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With the recent increases in international commercial activity, there are concomitant increases in "international" bankruptcies. As a result, bankruptcy adjudications in one country frequently have implications in other countries, and therefore raise complex conflict of laws questions. In this article, the author examines the new Bankruptcy Code of the United States and focuses on the provisions relating to bankruptcies brought by foreign representatives in the United States. The author also analyzes the treatment accorded United States creditors in foreign countries. The article concludes that the new Bankruptcy Code is an important first step in bringing about international uniformity in bankruptcy adjudication and cites the need for further international cooperation.

INTRODUCTION

THE ECONOMICS of most countries are becoming increasingly linked and interrelated. Foreign trade has increased and become more complex, and the activities of multinational corporations have become extremely pervasive. Even individuals may live and have residences in more than one country. One of the important legal issues accompanying this increase in international activity is that of international bankruptcy: in situations where the debtor, the creditors, and the debtor's properties are located in more than one country, complex conflict of laws questions frequently arise.

For instance, a court sitting in an "international" bankruptcy matter must at the outset determine whether it has jurisdiction over the proceeding. This is done by determining the limits of the bankruptcy law in that jurisdiction as it applies to the persons, property, and transactions involved in the case.

Related to the question of jurisdiction is the question of judgment effects. In bankruptcy, it is important to know, for example, the extent to which a bankruptcy adjudication or arrangement or

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release of debts will be recognized and enforced in foreign countries. This, as a rule, is tested in the United States by determining whether the judgment court had "international jurisdiction" over the dispute.[1]

The basic problems involving the choice of law relate to when a local court will apply the laws of a foreign country: when it may do so and when it must do so.

The long history of bankruptcy in the United States has shown it to be an expanding concept.[2] One example is the evolution of bankruptcy legislation that has recognized the changing class of debtors. As more business was conducted by corporations instead of individual traders or merchants, and as consumer credit reached ever-increasing levels, bankruptcy legislation was adopted to meet the new circumstances.[3] Similarly, since the world has increasingly become a "global village",[4] it has been necessary to recognize the special problems arising in transnational insolvencies and to find new ways to deal with them. The new Bankruptcy Reform Act of 1978 (Bankruptcy Code)[5] has gone further than any previous statute in recognizing the international dimensions of bankruptcy. It has given a new flexibility to national bankruptcy legislation to promote greater cooperation in solving the international affairs of insolvent debtors.

This Article will examine many of the conflict of laws problems that typically arise in international bankruptcy.[6] Special

1. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 98, Comments a–d (1971). *See, e.g.*, Mpiliris v. Hellenic Lines, Ltd., 323 F. Supp. 865, 872 (S.D. Tex. 1970), *aff'd*, 440 F.2d 1163 (5th Cir. 1971) (". . . courts of this country ordinarily recognize and enforce an internationally foreign judgment if the rendering court is determined to have possessed adjudicatory jurisdiction in the international sense (that is, it was appropriate for this country to adjudicate this particular dispute)").

2. *See generally*, C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY (1935).

3. *Id.* at 8.

4. This "global village" may be compared to the Roman Empire that extended from Britain to Syria and Egypt, a distance in a direct line of approximately 2,700 miles. It was one country, with one official language, the same laws, the same currency, and the same administrative system. Today, some 20 independent countries separate Britain from Syria, each with its own government, its own laws, politics, customs fees, passports, and currencies, making commercial cooperation almost impossible. Glubb, *The Fate of Empires*, 12 L. SOC'Y OF UPPER CAN. GAZETTE 11 (1978).

5. Bankruptcy Reform Act of 1978, 11 U.S.C.A. §§ 101–700 (West 1979). The words "the Code" or "[T]he Bankruptcy Reform Act of 1978" are used in this Article to refer to Title 1, Pub. L. No. 95–598, 92 Stat. 2549 (1978). The words "the former Bankruptcy Act" or "the former Act" are used to refer to former Title 11 of the United States Code as repealed by Pub. L. No. 95–598.

6. One basic bankruptcy issue that receives different treatment in different countries is the consequences for a person who acquires the status of a bankrupt. Although the status

attention is given to the provisions in the new Bankruptcy Code relating to foreign proceedings, and in most instances, both the domestic and foreign points of view are considered.

I. CONFLICT OF LAWS THEORIES IN BANKRUPTCY

The history of conflict of laws as it relates to bankruptcy reflects competing doctrines designed to "avoid conflict." Two major doctrines have been advanced by continental jurists—the doctrine of unity, or the universality notion of bankruptcy; and the doctrine of territoriality, or the pluralistic notion of bankruptcy.

The universality theory of bankruptcy requires a bankruptcy judgment declared at the domicile of an individual debtor or the principal office of a corporate debtor to be recognized everywhere.[7] Under this theory, the law of the country having jurisdiction governs both the local and foreign effects of the bankruptcy. The trustee in bankruptcy appointed in that country is required to take possession of the property of the debtor, wherever located. The trustee must then remove it to the jurisdiction of the court pursuant to the laws by which the trustee was appointed. All creditors are thus obliged to come to that country and prove their claims.[8]

In theory, there would be greater equality among creditors if the universal effects of a bankruptcy were recognized. Those who support this doctrine argue that without a universal approach to

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usually follows a person wherever he or she may go, and is generally recognized elsewhere, the incidents of that status are prescribed by the law of the jurisdiction where the transactions took place. Sun Oil Co. v. Guidry, 99 So. 2d 424 (La. App. 1951).

In the United States, a debtor or former debtor suffers only minor disabilities. For example, within 180 days of the filing, a bankrupt may not acquire property by bequest, devise, inheritance, through a settlement with a spouse, or as a beneficiary of a life insurance policy or death benefit plan. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 541(5) (West 1979). These disabilities apply only to debtors adjudged bankrupt under the Bankruptcy Code of the United States. Foreign bankrupts residing in the United States are not affected by these incapacities. The policy of bankruptcy in the United States is to give debtors a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.

In other countries, where bankruptcy is still regarded as quasi-criminal legislation, and there is not the same emphasis placed upon the economic rehabilitation of the debtor, bankrupts are subject to many disabilities. These relate to the capacity of a bankrupt to deal with property, to enter into certain transactions, to hold public office, to be licensed to conduct certain activities, to practice a profession, or to be a director or officer of a corporation. *See* Poultney, The "Status" of a Bankrupt, 19 CAN. BAR REV. (n.s.) 105 (Can. 1975).

