liquidator chose not to participate in the interpleader action, probably fearing he would subject himself and the Herstatt estate to the full jurisdiction of the District Courts and the possible res judicata effect a New York determination may have had on the German proceeding.

On August 6, 1974, Citibank unexpectedly initiated an involuntary bankruptcy proceeding against Herstatt in the Southern District of New York. The proceeding was designed to wipe out the attachments of the Chase account. The attaching creditors quickly challenged Citibank's ability to initiate an involuntary bankruptcy proceeding on the ground that Herstatt was a banking corporation, and that such institutions were expressly not subject to the provisions of the former Act. Under the former Act, banks were excluded from the definition of debtors on the ground that the in-

40. An issue was also raised whether Herstatt was a corporation since it was organized as a K.G.a.A. in Germany, which has characteristics of both corporations and partnerships. See Becker, supra note 39, at 1293.
solvency of these institutions was adequately governed by applicable state and federal banking authorities.\textsuperscript{41} Citibank's challenge raised a crucial, previously unlitigated issue: did the exclusion of banking corporations from the jurisdiction of the former Act apply to foreign banks which were not engaged in the banking business in the United States?

To resolve this issue, the court was only able to look to the specific statutory language defining debtors and the underdeveloped comity doctrine for guidance. Uncertainty over the position the court would take on this issue and the lengthy time period anticipated for final determination essentially forced Herstatt's creditors to settle their claims. The need for these creditors to create their own solution highlighted the inability of American law to provide satisfactory guidance in this international context.

The motivation to settle had been further enhanced by a May, 1976 decision of another bankruptcy court in New York of similar issues. In \textit{In re Israel—British Bank (London) Ltd. v. Federal Deposit Insurance Corporation},\textsuperscript{42} a London bank which had never done business in the United States commenced a voluntary bankruptcy proceeding in the bankruptcy court in New York to recover funds held by its New York correspondent banks.\textsuperscript{43} These funds had been attached by United States creditors. The court ruled it had subject matter jurisdiction by holding that the language excluding banks from the scope of the former Act did not apply to foreign banks.\textsuperscript{44}

This holding was affirmed and expanded the following year in \textit{In re Banque de Financement, S.A. (Finabank)}.\textsuperscript{45} The debtor, Finabank, was a Swiss banking corporation which was rendered insolvent when one of its customers defaulted on its obligations to Finabank under foreign exchange contracts. Chase and the First National Bank of Boston (FNBB) were

\begin{itemize}
  \item \textsuperscript{41} See infra note 53.
  \item \textsuperscript{43} Foreign corporations which did not do business in the United States but which had assets located there were entitled to commence voluntary bankruptcy proceedings under section 2(a)1 of the former Act.
  \item \textsuperscript{44} This decision was reversed by the district court and reversed again by the court of appeals in the Second Circuit. In reaching this decision, the court of appeals looked to legislative history excluding banking corporations from the former Act. It found that banking corporations had been excepted from the scope of the Act because separate federal and state regulations supervised the failure of these institutions. Congress respected these regulatory authorities in exempting banking corporations from the Act. No such rationale could be applied to foreign banks not doing business in the United States since they were not subject to federal or state regulations. The court also noted that if the London bank was not subject to bankruptcy jurisdiction, the attachments of a few creditors would be valid and have priority over other creditors, both American and foreign. To prevent this inequitable result, the court ordered the assets returned to the London receiver so they could be equitably distributed pursuant to the London proceeding. 536 F.2d at 511–515.
  \item \textsuperscript{45} 568 F.2d 911 (2d Cir. 1977).
\end{itemize}
Finabank's correspondent banks in New York. Like Herstatt, Finabank did not do business in the United States. After a petition for reorganization was filed by Finabank in Switzerland, Chase and FNBB attached a deposit by Finabank with Continental Bank International. Only a few hours before the four-month preference avoidance period under the former Act had expired, Finabank voluntarily filed a petition for arrangement under Chapter 11 with a New York bankruptcy court. The bankruptcy judge granted motions by Chase and FNBB to dismiss the petition on two grounds: first, the judge found that Finabank was a "banking corporation" and therefore excluded from the scope of the former Act, and, second, the judge found that no prospect of rehabilitation appeared since all efforts by Finabank to recover funds from its defaulting customer had failed, and since Finabank could not provide the court with a complete list of its creditors since such disclosure was prohibited by Swiss banking secrecy laws. The trial court affirmed, citing the 1908 case *Disconto v. Gesellschaft*, and held that the claims of the U.S. creditors should be protected before permitting the funds to be taken out of the country "for administration in favor of those residing beyond its borders."

The court of appeals reversed, based on its interpretation of the former Act. It reversed the finding that foreign banks were not subject to the former Act, citing its decision in *IBB* which had been rendered during the appeal. Instead of looking to the principles of comity, the court looked to section 2(a)(22) of the former Act. This section allowed bankruptcy courts to hold ancillary proceedings to foreign proceedings to assist in the administration of assets located within the court's jurisdiction. According to the court, that section provided the jurisdictional authority to allow courts to foster "one of the basic purposes of the Act, i.e., equal distribution among creditors" in the international context. The court held that the lower courts had abused their discretion in dismissing Finabank's petition since the petition had been filed to avoid the preferential claims of Chase and FNBB. It rejected assertions that comity required local creditors to be protected, noting that this interpretation would have authorized preferential transfers in contradiction with the purposes of the former Act. The court also reversed the findings that Finabank had no prospect of rehabilitation on other grounds. The deposited funds were ordered transferred to Switzerland to be administered along with Finabank's other assets.