7. J. STORY, COMMENTARIES IN THE CONFLICT OF LAWS §§ 403–05 (4th ed. 1852).

8. *Id.*

bankruptcy, the same debtor could be adjudged bankrupt in two or more countries. In that event, there would be multiple estates, each with a set of creditors who had proved their claims. Dividends would inevitably be unequal, and some creditors might not be paid at all. One bankruptcy might be determined by a discharge, another by an arrangement, and in another there might be no final resolution. Thus, unless there were concurrent bankruptcies in each country in which a debtor had assets, local creditors acting in their individual interests could attach local assets with impunity.

Those who criticize this theory argue that the creditors of a foreign bankrupt should be entitled to attach local property of the debtor and not have to prove their claims in a foreign bankruptcy court. It is argued that a debtor and creditors could be forced into a foreign system of bankruptcy and thereby suffer inconvenience and hardship greater than would be imposed by the standards of the local bankruptcy law to which they were accustomed.[9]

It is axiomatic that the universality theory cannot function without universal acceptance. It was suitable to the Roman and British Empires within which there was the political reality of "one world." Within these empires the internationalism in both law and trade prevented conflict of laws.[10] In the modern world, universality is, for the most part, effective only when two or more countries agree to recognize the universality of bankruptcy through a bankruptcy treaty.

The doctrine of territoriality or pluralism gives no extraterritorial effect to the laws of a country.[11] Under this theory, any country is free to entertain proceedings pursuant to their bankruptcy laws without regard to any foreign judgments. Accordingly, it is possible for several concurrent bankruptcies to be initiated in different countries with respect to the same debtor.

The effect of the theory is that property of the debtor located outside the domestic jurisdiction of a bankruptcy court is not affected by that court's adjudication. The debtor may freely dispose of it and legally give preferences to his or her creditors. Such property is subject to attachment, however, by creditors in the

9. *See* J. STORY, *supra* note 7. For example, the order of priority in the payment of claims is different from one country to another. Some countries permit secret liens such as reservation of title in sales. In France, there are new rules for piercing the corporate veil of debtor corporations to impose criminal sanctions upon those who control the corporation.

10. A. EHRENZWEIG, CONFLICT OF LAWS § 2 (1962).

11. *Id.*; J. STORY, *supra* note 7, at §§ 410-17.

country where the property is located. The recent collapse of several large financial institutions holding assets in many countries has shown that the most knowledgeable creditors are very swift in attaching their debtors' foreign assets.[12] The creditors are thereby permitted to receive preferences notwithstanding the fact that domestic laws of all countries prohibit execution of a single creditor after an adjudication in bankruptcy.[13] This doctrine as applied by some countries has met considerable international criticism as in practice it rejects, if not contravenes, the principle of creditor equality and encourages the race to the courthouse. This doctrine prevails in the United States at least in the context of the recognition afforded locally to a foreign bankruptcy adjudication. The courts have traditionally rejected the doctrine of universality in the operation of bankruptcy laws and have been hostile to the recognition of claims asserted by foreign trustees in bankruptcy property located in the United States.[14] In *Harrison v. Sterry*,[15] decided in 1809, Chief Justice Marshall held that "the bankrupt law of a foreign country is incapable of operating a legal transfer of property in the United States."[16] The Supreme Court affirmed this principle eighteen years later in *Ogden v. Saunders*,[17] holding that a foreign discharge in bankruptcy is not a defense to an action by a creditor residing in the United States unless the creditor consented to the foreign court jurisdiction over the claim.[18]

Justice Story, in his *Commentaries on the Conflict of Laws*,[19] did not adopt the broad statement of the nonrecognition principle found in *Harrison*. Instead, he advocated a more narrow view of the principle relying on language found in *Ogden*. He opined that national comity required that effect be given to foreign bankruptcies, but only so far as might be done without impairing the remedies or lessening the securities which ". . . our laws have provided for our own citizens."[20] This has been the approach since taken

12. *See* Becker, *International Insolvency: The Case of Herstatt*, 62 A.B.A.J. 1290 (1976); Riesenfeld, *The Status of Foreign Administrators of Insolvent Estates: A Comparative View*, 24 AM. J. COMP. L. 288, 288–90 (1976).

13. *See, e.g.*, Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 1301 (West 1979).

14. Riesenfeld, *supra* note 12, at 290. According to Story, the objection of the courts to the doctrine of universality was based upon the ground that "it could be prejudicial to the rights of American citizens." J. STORY, *supra* note 7, § 410.

15. 9 U.S. (5 Cranch) 289 (1809).

16. *Id.* at 302.

17. 25 U.S. (12 Wheat.) 213 (1827).

18. *Id.* at 360.

19. J. STORY, *supra* note 7.

20. *Id.* at § 414.

by the courts. Foreign judgments are given effect in the United States only as a matter of comity which, 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."[21]

Courts in the United States have generally viewed comity in terms of international fair play and justice. If the foreign court had jurisdiction over the issue and the parties and fair proceedings were utilized, the judgment, as a rule, will be recognized.[22] Thus, for example, a New York court has held that a foreign trustee in bankruptcy may be given assets in the absence of local attaching creditors.

> We have not a case here where there is a conflict between the foreign trustee and domestic creditors. So far as appears no injustice whatever will be done to any of our own citizens, or to any one else, by allowing the transfer to have full effect here. Indeed justice seems to require that this money should be paid to the foreign trustee for distribution among the foreign creditor [*sic*] of the bankrupts.[23]

While the courts of the United States have rejected the extraterritorial effect of foreign bankruptcy laws, both the 1978 Bankruptcy Code and former statutes upon which it is based purported to give extraterritorial effect to the bankruptcy legislation of the United States. For example, since 1952 the legislation has provided that all of the debtor's property, "wherever located", either vests in the trustee (in the former Act)[24] or comprises the estate of the bankrupt (in the Code).[25] In summary, the attitude of the United States towards the extraterritorial effect of bankruptcy judgments is ambivalent. Where a foreign adjudication is concerned, the courts have adopted the plurality theory; where a domestic bankruptcy is concerned, Congress seems to demand universal recognition.

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21. Hilton v. Guyot, 159 U.S. 113, 163–64 (1895). For recent examples of the application of comity in bankruptcy cases, see Clarkson Co. v. Shaheen, 544 F.2d 624 (2d Cir. 1976); Waxman v. Kealoha, 296 F. Supp. 1190 (D. Haw. 1969).

22. Zorgias v. S.S. Hellenic Star, 370 F. Supp. 591 (E.D. La. 1972), *aff'd*, 487 F.2d 519 (5th Cir. 1973); Mpiliris v. Hellenic Lines, Ltd., 323 F. Supp. 865 (S.D. Tex. 1970), *aff'd*, 440 F.2d 1163 (5th Cir. 1971); Harrison v. Triplex Gold Mines Ltd., 33 F.2d 667 (1st Cir. 1929).

23. *In re* Waite, 99 N.Y. 433, 439, 2 N.E. 440, 443 (1885).

24. 11 U.S.C. § 711 (1976) (repealed 1978).

25. 11 U.S.C.A. § 241 (West 1979). *See* notes 128–35 *infra* and accompanying text.

II. JURISDICTION UNDER THE BANKRUPTCY CODE

A. *Who May Be a Debtor?*

An important consideration in any conflict of laws question is determining the purported scope of the statute or rule of decision. One branch of this concept in the context of a bankruptcy proceeding is determining the debtors over which the bankruptcy court will assume jurisdiction.

The Code provides that a voluntary case may be commenced by a person,[26] whether an individual, partnership or a corporation, but not a governmental unit, who resides, has a domicile, has a place of business, or has property in the United States. The Code[27] also provides that such persons[28] do not include a railroad, a domestic insurance company, bank, savings bank, cooperative bank, saving and loan association, building and loan association, homestead association, or credit union;[29] or a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association or credit union engaged in such business in the United States unless a foreign proceeding in respect of such bank is pending.[30]

The application of these statutory terms will be crucial in determining who is within the jurisdiction of the Code. Thus, some of these terms merit further discussion.

1. *Place of Business*

A debtor who neither resides nor is domiciled in the United States may nevertheless come under the jurisdiction of a bankruptcy court in the United States if he or she either possesses property or has a place of business in the United States. The term "place of business" should be contrasted with the term "principal place of business" used in the former Act;[31] "place of business" is

26. For the Code definition of "person," see Bankruptcy Reform Act of 1978 § 101, 11 U.S.C.A. § 101(30) (West 1979).

27. *Id.*, 11 U.S.C.A. §§ 303, 109.

28. The Code defines "farmer" to mean a person who has received more than 80% of his or her gross income during the taxable year in which the case was commenced from a farming operation owned or operated by such person. *Id.* 11 U.S.C.A. § 101(17). Section 101(18) defines "farming operation" to include farming; tillage of the soil; dairy farming, ranching; production or raising of crops, poultry, or livestock; and production of poultry or livestock products in an unmanufactured state. *Id.*, 11 U.S.C.A. § 101(18).

29. Corporations coming within this classification generally include churches, schools, charitable organizations, and foundations.

30. *Id.*, 11 U.S.C.A. § 303.

31. *Compare* Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 109 (West 1979)

a broader term than "principal place of business." It is not clear whether jurisdiction under this branch of the statute was deliberately or unintentionally modified by the drafters of the Code, as there was no real criticism of the former rule. Still, this expanded jurisdiction under the Code is not so broad as it is in some countries where the courts have stretched the concept of carrying on business in order to assume jurisdiction. This has been done in some countries by deeming that a debtor continues to carry on business within the country until all debts incurred by the operation of the business have been paid and all accounts collected.[32]

2. *Presence of Property*

A further basis for a court to assume jurisdiction over a nonresident debtor is the presence of property of the debtor in the United States. This jurisdiction has existed since 1892.[33] It is designed in part to alleviate the strictness of the conflict of laws rule that refuses to recognize a foreign bankruptcy as an assignment of property of the debtor situated within the United States. If the rule were to stand alone, local creditors could attach local property of a foreign debtor with impunity. This, however, is not the case since a foreign representative, within the meaning of the Code, or foreign creditors can prevent or set aside local attachments by obtaining a local bankruptcy. If the court does not otherwise have jurisdiction over the debtor, the mere presence of assets of the debtor gives it jurisdiction. Indeed, jurisdiction based upon the presence of assets is almost always involved in proceedings collateral to a foreign bankruptcy involving a foreign debtor.[34]

The effect of bankruptcy as an assignment of property both at home and abroad, and the recognition given by one country to a bankruptcy order made by another is discussed in full later in this Article.[35] Reference is made therein to the fact that a bankruptcy order made in the United States pursuant to the jurisdiciton of the court based only upon the presence of assets is least likely to be

with the Bankruptcy Act of 1898, § 2a(1), 30 Stat. 545 (1898) codified at 11 U.S.C. § 11 (1976) (repealed 1979).

32. *See* Re Cherrio Toys and Games Ltd., 13 Can. Bar Rev. (n.s.) 41 (Can. 1970); Theophile v. Solicitor-General [1950] 1 All. E.R. 405.

33. Bankruptcy Act of 1898, § 2a(1), 30 Stat. 545 (1898) (repealed 1979).

34. "Congress did not mean to exclude from the operation of the [Bankruptcy] act those persons who are aliens whether living here or abroad, who have property within the United States." *In re* Berthoud, 231 F. 529, 532 (S.D.N.Y. 1916).

35. *See* notes 128–53 *infra* and accompanying text.

recognized abroad. A bankruptcy order with respect to a nonresident who does not submit to the jurisdiction of the court is an *in rem* proceeding. By the very nature of an *in rem* proceeding, jurisdiction is confined to the property within the country.[36] As a general rule, no state by its own act can affect property within the control of another state.[37]

3. *Foreign Banks*

Recent cases under the former Act have demonstrated that the provision prohibiting banking corporations from being a bankrupt was not clear.[38] On its face, the section appeared to remove all banks, foreign and domestic, from the jurisdiction of the bankruptcy court. One court noted, however, that the legislative history of the section indicated that the exemption was premised on the existence of extensive banking regulation.[39] Thus, a foreign bank not doing business in the United States and not subject to these regulations was not included within the definition of banking corporation.[40] A foreign bank was, therefore, subject to the jurisdiction of the United States bankruptcy courts.[41]

The words "banking corporation" have been replaced in the Code by the words "bank, savings bank [or] cooperative bank." The Code also draws distinction between foreign and domestic institutions and between those doing business in the United States and those that do not.