Although *IBB* and *Finabank* resolved the issue of whether foreign banks not doing business in the United States could be voluntary debtors under the

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46. *See supra* text accompanying note 28.
47. 568 F.2d at 921.
49. 568 F.2d at 918.
former Act, many issues regarding recognition of foreign insolvency proceedings were left unresolved. Finabank's refusal to apply the interpretation of comity which had developed under common law threw into question what authority and guidelines bankruptcy courts were to follow when presented with these internationally sensitive issues. By enacting the Bankruptcy Code of 1978, Congress provided significant direction for bankruptcy courts faced with claims of foreign insolvency proceedings.

IV. The Bankruptcy Code of 1978: Section 304 and Its Interpretation

By 1970, general dissatisfaction with the adequacy of the former Act prompted Congress to create a Bankruptcy Review Commission to evaluate the Act and recommend changes. After two years and extensive public hearings, the Commission submitted its findings together with a proposed draft of a new Bankruptcy Code. The frustration of the Herstatt affair and the lack of statutory direction in IBB and Finabank prompted extensive expansion of sections of the Code dealing with foreign insolvency proceedings and foreign representatives. It was hoped that the expansion of the sections of the Code addressing foreign insolvency issues would encourage other countries to adopt similar provisions and enhance the probability that U.S. bankruptcy proceedings would receive greater recognition abroad.

A. FOREIGN BANKS AS DEBTORS UNDER THE CODE

Although it had been decided in IBB and Finabank, Congress addressed the issue of whether foreign banks could be debtors under the Code and come within the jurisdiction of the bankruptcy courts. Section 109 of the Code, which defines who may be a debtor, provides that a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, or credit union engaged in such business in the United States may not qualify as a debtor and therefore is not subject to the jurisdiction of the Code. These institutions are excluded since alternative provisions for their


51. In a note in the 1973 draft of the Code prepared by the Commission on the Bankruptcy Laws of the United States, it was stated that "recognition accorded a foreign trustee . . . should enhance the likelihood that a trustee of an estate appointed or elected in this country will be accorded respect when he sues to recover property located abroad." Bankruptcy Act Revisions, supra note 4, at 1443 and 1448. Nadelmann criticized this rationale in his statements to the Subcommittee on the ground that reciprocity had not presented problems for United States trustees. Id. See also Honsberger, supra note 5, at 671.

52. 11 U.S.C. § 109(b)(3)(1982) provides as follows: "A person may be a debtor under Chapter 7 of this title only if such person is not . . . (3) a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, or credit union, engaged in business in the United States."
liquidation exist under various federal and state regulations.\textsuperscript{53} Conversely, a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, or credit union not engaged in such business in the United States is subject to federal bankruptcy jurisdiction.\textsuperscript{54} Federal and state regulatory laws do not apply to these entities, so the bankruptcy laws are the only laws applicable to the administration of any assets located in the United States.\textsuperscript{55}

In addition to addressing this issue, Congress distinguished the ability of foreign banks to be voluntary or involuntary debtors under the Code. Foreign banks which are engaged in the banking business in the United States may commence voluntary proceedings under Chapter 7 or Chapter 11 of the Code,\textsuperscript{56} but involuntary proceedings may only be commenced under Chapter 7 and a foreign proceeding concerning such bank must be pending.\textsuperscript{57} The Senate Judiciary Report indicates that this distinction was made to prevent creditors from "essentially closing down" a foreign bank by commencing an involuntary proceeding unless that bank is afforded the protections of a proceeding abroad.\textsuperscript{58} It has also been suggested that since a foreign bank is presumed to be large, its bankruptcy could potentially endanger the financial stability of its home country. To prevent creditors from exercising this kind of power, commencement of involuntary proceedings have been conditioned upon the existence of a concurrent proceeding against such bank in its home country.\textsuperscript{59}

An inconsistency in the Code arises out of this distinction. Section 303(k) specifically provides that these special rules for involuntary proceedings apply to "foreign banks."\textsuperscript{60} Yet, section 109(b)(3) of the Code refers to other banking type entities in addition to foreign banks in setting forth who may be a debtor.\textsuperscript{61} The Code does not define the difference between a foreign "bank" and a "savings bank," a "cooperative bank" or a "savings and loan association." Perhaps in some countries there is no difference between these entities. Should a U.S. court define the foreign entity accord-

\textsuperscript{54} Id.; 11 U.S.C. § 109(b)(3) (by inference).
\textsuperscript{55} See S. Rep. No. 989, supra note 53.
\textsuperscript{56} 11 U.S.C. §§ 109(b)(3), (d).
\textsuperscript{57} 11 U.S.C. § 303(k)(1982) provides as follows:

"Notwithstanding subsection (a) of this section, an involuntary case may be commenced against a foreign bank that is not engaged in such business in the United States only under Chapter 7 of this title and only if a foreign proceeding concerning such bank is pending."

\textsuperscript{58} S. Rep. No. 989, supra note 53, at 5821. Although section 303(k) simply specifies that a "foreign" proceeding against the bank must have been commenced, it should be presumed that Congress intended for this foreign proceeding to take place in the jurisdiction of the bank's incorporation or creation.

\textsuperscript{59} Honsberger, supra note 5, at 640.
\textsuperscript{60} 11 U.S.C. § 303(k) (1982).
\textsuperscript{61} See supra note 52.
ing to its foreign definition or the nature of its status if it were a United States entity? Even in the United States it is far from clear how to distinguish between banks and other related entities, as evidenced by the recent discussions and regulations relating to non-bank banks. Future revisions of the Code should either include the related bank entities of section 109(b)(3) with the involuntary proceeding rules of section 303(k), or clearly define the distinctions between foreign banks and these related entities.

B. FOREIGN TRUSTEE: SPECIAL JURISDICTIONAL STATUS

As a response to the reluctance of the German liquidator in the Herstatt affair to appear in the New York bankruptcy proceedings, Congress allayed the fears of foreign trustees by setting forth guidelines to encourage them to appear in the United States and seek relief of United States bankruptcy courts. To qualify as a foreign representative, the petitioner must be a "duly selected trustee, administrator, or other representative of an estate in a foreign proceeding." Foreign representatives may petition for relief under sections 303, 304 or 305 of the Bankruptcy Code. They may submit to the jurisdiction of the bankruptcy court for such limited purposes without being exposed to the jurisdiction of any other United States court for any other purpose. The bankruptcy court may recognize this limited jurisdiction, but condition any order for requested relief on compliance by

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63. See supra text accompanying note 39.
64. 11 U.S.C.A. § 101 (20). A foreign proceeding is broadly defined as one 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 U.S.C. 101 (19).
65. 11 U.S.C. § 306 provides as follows:

An appearance in a bankruptcy court by a foreign representative in connection with a petition or request under section 303, 304, or 305 of this title does not submit such foreign representative to the jurisdiction of any court in the United States for any purpose, but the bankruptcy court may condition any order under section 303, 304, or 305 of this title on compliance by such foreign representative with the orders of such bankruptcy court.

According to the House and Senate report, the inclusion of this limited appearance in the Code is necessary to allow the foreign representative to present his case and the case of the foreign estate, without waiving the normal jurisdictional rules of the foreign country. That is, creditors in this country will still have to seek redress against the foreign estate according to the host country's jurisdictional rules. Any other result would permit local creditors to obtain unfair advantage by filing an involuntary case, thus requiring the foreign representative to appear, and then obtaining local jurisdiction over the representative in connection with his appearance in this country. That kind of bankruptcy law would legalize an ambush technique that has frequently been rejected by the common law in other contexts.

See supra note 53, at 5822.
the foreign representative with various requirements of the bankruptcy court.66

C. RELIEF AVAILABLE TO FOREIGN TRUSTEES

Five forms of relief are available to foreign representatives under the Code.67 First, the foreign representatives may commence an involuntary proceeding under Chapter 7 or 11 against a foreign debtor as an ancillary case to a foreign proceeding.68 Under the former Act, foreign representatives could not commence proceedings in United States courts unless they convinced local creditors to petition on their behalf.69 By conducting an ancillary proceeding in the United States, the foreign trustee can administer assets located in the United States in a manner which is consistent with a foreign proceeding.

Second, a foreign representative may seek to enjoin the commencement or continuation of any actions against the debtor or its property, the enforcement of any judgment against the debtor with respect to such property, or the commencement or continuation of any proceeding to create or enforce a lien against the debtor or its property.70 This section recognizes that if U.S. proceedings unduly interfere with foreign proceedings, the U.S. proceed-

68. 11 U.S.C. 303(b)(4), 304(a)(1982). Section 303(b)(4) provides as follows: "An involuntary case is commenced by the filing with the bankruptcy court of a petition under Chapter 7 or 11 of this title ... by a foreign representative of the estate in a foreign proceeding concerning such person." Section 304(a) provides as follows: "A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative."
69. 2 Collier Bankr., § 304.01 at 304-4 (L. King 15th ed. 1985); Honsberger, supra note 5, at 644. However, as evidenced by the IBB and Finabank cases, under the former Act courts could recognize foreign proceedings on the basis of comity. See supra text accompanying notes 42-49.
70. 11 U.S.C. § 304(b)(1)(1982). Section 304(b) provides as follows:
   (b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may—
   (1) enjoin the commencement or continuation of
   (A) any action against—
   (i) a debtor with respect to property involved in such foreign proceeding; or
   (ii) such property; or
   (B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
   (2) order turnover of the property or such estate, or the proceeds of such property, to such foreign representative; or
   (3) order other appropriate relief.
ings may be enjoined to encourage a single, consistent administration of the estate.\footnote{71}

Third, a foreign representative may request the court to order the property of the debtor or the proceeds of such property to be turned over to the foreign representative to be included as part of a foreign proceeding.\footnote{72} This turnover may be conditioned upon compliance with certain court orders designed to protect the rights of local creditors before the property is released from the court's jurisdiction.\footnote{73}

Fourth, a foreign representative can ask for "other appropriate relief" of the bankruptcy court.\footnote{74} This catchall provision allows the court flexibility in determining the appropriate remedy under the circumstances. For example, it has been used to allow a foreign representative to conduct discovery proceedings in the United States to assist in a foreign proceeding.\footnote{75}

Finally, under section 305 of the Code, a foreign representative may request a court to abstain from any adjudication of issues relating to a debtor or its property, and to suspend or dismiss all such proceedings. A court may grant this relief either if such dismissal or suspension would be in the best interests of the creditors and the debtor, or if a foreign proceeding is pending and the factors of section 304(c), discussed below, are met.\footnote{76} Section 305 allows a bankruptcy court to decline jurisdiction over an entire case\footnote{77} at any