Under the Code, a foreign insurance company, bank, savings bank, cooperative bank, savings and loan association, or credit union engaged in such business in the United States is not subject to bankruptcy jurisdiction.[42] These institutions are excluded because there are regulatory agencies which provide for the liquida-

36. Nadelmann, *The National Bankruptcy Act and the Conflict of Laws*, 59 HARV. L. REV. 1025, 1041 (1946).

37. H. GOODRICH & E. SCOLES, CONFLICT OF LAWS § 68 (4th ed. 1964).

38. Banque de Financement, S.A. v. First Nat'l Bank of Boston, 568 F.2d 911 (2d Cir. 1977); Israel-British Bank (London) Ltd., 1 Bank Ct. Dec. 528 (S.D.N.Y. 1974), *rev'd*, 401 F. Supp. 1159 (S.D.N.Y. 1975), *rev'd sub nom*, Israel-British Bank (London) Ltd. v. Fed. Deposit Ins. Corp., 536 F.2d 509 (2d Cir. 1976), *cert. denied*, 429 U.S. 978 (1976). *See also* Nadelmann, *Rehabilitating International Bankruptcy Law: Lessons Taught by Herstatt and Company*, 52 N.Y.U.L. REV. 1 (1977).

39. Israel-British Bank Ltd. v. Fed. Deposit Ins. Corp., 536 F.2d 509, 512–15 (2d Cir. 1976), *cert. denied*, 429 U.S. 978 (1976).

40. *Id.*

41. *Id.*

42. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 109(b) (West 1979).

tion of such entities.[43]

With the exception of a foreign bank, if any of the foreign entities above described is not engaged in business in the United States the entity is nevertheless subject to bankruptcy jurisdiction.[44] A foreign bank not engaged in business in the United States may commence a voluntary case, but an involuntary case may be commenced against it only if a foreign proceeding concerning such bank is pending.[45]

Any bankruptcy proceedings will effectively close down a bank. The special protection afforded a foreign bank that is not doing business in the United States is designed to force creditors wishing to commence a local involuntary case to first take proceedings against the bank in the foreign country.[46] This will immediately alert the foreign banking regulatory authority to take appropriate action. Once there is a pending foreign proceeding, creditors are free to commence a local involuntary case.

Note, however, that only a foreign *bank* receives this protection. The protection does not extend to a foreign savings bank, or cooperative bank or any "near bank". Why this distinction should be made is not altogether clear. It apparently was considered that although bankruptcy proceedings against a foreign bank could injure the financial stability of a foreign country, this would not happen in the case of bankruptcy proceedings against a savings bank or cooperative bank. This would seem to assume, and in general it would be correct, that all foreign banks are large and important financial institutions and that all foreign savings banks

43. S. REP. No. 989, 95th Cong., 2d Sess. 31, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5817.

44. Section 109(b) generally includes all corporations in the class of persons that may be debtors. Since only domestic institutions and foreign institutions doing business in the United States are excluded, it follows that, foreign institutions not doing business must still be within bankruptcy court jurisdiction for voluntary cases. Bankruptcy Reform Act of 1978, § 181, 11 U.S.C.A. § 109(b) (West 1979).

45. A foreign bank not engaged in business in the United States is discussed in the previous footnote for voluntary cases. However, § 303, titled "Involuntary Cases" provides that "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." *Id.*, 11 U.S.C.A. § 303(k). A foreign proceeding is defined by § 101 to mean a "proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceedings, for the purpose of liquidating an estate, adjusting debts by composition, extension or discharge, or effecting a reorganization." *Id.*, 11 U.S.C.A. § 101(18).

46. S. REP. No. 989, 95th Cong., 2d Sess. 35, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5821.

and cooperative banks are small and their threatened failure would not have a substantial adverse effect upon the financial stability of a country or its institutions.

The lack of any definition of a foreign bank, savings bank or cooperative bank may lead to some problems. Financial institutions perform a range of "banking" functions. Not every bank need perform all of these functions in order to be considered a "bank". As a general rule, a mutual savings bank is regarded as an institution in the nature of a bank. It differs from ordinary banks in that it is not engaged in business for profit.[47] Some foreign savings banks, however, although described as savings banks, have capital stock and are in business for the profit of their stockholders.[48]

In the context of the Bankruptcy Code, the question as to what is a bank, savings bank or cooperative bank relates to the entities that may or may not be the subject of a bankruptcy case. As this is a matter of procedure, it is governed by the *lex fori*. Thus, the United States courts are required to determine whether, for example, a foreign institution is in fact a bank or savings bank under the law of the United States.

B. *Who May Be a Creditor?*

Included in the group of persons to whom the Code applied are creditors. Creditor is defined in section 101(9) of the Code as an

(A) entity that has a claim[49] against the debtor that arose at the time of or before the order for relief concerning the debtor;

(B) entity that has a claim against the estate of a kind speci-

47. Commercial Trust Co. of N.J. v. Hudson County Bd. of Taxation, 86 N.J. L. 424, 92 A. 263, 265 (1914).

48. For example, the Montreal City and District Savings Bank is authorized to do business pursuant to the Quebec Savings Bank Act, CAN. REV. STAT. B-4 (1970). It may perform a wide range of conventional banking functions and may have deposits in foreign banks. It has an authorized capital of 3 million dollars and it is engaged in business for profit. Thus, while described and known as a savings bank, it is in fact a bank.

49. Section 101(4) defines claim to mean:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 101(4) (West 1979).

fied in section 502(f), 502(g), 502(h) or 502(i) of this title,[50] or

(C) entity that has a community claim

. . . .[51]

Entity is, in turn, defined as a person, which includes individual, partnership or corporation;[52] estate; trust; or governmental unit, either domestic or foreign.[53]

Generally, foreign and domestic creditors have identical rights in the United States bankruptcy courts.[54] Free access to courts, in the absence of a treaty and subject to wartime restrictions upon enemy aliens, is recognized as a precept of customary international law.[55] In addition, a foreign governmental unit, whether a foreign state, or a department, agency, or instrumentality of a foreign state is specifically, although indirectly, included in the defi-

50. The four kinds of claim specified in §§ 502(f)–502(i) are:

(f) In an involuntary case, a claim arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief. . . .

(g) A claim arising from the rejection, under section 365 or under a plan under chapter 9, 11, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed. . . .

(h) A claim arising from the recovery of property under section 522(i), 550, or 553 of this title. . . .

(i) A claim that does not arise until after the commencement of the case for a tax entitled to priority under section 507(a)6 of this title. . . .

Id., 11 U.S.C.A. §§ 502(f)–502(i) (West 1979).

51. *Id.*, 11 U.S.C.A § 101(a) (West 1979). A community claim is defined as one that arose before the commencement of the case concerning property held by the debtor and debtor's spouse as community property, which property is liable for the claim whether or not there is any such property at the time of the commencement of the case. *Id.*, 11 U.S.C.A. § 101(6) (West 1979).

52. The Code provides that corporation includes:

(i) association having a power or privilege that a private corporation, but not an individual or a partnership, possesses;

(ii) partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association;

(iii) joint-stock company;

(iv) unincorporated company or association; or

(v) business trust.

Id., 11 U.S.C.A. § 101(8) (West 1979). It does not include limited partnership. *Id.*

53. *Id.*, 11 U.S.C.A. § 101(14) (West 1979). The Code defines "governmental unit" to mean "United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States, a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government." *Id.*, 11 U.S.C.A. § 101(21) (West 1979).

54. *See, e.g., In re* Berthoud, 231 F. 529 (S.D.N.Y. 1916) where the court explained that "the United States is engaged in a world wide business and it is fair to assume, as a matter of policy and comity, that Congress intended to give all persons, whether citizens, or residents, or neither, equal opportunity to share in the distribution of the property [of the bankrupt]." *Id.* at 533.

55. A. EHRENZWEIG, *supra* note 10, at 41.

nition of a creditor.[56]

C. *Who May Petition For a Bankruptcy Order?*

Any person who may be a debtor under the Code may commence a voluntary case.[57] An involuntary case, however, may be commenced only under Chapter 7 [Liquidation] or Chapter 11 [Reorganization] of the Code. Furthermore, one may only be commenced against a person (defined to include an individual, partnership and corporation) that may be a debtor under the chapter under which the case was commenced.[58] This group does not include a farmer or a corporation that is not a "moneyed, business or commercial corporation."[59] The persons who may file a petition in an involuntary case are discussed below.

1. *Creditors*

Three or more creditors holding claims in the aggregate of at least $5,000 may commence an involuntary case against a debtor. If there are fewer than twelve creditors, excluding insiders of the debtor and claimants with respect to certain voidable transactions, one or more creditors holding claims in the aggregate of at least $5,000 may commence an involuntary case.[60]

2. *Partners*

Any number of the general partners of a partnership may commence an involuntary case against the partnership.[61] If, however, relief has been ordered under the Code with respect to all of the general partners of a partnership, a general partner, the trustee of

56. The Code, § 101(9) provides that "creditor" means an "entity having a claim;" § 101(14) provides that an "entity" includes a "governmental unit;" and § 101(21) provides that a "governmental unit" means *inter alia* a "foreign state" or a department, agency, or instrumentality of a foreign state, or other foreign government. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. 101(9), 101(14), 101(21) (West 1979).

57. *Id.*, 11 U.S.C.A. § 301 (West 1979). For a discussion of who may be a debtor under the Code, see notes 26-48 *supra* and accompanying text.

58. *Id.*, 11 U.S.C.A. § 303 (West 1979).

59. *Id.*

60. *Id.* 11 U.S.C.A. §§ 303(b)(1), 303(b)(2) (West 1979). The definition of "creditor," as given in the Code and discussed *supra*, includes a class of creditors who do not become creditors until after some type of adjudication, *e.g.*, those who become creditors through the avoidance of a transfer or the recovery of a setoff. Accordingly, it is not any creditor defined by the Code who may join in an involuntary petition pursuant to § 303, but only a creditor who at the time of the petition is "the holder of a claim." *See id.*, 11 U.S.C.A. § 101(25) (West 1979) for the definition of "insider."

61. *Id.*, 11 U.S.C.A. § 303(b)(3)(A) (West 1979).

a general partner, or a holder of a claim against the partnership may commence an involuntary case against the partnership.[62]

3. *A Foreign Representative*

A foreign representative of the estate in a foreign proceeding may commence an involuntary proceeding against a person subject to such a proceeding.[63] A "foreign representative" means a duly selected trustee, administrator, or other representative of an estate in a foreign proceeding.[64]

Under the former Act, a foreign trustee who wished to obtain a local bankruptcy was required to solicit local creditors to petition on their behalf.[65] Thus, the trustee could do indirectly what could not be done directly. It was often difficult, however, to find two other creditors who would consent to join in the petition. Local creditors who had the opportunity to attach local assets would not generally find it to their advantage to have a bankruptcy in which all creditors, wherever located, could participate and have an equal share in the distribution of the bankrupt's property. In 1973, the Commission on the Bankruptcy Laws of the United States recommended that only a single creditor be required to initiate an involuntary proceeding.[66] The Commission made no reference to the difficulty sometimes experienced by foreign creditors, but based its recommendation upon the useless and complex litigation often caused by the requirement of three or more creditors.[67] Earlier bills which formed the basis for the Code required only a single creditor in an involuntary petition and permitted a foreign representative to "petition as a creditor" if the debtor was subject to involuntary relief.[68] When these earlier bills were amended to reinstate the general requirement of three petitioning creditors, the provision was also changed to permit

62. *Id.*, 11 U.S.C.A. § 303(b)(3)(B) (West 1979).

63. *Id.*, 11 U.S.C.A. § 303(b)(4) (West 1979).

64. For a definition of foreign proceedings, *see id.*, 11 U.S.C.A. § 101(19) (West 1979) and note 45 *supra*.

65. Bankruptcy Act of 1898, § 59b, 11 U.S.C. § 95(b) (1976) (repealed 1978).

66. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 137, 93d Cong., 1st Sess. Part I at 188–89, Part II at 74–75 (1973) [hereinafter cited as COMMISSION REPORT]. The Commission on the Bankruptcy Laws of the United States, created by the Act of July 24, 1970, Pub. L. No. 91–354, 84 Stat. 468 (1970), proposed a comprehensive revision of the bankruptcy laws in Part II of its report, which contained a draft of a proposed Bankruptcy Act of 1973.