\footnote{71. See infra text accompanying note 127.}
\footnote{72. 11 U.S.C. § 304 (b) (2) (1982).}
\footnote{73. In re Lineas Areas de Nicaragua, S.A., supra note 66, and text accompanying note 92.}
\footnote{74. 11 U.S.C. § 304(b) (3) (1982).}
\footnote{75. Angulo v. Kedzep Ltd., 29 BANKR. 417 (S.D. Tex. 1983). Section 304 (b) (3) has also been used to appoint an independent U.S. trustee to protect creditors. See In re Lineas Areas de Nicaragua, supra note 66.}
\footnote{76. 11 U.S.C. 305 (1982). Section 305 provides as follows:
(a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if—
(1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or
(2)(A) there is pending a foreign proceeding; and
(B) the factors specified in section 304(c) of this title warrant such dismissal or suspension.
(b) A foreign representative may seek dismissal or suspension under subsection (a)(2) of this section.
(c) An order under subsection (a) of this section dismissing a case or suspending all proceedings in a case, or a decision not so to dismiss or suspend, is not reviewable by appeal or otherwise.
This relief may be appropriate, for example, if an arrangement is being worked out by creditors and the debtor out of court, there is no prejudice to the results of creditors in that arrangement, and an involuntary case has been commenced by a fed recalcitrant creditors to provide a basis for future threats to extract full payment. The less expensive out-of-court workout may better serve the interests in the case. S. Rep. No. 989, supra note 53, at 5822.}
\footnote{77. Id. at 5821.}

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time after notice and a hearing has been held.\textsuperscript{78} This type of relief is particularly significant because a court's decision to dismiss or suspend under section 305\textsuperscript{79} is not reviewable by appeal or otherwise.\textsuperscript{80}

D. FACTORS TO BE CONSIDERED IN GRANTING APPROPRIATE RELIEF: SECTION 304(c)

Bankruptcy courts are specifically directed to look to the factors set forth in section 304(c) to determine if an injunction, turnover of assets or other appropriate relief should be granted under 304(b).\textsuperscript{81} These factors are also to be examined to determine if abstention under section 305(a)(2) should be granted when a foreign proceeding is pending.\textsuperscript{82} Section 304(c) directs bankruptcy courts to

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 or interest 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.\textsuperscript{83}

These factors demonstrate the concurrent adoption of both the "universality" and "territoriality" theories of bankruptcy jurisdiction\textsuperscript{84} as guidelines for U.S. bankruptcy courts. The first, third and fourth factors reflect the universalist approach since they would seem to encourage a single, comprehensive disposition of a debtor's estate which would treat all creditors equally and ignore preferential or fraudulent transfers which might occur if proceedings were held in various jurisdictions.\textsuperscript{85} The second and

\textsuperscript{78} 11 U.S.C. § 305(a)(1982). Abstention was granted in Buffington v. First Service Corp., 672 F.2d 687 (8th Cir. 1982). The bankruptcy judge decided to abstain from exercising the court's jurisdiction since, after an adversary hearing, it did not appear that the debtor was a proper candidate for the reorganization sought. Similarly, in In re Trackman, 33 Bankr. 780 (S.D.N.Y. 1983), section 305 was used to suspend a petition for relief requested under section 304 in order to encourage a consolidated interpleader action concurrently underway in a U.S. district court.

\textsuperscript{79} (or a court's decision not to dismiss or suspend).

\textsuperscript{80} 11 U.S.C. § 305(c)(1982).

\textsuperscript{81} 11 U.S.C. § 304(c)(1982).

\textsuperscript{82} 11 U.S.C. § 305(c)(1982).

\textsuperscript{83} 11 U.S.C. § 304(c)(1982).

\textsuperscript{84} See supra text accompanying notes 1-11.

\textsuperscript{85} The "order prescribed by this title" corresponds with the purpose behind the enactment of the Code, which is to assure the fair and equitable administration of the debtor's estate. See, e.g., Finabank, supra note 45, at 918; In re Culmer, 25 Bankr. 621 (S.D.N.Y. 1982).
fifth factors of section 304(c), on the other hand, are more consistent with the territorial notions of bankruptcy jurisdiction. By protecting U.S. claim holders and applying the principles of comity which had developed at common law, U.S. bankruptcy courts are authorized to refuse recognition of foreign proceedings attempting to reach assets located in the United States.

It is not determinative, however, that since three of the factors set forth in section 304(c) reflect the universality approach and only two reflect territorial principles that Congress intended the universality approach to outweigh territorial concerns in every situation. According to the House and Senate report accompanying the enactment of the Code, the factors set forth in section 304(c) are to serve as
guidelines . . . designed to give the court maximum flexibility in handling ancillary cases. Principles of international comity and respect for the judgments and laws of other nations suggest that the court be permitted to make the appropriate orders under all of the circumstances of each case, rather than being provided with inflexible rules.86

In addition to the factors set forth in section 304(c), it has been suggested that courts look to other factors as well. For instance, factors which weigh in favor of granting the petition of a foreign representative are:

(1) where the failure to grant an order in an ancillary proceeding will require a local bankruptcy to protect local assets, necessitating concurrent bankruptcies and higher administrative costs;
(2) where the foreign bankruptcy law is similar to that of the United States;
(3) where the relative ease of access to the foreign country and relative ease of communication with the foreign creditors facilitates a convenient proceeding (on these grounds alone it would seem that all things being equal, a court's discretion is more likely to be exercised in favor of a trustee from neighboring Canada than one from Japan); [and]
(4) where more creditors and a greater part of the estate of the debtor are located in the foreign country.87

It has also been suggested that a court may look to the principles of res judicata to avoid relitigation of an issue which was raised and adequately defended by a party in a foreign proceeding.88 Courts have also looked beyond the specific factors of section 304(c) to determine what type of relief is appropriate under the circumstances.89

Unlike the status of U.S. law at the time of the Herstatt affair, the enactment of the Code has provided significant guidance to both U.S. bankruptcy courts and foreign representatives in setting forth who may petition for relief, the kinds of relief which may be sought and factors to be weighed in determining what type of relief to be granted. Removing these

87. Honsberger, supra note 5, at 656.
89. See, e.g., In re Culmer, infra text accompanying notes 95 to 110.
uncertainties has provided comfort and a sense of stability in international insolvency situations.