67. COMMISSION REPORT, *supra* note 66 at Part I, 188.

68. *See* H.R. 16642, 93d Cong., 2d Sess. § 4–102(b)(1) (1974); H.R. 16653, 93d Cong., 2d Sess. § 4–102(b)(1) (1974).

foreign representatives to petition in their own right (not merely as creditors) and to save them from the burden of locating two creditors to join the petition.[69]

In order to file a petition, a foreign representative must establish that he has been "duly selected" as a foreign representative in a foreign proceeding with respect to the debtor. As a rule, this will be done by producing the foreign order "selecting" or appointing the foreign representative, attested to by the local vice consul of the United States. The foreign representative must also be prepared to establish that he or she comes within the definition of a "foreign representative" which requires *inter alia* a demonstration that the foreign proceeding in which he or she was appointed trustee was a proceeding in another country in which the debtor had some substantial connection.[70]

III. CONDITIONS FOR A COURT TO ORDER RELIEF AGAINST A DEBTOR IN INVOLUNTARY CASES

If the petition in an involuntary case is not timely controverted, the court must order relief against the debtor.[71] Otherwise, after trial the court must order relief against the debtor only if:

> (1) the debtor is generally not paying such debtor's debts as such debts become due; or
>
> (2) within 120 days before the date of the filing of the petition, a custodian,[72] other than a trustee, receiver, or agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession.[73]

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69. *See* Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 303(b)(4) (West 1979).

70. *See id.*, 11 U.S.C.A. § 101(19) (West 1979), for the requirements of a foreign proceeding.

71. *Id.*, 11 U.S.C.A. § 303(b) (West 1979).

72. The Code defines "custodian" to mean:

> (A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;
>
> (B) assignee under a general assignment for the benefit of the debtor's creditors; or
>
> (C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

Id., 11 U.S.C.A. § 101(10) (West 1979).

73. *Id.*, 11 U.S.C.A. § 303(h) (West 1979) (footnote added).

A. *General Inability of the Debtor to Pay Debts as They Become Due*

In some countries, a distinction is made between acts of bankruptcy committed within the country and those committed elsewhere.[74] In the United States, however, neither the former Act with respect to the old acts of bankruptcy,[75] nor the present Code with respect to the general inability of the debtor to pay debts as they become due,[76] make any reference to where these circumstances must occur in order for the court to grant relief in an involuntary case. Generally, a country is free to determine when its own law and when foreign law is to be applied.[77] In the absence of express or implied intention, however, the presumption is that the legislature does not intend a statute to operate beyond the territorial limits of its jurisdiction.[78] Thus, the extraterritorial scope of the Code in this regard must be examined more closely.

Before attempting to determine whether there is a territorial limitation on the inability to pay debts under the new Code, it would be helpful to consider whether there was any such limitation with respect to committing acts of bankruptcy under the former Act. In that Act the first three acts of bankrupty—a fraudulent transfer, a preferential transfer, and failure to discharge a lien obtained by legal proceedings or distraint—referred to "any of his property" or "any of the property of the debtor" without reference to the location of the property.[79] Since the definition of property vesting in the trustee referred to property wherever located and the legal proceedings referred to under the third act could apply equally to proceedings in local and foreign courts, it was certainly arguable that one could be the subject of an involuntary case whether these acts of bankruptcy took place within or without the country. On the other hand, it could be argued that a transfer of property abroad, being governed by foreign law, could not be said to be an act of bankruptcy in the United States.[80] This overlooks the fact, however, that the acts of bankruptcy tests were created by Congress to protect creditors, and it is immaterial

74. *See, e.g.*, Bankruptcy Act CAN. REV. STAT. B-3, §§ 24(1)(a)-24(1)(c) (1970) (Can.); Bankruptcy Act, 1914 and 1926, 4 and 5 Geo. 5 C. 59; 16 and 17 Geo. 5 C.7 § 1.

75. *See* Bankruptcy Act of 1898, § 3a, 30 Stat. 546 (repealed 1979).

76. *See* Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 303(h) (West 1979).

77. Lipstein, *Jurisdiction in Bankruptcy*, 12 MOD. L. REV. 454, 475 (1949).

78. 15A C.J.S. *Conflict of Laws* § 3(1) (1967).

79. Bankruptcy Act of 1898, §§ 3a(1)-3a(3), 66 Stat. 421 (1952) (repealed 1979).

80. *See* Cooke v. Charles Vogler Co. [1901] A.C. 102, 113; Re Debtors (No. 836 of 1935) [1936] All E.R. 875.

where the transaction took place if it indicates financial difficulty on the part of the debtor.[81]

The fourth act of bankruptcy under the former Act, a general assignment by the debtor for the benefit of creditors, has been held to be applicable to such assignments committed abroad.

> Obviously, [an assignment for the benefit of creditors] was made an act of bankruptcy because the alleged bankrupt thereby placed the property for the time being beyond his control. It is, therefore, immaterial whether such a general assignment is made within or without the United States, and the statute evidently contemplated that wherever a person made such a general assignment the act was an act of bankruptcy.[82]

The former fifth act of bankruptcy, permitting the appointment of a receiver or trustee to take charge of the debtor's property, was not included in the original Act of 1898. It was added in 1903, but specifically referred to this receiver or trustee as one appointed under the laws of a State, of a Territory, or of the United States.[83] This, of course, excluded a foreign receiver or trustee. In 1926, the provision was amended and any reference to the laws under which the receiver or trustee had been appointed was removed.[84]

> [The present version of the fifth act] covers the appointment abroad of a trustee in bankruptcy. It does not seem to make any difference whether the trustee has been appointed by the court of the domicile or another court. Thus, a bankruptcy declaration abroad will generally be sufficient to obtain, without further proof, a bankruptcy adjudication in the United States if the debtor has assets in this country.[85]

It is likely that the former Bankruptcy Act was intended to take a global view of the debtor's financial condition and the debtor's behavior respecting the payment of debts. However, if Congress intended the Bankruptcy Act to take a worldwide view of the debtor's financial condition, this intention was not in all respects clearly expressed.

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81. While the definition of insolvency under the former Act referred to the aggregate of the debtor's property, it did not specifically state that that property included property "wherever located." *See* Bankruptcy Act of 1898, 1(19), 52 Stat. 841 (1938) (repealed 1979). On the other hand, the Act specifically provided that all of the debtor's nonexempt property "wherever located" vested in the trustee. *Id.* § 70(a), 66 Stat. 430 (1952) (repealed 1979).

82. *In re* Berthoud, 231 F. 529, 534 (S.D.N.Y. 1916).