E. INITIAL INTERPRETATIONS OF THE CODE:
   CONTINUED PROTECTION OF LOCAL CREDITORS

Since its enactment in 1978, very few bankruptcy courts have been faced with petitions by foreign representatives seeking relief under section 304 or 305. Section 304 has been used, for example, to establish an ancillary proceeding in the United States to assist a South African bankruptcy proceeding to determine the rights of parties to real property located in the United States. 90 It was recognized that this proceeding was in rem in nature, only affecting the rights to the real property. 91

Initially, courts faced with conflicting claims of U.S. creditors and foreign representatives to assets located in the United States essentially reached the same result of protecting the interests of U.S. creditors as had developed under the principles of comity at common law. In In re Lineas Areas de Nicaragua, S.A., 92 the first significant case addressing what type of relief should be granted under section 304, the foreign administrator of a bankrupt Nicaraguan airline petitioned the bankruptcy court to enjoin all proceedings and liens against the debtor and to turn over all its assets to be included in the Nicaraguan bankruptcy proceeding. The bankruptcy court recognized the status of the foreign representative and agreed to issue the injunction and turn over the assets, subject to the condition that all claims of U.S. creditors be satisfied first. United States creditors were allowed to bring their claims to judgment and seek enforcement against the assets upon obtaining leave from the court. Since the outstanding claims of U.S. creditors exceeded the value of the assets located in the United States, 93 this recognition and the turnover order were empty gestures of deference to the foreign proceeding.

Similarly, in In Re Egeria Societa Per Azioni Di Navigazione, 94 the bankruptcy court in dicta indicated that the U.S. creditor claims under prior maritime attachments to a vessel located in the U.S. should be adequately protected before the ship would be released.

F. FURTHER INTERPRETATION OF THE CODE:
   THE MOVE TOWARD GREATER RECOGNITION

This policy of protecting U.S. creditors as the foremost consideration was reversed in In re Culmer. 95 As the only case which has carefully analyzed

91. Id. at 415.
93. The total value of the debtor's assets in the United States was approximately $203,000, and claims against the debtor and such assets exceeded $4,000,000. In re Lineas Areas de Nicaragua, S.A., 13 Bankr. 779, 780 (Bankr. S.D. Fla. 1981).
94. 20 Bankr. 625 (E.D. Va. 1982).
95. 25 Bankr. 621 (S.D.N.Y. 1982).
section 304 in reaching its decision, *In re* Culmer deserves a closer look.

The debtor, Banco Ambrosiano Overseas Limited (BAOL) was a Bahamian banking corporation which had been closed down by Bahamian banking authorities. The shareholders voluntarily agreed that BAOL would be wound up, and commenced a voluntary proceeding in the Bahamas for that purpose. Liquidators were appointed and the liquidation proceedings were underway in the Bahamas when the liquidators filed a petition in the Southern District of New York under section 304 seeking both to enjoin all proceedings and liens against BAOL and its assets in the United States, and to turn over all its U.S. deposits and assets to be included in the Bahamian liquidation proceeding.

Several banks and financial institutions located in New York attached or set-off various assets of BAOL prior to the commencement of the section 304 petition. These creditors opposed the relief sought by the Bahamian liquidators, and one moved to dismiss the section 304 petition on the ground that BAOL was a bank doing business in the United States and was therefore ineligible as a debtor under section 109 of the Code. At the time the liquidation proceedings were commenced, BAOL did not directly operate a branch or similar office in New York, but did maintain various brokerage, clearing and custodial accounts with banks and other financial institutions located there. In a preliminary hearing, the court found that BAOL was not engaged in the banking business in the United States and therefore could qualify as a debtor under the Code. The issue which had posed an insurmountable obstacle in the Herstatt affair was quickly resolved simply by looking to the provisions of the Code.

The creditors further opposed the section 304 petition by looking to the factors of section 304(c) in making their arguments. They asserted that they should not be required to submit their claims to the Bahamian liquidation since Bahamian liquidation law so differed from U.S. bankruptcy law as to be inherently prejudicial and inconvenient to the U.S. creditors. The court specifically reviewed Bahamian liquidation laws and procedures and found them to be in substantial conformity with U.S. bankruptcy laws and procedures. For example, the court found that the liquidation was supervised by a Bahamian court, preferential claims and fraudulent transfers were not recognized, all transfers and attachments subsequent to the commencement of the liquidation were deemed void, and no preference was given to the claims of Bahamian citizens. In view of all these safeguards, the U.S. creditors could not demonstrate anything inherently prejudicial to their interests. The court noted that the Bahamian proceedings were not even necessarily inconvenient, since creditors were allowed to prove their claims by mail.  

96. *Id.* at 624.
97. *Id.* at 628–30.

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The creditors also argued that the Bahamian proceedings were tainted by fraud, since the liquidators allegedly remained loyal to the parent corporation of BAOL in Italy, which had purported ties to the Vatican. This loyalty allegedly biased the liquidators in their duties. However, since the creditors were unable to substantiate these assertions, they were not granted any credence by the court.

When the court looked to the comity consideration as set forth in section 304(c), it applied a more narrow interpretation of comity which had been adopted by New York courts. This construction provides that foreign proceedings will be recognized unless the judicial enforcement of these claims would approve a transaction which is "inherently vicious, wicked, or immoral, and shocking to the prevailing moral sense."\(^\text{98}\) Applying this rule, the court found that since Bahamian liquidation law was substantially similar to U.S. law and no convincing evidence of anything shocking or immoral had been presented, the foreign proceedings should be recognized under principles of comity.

In examining the factors of section 304(c) in making its determination, the court looked back to the legislative history indicating that the factors are to serve as "guidelines" to give a court "maximum flexibility" and are not to be viewed as "inflexible rules."\(^\text{99}\) Adopting this flexible approach, the court looked beyond the factors expressly set forth in section 304(c) in forming its opinion.

The court looked to the purpose behind the Code in making its central examination of what kind of relief to grant under section 304. The court cited IBB in finding that the basic purpose of the Code "is equality of distribution of assets among creditors, . . . and correlatively avoidance of preference to some. . . . The road to equity is not a race course for the swiftest."\(^\text{100}\) Looking to the facts before it, the court found it significant that the section 304 petition was controverted only by those creditors with attachments or which had exercised set-offs, and that the two major creditors, which did not have any such attachments or set-offs, did not oppose the transfer of assets to the Bahamian liquidation. The court stated that, "[t]o allow these opposing creditors to preclude the relief requested would grant them preferences to which they are not entitled either in a Bahamian liquidation. . . . This court is thus not obliged to protect the positions of fast-moving American and foreign attachment creditors over the policy favoring uniform administration in a foreign court."\(^\text{101}\) This finding is significant because it specifically rejects the rule which had developed at

\(^{98}\) Id. at 629.

\(^{99}\) The court cited the House and Senate report quoted in text accompanying supra note 86.

\(^{100}\) 25 BANKR. 628 (S.D.N.Y. 1982), citing IBB, 536 F.2d at 513.

\(^{101}\) Id., at 629.
common law to satisfy the claims of U.S. creditors, even if preferential, before assets would be turned over to a foreign trustee. Instead, the court found that when the basic purpose of the Bankruptcy Code requiring equality of distribution and avoidance of preferential or fraudulent transfers directly conflicts with the claims of U.S. creditors, that the interests of U.S. creditors will be compromised in favor of equitable distribution.

In addition to looking to the purpose behind the Code, the court looked to other factors not listed in section 304(c). The preface to 304(c) directs courts to look to the specific factors listed to "best assure an economical and expeditious administration of [the] estate." Since BAOL's records and employees were in the Bahamas and the liquidators and their staffs were located there and were bound by Bahamian law and rulings of the Bahamian court supervising the liquidation, the court found that the "Bahamian court can most efficiently deal with all of BAOL's creditors, both American and worldwide." The court supported the theory that the most efficient and economical disposition of an estate should take place in a single place. Absent a showing of unfairness to U.S. creditors in the foreign proceeding, it found that this efficiency should be encouraged.

The court also found it significant that the Bahamas was a "sister common law" jurisdiction. Looking back to Gebhard and Cornfeld, the court reviewed the special deference which had traditionally been given to Canadian proceedings. Since the English Companies Act formed the basis for both Canadian and Bahamian liquidation law, the court held that Bahamian proceedings should also receive special deference.

In addition, the court cited the rationale set forth in Gebhard in finding that the U.S. creditors had impliedly consented to the application of Bahamian law since they had voluntarily dealt with a Bahamian corporation. This rationale has been criticized because it cuts both ways: a foreign corporation which voluntarily deals with U.S. businesses should equally expect to be governed by U.S. law.

Citing all of these considerations, the court granted the section 304 petition filed by the Bahamian liquidators. It enjoined the creation, perfection or enforcement of any lien, set-off, attachment or judgment of any assets of BAOL located in the district without the prior order of the

103. 25 BANKR. 628 (S.D.N.Y. 1982).
104. Id., at 633.
105. Id., at 631.
106. 109 U.S. 527 (1883); see supra text accompanying notes 19–21.
Bahamian court, enjoined all proceedings against BAOL or its assets and ordered the assets to be turned over to the liquidators to be administered by the Bahamian court.110

V. The Trend toward Greater Recognition: Post Code Non-Bankruptcy Cases

The enactment of the foreign insolvency provisions of the Bankruptcy Code did not have any direct impact on non-bankruptcy courts, since only bankruptcy courts and courts reviewing bankruptcy decisions are bound by the Code. All other courts must still look to the principle of comity established by common law to determine whether a foreign insolvency proceeding should be recognized. After the enactment of the Code in 1978, non-bankruptcy courts applying rules of comity became more lenient in recognizing the effectiveness of foreign insolvency proceedings when such proceedings conflicted with the interests of U.S. citizens. This trend began with the cases immediately preceding the Herstatt affair, e.g., Clarkson,111 IBB112 and Finabank,113 and has continued in a steady pattern.

A. Deference toward Common Law Jurisdictions, Fraud by U.S. Creditors

Cornfeld v. Investors Overseas Services, Ltd.,114 which has been frequently cited by both courts and commentators, illustrates the continued special recognition given by U.S. courts to proceedings held in sister common law jurisdictions.115 The debtor, Investors Overseas Services, Ltd. (IOS), was a Canadian corporation being liquidated in Canada. Cornfeld, a former officer and director of IOS, sued IOS under an indemnity agreement in the Southern District of New York and sought to attach over one million dollars of IOS funds located in New York. The Canadian liquidator moved to dismiss on the ground that the court should defer to the Canadian liquidation proceeding. Cornfeld opposed the motion on the ground that his interests as a U.S. resident would be impaired if he were unable to recover in New York.

The court dismissed the case on the principles of comity in deference to Canada as a sister common law jurisdiction, and since such dismissal did not violate the public policy of New York or the United States. Not only would this recognition not violate public policy, the court found that recognition

110. 25 Bankr. 634 (S.D.N.Y. 1982).
111. See supra text accompanying note 36.
112. See supra text accompanying notes 42 to 44.
113. See supra text accompanying notes 45 to 49.
would further public policy, "for the firm policy of American courts is the
staying of actions against a corporation which is the subject of a bankruptcy
proceeding in another jurisdiction."\footnote{116} The court cited \textit{Gebhard} in stressing
that a liquidation of the size and scope of IOS, which had assets and creditors
all over the world, could only be effective if each country cooperated with a
single proceeding located at the jurisdiction of the debtor's incorporation.
Both the Canadian and American bankruptcy codes contain provisions
which were "intended to ensure that the assets of a bankrupt are efficiently
and fairly distributed among its creditors in a single proceeding instead of
erratically being disposed of in a number of different lawsuits."\footnote{117} The court
struck down Cornfeld's attempt to attach U.S. funds to defraud the Cana-
dian liquidation and ordered him to go to Canada to assert his claims.