83. Bankruptcy Act of 1898, § 3a(4), 32 Stat. 797 (1903) (amended 1926) (repealed 1979).

84. *See* Bankruptcy Act of 1898, § 3a(5), 44 Stat. 663 (1926) (repealed 1979).

85. Nadelmann, *supra* note 36, at 1039.

The Bankruptcy Code has abandoned acts of bankruptcy which in some cases required proof of insolvency to trigger bankruptcy. The conditions for an involuntary case have been replaced by the inability of the debtor to pay debts as they become due and the appointment of a custodian authorized to take charge of substantially all of the property of the debtor.[86]

The financial system upon which the commercial world functions depends upon the prompt settlement of obligations. The default of one participant in the system endangers the others. It is for this reason that the cessation of payments is regarded as a danger signal which gives rise to a presumption: one who defaults in payments is in financial difficulty. Given the advantage to creditors of a bankruptcy soon after the debtor is first unable to pay one hundred cents on the dollar of his or her debts, it is not unreasonable to take a global view of a debtor's financial condition. Both foreign and local defaults are equally indicative of the debtor's financial trouble. It is, therefore, not unreasonable to assume that Congress intended the cessation of payments to trigger a bankruptcy, regardless of where the cessation took place. In other words, a general cessation in the payment of debts standard requires a worldwide, rather than a local or territorial, view.

It must be noted, however, that, aside from the policy discussed above, there is little concrete basis for concluding that Congress intended the Code to operate beyond the territorial limits of the United States. The general rule is that legislation is *prima facie* territorial. If a statute is to have an extraterritorial effect it should plainly so indicate, as has been done in other provisions of the Code. For example, all property of the debtor, wherever located, forms the debtor's estate.[87] Similarly, a governmental unit is specifically defined to include a foreign state or a department, agency, or instrumentality of a foreign state, or other foreign government.[88] If Congress intended the statute to operate beyond the territorial limits of the United States so as to apply to a foreign cessation of payments, it could have provided that the court shall order relief against the debtor in an involuntary case when "the debtor is generally not paying such debts *within or without the United States* as such debts become due" or some similar language. Nonetheless, Congress did not do so.

86. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 303(h)(1)-(2) (West 1979).
87. *Id.*, 11 U.S.C.A. § 541(a) (West 1979).
88. *Id.*, 11 U.S.C.A. § 101(211) (West 1979).

Furthermore, there is no evidence to indicate that the drafters of the Code specifically considered the problems of a foreign cessation of payments by either a foreign national or by a debtor domiciled in the United States. They also did not consider whether the unpaid debts had any substantial connection with the United States.

It is clear that Congress has the legislative capacity to provide that a foreign act or transaction could be used to trigger a local bankruptcy. The question is whether the legislation has been drafted so as to require such an approach. Certainly this is the preferable view. The cessation of payments is a danger signal wherever it occurs. A court should, and no doubt would, strive to interpret the statute to give effect to this view.

A related question is whether a foreign debtor may rely on the bankruptcy law of his or her country as a defense to the allegation that, under United States bankruptcy standards, his or her debts are generally not being paid as they become due. In some countries, such as Norway[89] and Denmark,[90] a debtor must be insolvent to be adjudged bankrupt. France, on the other hand, uses the cessation of payments test (*qui cesse ses paiments*[91]). In England a company may be wound up if it is unable to pay its debts. The company is deemed to be unable to pay its debts if, for example, it does not pay a creditor to whom it is indebted after a demand for payment is made, or execution issued on a judgment in favor of a creditor of the company is returned unsatisfied in whole or in part.[92]

Thus, in United States bankruptcy proceedings against a Norwegian debtor, it would be immaterial whether the debtor was insolvent, if he or she was in fact not paying debts as they became due, since the *lex fori* determines the applicable law. Similarily, a debtor domiciled in France may have ceased payments according to the law of France, or an English company may be unable to pay its debts according to the law of England, and either could still be considered as paying debts as they became due under the United States Bankruptcy Code. Under these circumstances a

89. Law of 6 June 1863, article 3.

90. Bankruptcies Act of 25 March, 1872, articles 40 and 43.

91. Law No. 67-563 §§ 1, 4 [1967] J.O.

92. Companies Act, 11 and 12 Geo. 6 C. 38, § 222(e), 223. The New Canadian Bankruptcy Bill provides that in certain events, a debtor is deemed to have ceased to pay debts generally as they become due and in other events deemed, unless the contrary is proved, to have ceased to pay debts generally as they become due. S. 9, 31st Parlt., 1st Sess. § 5 (1979) [hereinafter cited as Canadian Bankruptcy Bill].

court would not have authority under the Code to order relief against the debtor. It must be assumed that Congress, in propounding the test of general inability to pay debts, was primarily trying to protect national creditors. Thus, any other test is immaterial when the *lex fori* is the United States.

B. *Appointment of a Custodian*

A bankruptcy court may also order relief against a debtor in an involuntary case if, within 120 days before the filing of the petition, a custodian is appointed to take charge of property of the debtor for the purpose of enforcing a lien against that property.[93] This provision is based on the former fifth act of bankruptcy.[94]

As in the case of general inability of the debtor to pay debts, the custodial rule does not specify whether it is applicable to the appointment of a foreign custodian. Again there is no doubt that Congress has the legislative capacity to enact legislation providing for a bankruptcy adjudication because of the foreign appointment of a custodian over the debtor's property. Yet, as in the case of a debtor generally not paying debts as they become due, Congress apparently did not expressly focus on whether the appointment of a foreign custodian constituted sufficient grounds for a bankruptcy adjudication. Considering the financial difficulty that the appointment of a custodian indicates and that a debtor's property, by definition, is property wherever located, it would seem that a court would strive to take a worldwide view of a debtor's financial condition, and order relief against a debtor if the custodial appointment took place.

IV. Direct Access of a Foreign Representative to the Bankruptcy Court

Under the former Bankruptcy Act, a foreign trustee seeking relief in the United States was required to litigate in either state or federal nonbankruptcy courts. Under the present system, a centralized court is provided for all bankruptcy related matters. The bankruptcy court now has original, though not exclusive, jurisdiction over all court proceedings arising under title 11 or arising in or related to cases under title 11.[95] Pursuant to this widened juris-

93. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 303(h)(2) (1979) (West 1979).

94. Bankruptcy Act of 1898, § 3a(5), 52 Stat. 844 (1938) (repealed 1979). *See* notes 83–85 *supra* and accompanying text.