A more blatant attempt by a U.S. citizen to defraud a foreign insolvency
proceeding may be found in the recent case of \\textit{Daniels v. Powell}.\footnote{118} As in
\textit{Cornfeld}, a director of a Bahamian corporation sought to avoid foreign
liquidation proceedings. Powell, the director, convinced the Bahamian
receiver to turn over deeds to some of the corporate debtor's real property
located in the U.S. upon the representation that Powell was merely trying to
negotiate with some of the corporation's creditors to avoid the need for
liquidation. In fact, Powell sold the properties in violation of the Bahamian
proceeding and used the funds to repay select creditors of the corporation,
including Powell's father, as well as for personal benefit.

The court in \textit{Daniels} had no problem finding that the liquidation proceed-
ings of the Bahamas, as a sister common law jurisdiction, should be recog-
nized under principles of comity. This finding allowed the court to recognize
the status of the receiver in order to grant her motion for summary judgmeiit
against Powell for conversion.\footnote{119} Both \textit{Cornfeld} and \textit{Daniels} reflect a strong
policy by courts not to tolerate fraudulent attempts by U.S. residents to
extricate themselves from their obligations under foreign insolvency pro-
ceedings.

\textbf{B. Non-Common Law Jurisdictions:

The Trend Continues}

In another well-known case, the district court in the Southern District of
New York, in \textit{Kenner Products Co. v. Societe Fonciere Et Financiere
Agache-Willot},\footnote{120} suspended a lawsuit on a guaranty pending before it in

\begin{footnotesize}
\begin{enumerate}
\item[116] 471 F. Supp. at 1259.
\item[117]  \textit{Id.} at 1260.
\item[118] No. 84 C 1889, slip op. (E.D. Ill. Mar. 14, 1985).
\item[119] The court also invoked the rationale of \textit{Gebhard}, supra note 20, in finding that Powell
had voluntarily invoked the laws of Bermuda by choosing to incorporate the debtor there.
\item[120] 532 F. Supp. 478 (S.D.N.Y. 1982).
\end{enumerate}
\end{footnotesize}
deference to an insolvency proceeding which had been filed against the
defendant in France after the U.S. suit had been filed. The court noted that
it was to look to the principles of comity, and that under the narrowly
construed exceptions to the comity doctrine adopted in New York, New
York courts generally recognize “the statutory title of an alien trustee in
bankruptcy as long as the foreign court had jurisdiction over the bankrupt
and the foreign proceeding has not resulted in the violation of public
policy.” Since U.S. bankruptcy law also provides for a suspension of
actions against a bankrupt to assist in the efficient and fair distribution of a
debtor’s assets in a single proceeding, the court found that U.S. policy would
not be violated if the suit were suspended pending the outcome of the
French bankruptcy proceeding.

It is not insignificant that the courts in both *Cornfeld* and *Agache-Willot*
declined to enforce the choice of law or choice of venue clauses in reaching
their decisions. The underlying contracts giving rise to the disputes to be
resolved in the U.S. courts contained clauses indicating New York law was
to govern and that actions with respect to such contracts were to be brought
in New York. In *Cornfeld*, the court held that the existence of such clause
was “not conclusive.” In *Agache-Willot*, the court found that such clause
did not “override” the “concerns for comity and judicial efficiency.” Any
fostering of international cooperation and stability through increased recog-
nition of foreign insolvency proceedings may be defeated if U.S. courts
concurrently remove the ability of parties to predictably choose the law
which will apply to their contracts and the ability to decide where any
disputes should be heard.

C. Analysis of U.S. Public Policy
   as an Element of Comity

Several recent decisions have demonstrated the need to analyze U.S.
public policy to determine whether deference to foreign proceedings should
be made on the principles of comity. For instance, in *Sabolyk v. Morgan
Guaranty Trust Co. of New York*, the court was forced to look to U.S.
letter of credit law to determine whether a foreign proceeding violated
public policy. The case addressed the issue of whether an attachment order
made by a Swiss court against letters of credit issued by the Zurich, Switzer-
land branch of Morgan Guaranty Trust Company of New York (Morgan-
Zurich) and the penal prohibition against Morgan-Zurich from paying
under the letters of credit should be honored by a U.S. court based on

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121. *Id.* at 479.
122. 471 F. Supp. at 1261.
123. 532 F. Supp. at 479.
124. No. 84 Civ. 3179 (MJL), slip op. (S.D.N.Y. Nov. 27, 1984).
principles of comity. The Swiss court had ordered the attachment on the basis of allegations of fraud in the underlying contract, which the court noted is also recognized as a defense to payment of letters of credit under U.S. and New York law. Finding that no public policy was violated and that the Swiss court had jurisdiction, the court deferred to the Swiss court's ruling on the principles of comity.

In a more recent and celebrated case, the Second Circuit reversed itself in Allied Bank International v. Banco Credito Agricola de Cartago, finding that its initial interpretation of U.S. policy had been incorrect. The case was brought by Allied Bank International as agent for a syndicate of thirty-nine banks to enforce promissory notes made by three Costa Rican banks. The government and Central Bank of Costa Rica had issued decrees suspending payments on external debt in connection with the restructuring of all Costa Rican debt. The Second Circuit court, in an April 1984 decision, ruled that Costa Rica's action should be recognized in the United States as a matter of comity. Citing Gebhard, it analogized Costa Rica's prohibition of payments of its external debt to the reorganization provisions of the Code. In addition, it determined that such suspension was consistent with the United States government's policy of assisting the Costa Rican government in its attempt to restructure its foreign debt since the President had specifically agreed to continue U.S. assistance to Costa Rica despite the suspension.

Upon rehearing, the United States Justice Department, in an amicus curie brief, disputed the court's analysis of United States policy in the matter. It argued that although the U.S. continued to assist Costa Rica and supported the efforts of the International Monetary Fund to restructure the debt, the underlying payment obligations remained valid and enforceable. By suspending payments, Costa Rica had attempted to unilaterally restructure its debt. This was inconsistent with the system of international cooperation and negotiation and was therefore inconsistent with United States policy. Persuaded by the government's interpretation of U.S. policy in this matter, the court nullified its prior holding.

D. THE CONTINUED TREND TOWARD GREATER RECOGNITION

As long as no claims of U.S. creditors are involved, courts have remained more than willing to defer to a foreign proceeding. In Cunard Steamship Co. v. Salen Reefer Services, the court was not faced with conflicting claims of U.S. creditors, but with a struggle between a Swedish bankruptcy trustee

126. 733 F.2d 23 (2d Cir. 1984).
127. 49 BANKR. 614 (S.D.N.Y. May 1, 1985).
and an English attaching creditor. Specifically, the court was presented with the issue of whether it should recognize a Swedish bankruptcy proceeding of a Swedish corporation which would invalidate a subsequent maritime attachment by an English creditor. The court looked to the comity principles set forth in Hilton and more recent comity decisions, as well as section 304 of the Bankruptcy Code, in holding that U.S. policy would be furthered by recognizing the Swedish proceeding to "facilitate the orderly and systematic distribution of the assets of Salen and avoid the piecemeal litigation of the estimated $650 million in liabilities of Salen and its affiliated companies." \(^{128}\) The English attachment was vacated so the assets of Salen could be "distributed in a single proceeding in Sweden pursuant to Swedish law." \(^{129}\)

The trend toward greater recognition of foreign proceedings is aptly illustrated by the most recent case in this area, *Drexel Burnham Lambert Group Inc. v. Galardi*. \(^{130}\) The debtor, Galardi, was a resident of Dubai, United Arab Emigrants. Galardi traded commodities on U.S. exchanges and maintained an account with Drexel in New York. Galardi was not successful in his commodity trading, and accrued a deficit account with Drexel exceeding nineteen million dollars. To assure repayment, Galardi made a promissory note payable to Drexel, secured by stock in the Union Bank of the Middle East Ltd. (UMBE). Galardi defaulted in payments on the note, which specified that it was governed by New York law. Drexel sued Galardi in the Southern District of New York for default in payments on the note.

Shortly after the lawsuit was filed, a Dubai court appointed a receiver to manage all Galardi's affairs and to administer an orderly liquidation of his estate. The receiver feared UMBE would suffer serious losses if involved in the Galardi liquidation, so to avert a national financial disaster the receiver sold the UMBE stock and deposited the proceeds with the rest of the estate. Galardi moved the district court to dismiss the suit against him on the note on the basis of international comity, arguing that the court should defer to the liquidation proceedings underway in Dubai. Drexel opposed dismissal, arguing that the proceeding in Dubai had been commenced as a direct response to its suit in a plan to fraudulently dispose of Drexel's security interests in the stock to reduce its chances for repayment.

The court, citing *Gebhard* and *Cornfeld*, stated that comity creates a presumption that American courts should defer to foreign proceedings which are essentially fair. By holding an orderly liquidation proceeding to administer all Galardi's assets, the court found the Dubai procedure to be

\(^{128}\) *Id.*

\(^{129}\) *Id.* The court rejected arguments requiring reciprocity, noting that it was irrelevant whether Sweden would similarly recognize American proceedings.

"facially" fair. The court was not persuaded by Drexel's argument that it had been defrauded when its collateral had been sold, noting that "[i]nternational comity is not reserved for foreign proceedings that obtain results identical to those under American law." Absent any clear showing of fraud, Drexel's assertions were not persuasive. The court dismissed the suit, holding that the Dubai proceeding should be deferred to as a matter of international comity.

Drexel is significant because it grants the relief sought by a foreign trustee even though the foreign jurisdiction was not a sister common law jurisdiction, the interests of the U.S. creditor were harmed as a result, and no fraudulent or inequitable conduct by the U.S. creditor was involved. Drexel, along with Agache-Willot, Finabank and Culmer, reflect a trend developing in United States courts to look primarily to the most equitable and efficient administration of a debtor's estate in determining what kind of relief should be granted. If a court can encourage this equitable administration it will do so, unless U.S. creditors can prove the foreign proceedings are inherently unfair. The fact that a U.S. creditor may not receive as beneficial a treatment as it might have received in the United States is not enough to persuade a court that inherent prejudices exist in the foreign system.

Conclusion

The long-standing protectionist attitudes of United States courts which evolved at common law are gradually being rejected as evidenced by recent case law interpreting common law principles of comity as well as the Bankruptcy Reform Act of 1978. This trend toward greater recognition of foreign proceedings represents a move away from territorial views of international insolvency toward the more cooperative universality views. The movement is consistent with Congress' intent in enacting the Bankruptcy Code, since this increased recognition of foreign proceedings by U.S. courts should encourage favorable treatment toward U.S. proceedings by foreign courts. This increased international cooperation and recognition should foster increased stability in international transactions which, in the long run, will benefit everyone concerned.

131. Id.