95. Bankruptcy Reform Act of 1978, § 201, 11 U.S.C.A. § 1471 (West Supp. 1979).

diction, foreign trustees are given direct access to the Court.

A. *What is a Foreign Proceeding and Who is a Foreign Representative*

Reference has already been made to "foreign representatives" and "foreign proceedings" in discussing the presentation of a petition for an involuntary case by a foreign representative.[96] These concepts will be more fully developed here.

A "foreign representative," who may be more conveniently referred to as a foreign trustee, is defined by the Code to mean a "duly selected trustee, administrator, or other representative of an estate in a foreign proceeding."[97]

A "foreign proceeding" is in turn defined to mean:

> [a] proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge or effecting a reorganization.[98]

A foreign trustee seeking to exercise the rights given by the Code must be prepared to establish that the definitional requirements are met.

First, the foreign trustee or representative must be "duly selected," *i.e.*, appointed pursuant to the foreign law. At a minimum, this requires the trustee to be appointed in the standard manner for that jurisdiction. A trustee appointed in any other manner would not be "duly selected."

Second, the foreign trustee must be the trustee, administrator, or foreign representative of an "estate." Initially, this would seem to require an "estate" as contemplated by the Bankruptcy Code, one that is created by the commencement of liquidation proceedings. The meaning of an "estate" must, however, be read broadly enough to include the "estate" of a debtor in reorganization proceedings, since the definition of "foreign proceedings" specifically refers to proceedings for the purpose of "adjusting debts by composition, extension, or discharge or effecting a reorganization."[99] It might even include the property of the debtor charged by a se-

96. *See* note 70 *supra* and accompanying text.
97. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 101(20) (West 1979).
98. *Id.*, 11 U.S.C.A. § 101(19) (West 1979).
99. *Id.*

curity agreement. Since the definition of foreign proceeding also specifically includes a proceeding to liquidate an estate, it would seem to include, in appropriate circumstances, the liquidation of charged property.

Third, the foreign proceeding pursuant to which the foreign representative is duly selected must be a "judicial or administrative proceeding." Thus, a foreign trustee appointed privately under a general assignment for the benefit of creditors or the private appointment of a receiver or other representative of a secured creditor under a security agreement for the purpose of liquidating the charged property would not satisfy this requirement.

Finally, the foreign country in which the foreign trustee is selected must be the country in which the debtor's "domicile, residence, principal place of business, or principal assets are located." Thus, for example, the trustee of a debtor adjudged bankrupt in Canada where the Canadian court has jurisdiction solely by reason of the presence of assets in Canada which do not amount to the debtor's principal assets, does not fit within the definition of a "foreign representative."

B. *Enjoining the Commencement or the Continuation of a Case on the Application of a Foreign Representative*

In addition to the right of a foreign representative to petition for a bankruptcy order in the United States,[100] a foreign representative may also petition the court to enjoin the commencement or continuation of certain actions. These include actions against the debtor with respect to property involved in the foreign proceeding, or against the property itself. Also included are actions to enjoin the commencement or the continuation of "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. . . ."[101]

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100. *See* notes 63–70 *supra* and accompanying text.

101. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 304(b)(1) (West 1979). There is no antecedent in the section for "such" in the reference to "such estate." It must be assumed that it refers to the estate to which the foreign representative has been approved.

The proper venue for proceedings instituted by a foreign representative is the bankruptcy court in which the action is pending or in the territories of which the property of the debtor is located. Bankr. R. 116. The debtor or a party in interest may controvert any ancillary proceedings commenced by a foreign representative. *Id.*, 11 U.S.C.A. § 304(b) (West 1979). The Code grants very broad discretion to the bankruptcy courts in determin-

The purpose behind granting to a foreign trustee the right to petition the court to enjoin the commencement or continuation of these proceedings and in other situations where cases ancillary to foreign proceedings may be brought, is to prevent dismemberment, by local creditors, of property of the debtor situated in the United States. A foreign representative generally has two remedies available where it is feared that local creditors may attempt to attach or have attached local property of the debtor, thereby gaining priority over other creditors. The foreign representative may either petition for a local concurrent bankruptcy pursuant to section 303(b)(4), or petition under section 304(b)(1) to enjoin the commencement or continuation of actions against local property, or to obtain a turnover order of local property.

A difficult question that arises is whether a foreign trustee could defeat rights acquired by local creditors through a levy on local assets. The Bankruptcy Commission, in its comment upon this section, assumed that the section does not override the general American conflict of laws rule that foreign trustees may not defeat rights acquired by local creditors.[102]

C. *A Foreign Representative May Seek a "Turnover Order"*

A foreign representative also may petition for a "turnover order," which results in the property or proceeds of the property of the estate being turned over to the foreign representative.[103] Given the equitable and discretionary power of the bankruptcy courts, a court, in issuing a turnover order, would presumably not be precluded from imposing conditions on the foreign trustee. An example of such a condition is found in a recent Australian case. The court ordered a turnover of Australian funds to a New Zealand liquidator, provided the liquidator first agreed to deal with the funds as part of the amalgamated balances and not to pay further dividends until Australian creditors had been paid a dividend comparable to that paid to New Zealand creditors.[104]

D. *A Foreign Representative May Seek Other Appropriate Relief*

Section 304(b) of the Code also has a catchall provision which

ing whether to grant relief to a foreign representative under § 304(b)(1). *See id.*, 11 U.S.C.A. § 304(c) (West 1979).

102. COMMISSION REPORT, *supra* note 66, Part II, at 70–71.

103. 11 U.S.C.A. § 304(b)(2) (West 1979). Again, although it is unclear on the face of the statute, the estate in question is the one which the foreign trustee represents.

104. *Re* Standard Insurance Co., [1968] Queensl. 118.

gives the court jurisdiction to make any appropriate order on the petition of a foreign trustee.[105] Such an order would relate primarily to the preservation of the property of the foreign debtor for the benefit of all the creditors.

To illustrate, if a foreign representative alleges that the debtor made a fraudulent preference under the law of the United States, the transaction could be attached only under the Bankruptcy Code and a local adjudication would first be required. If, however, the foreign representative alleges that a creditor in the United States received a fraudulent preference from a foreign debtor for whom the foreign representative has been appointed trustee, the bankruptcy court of the United States, in a case ancillary to the foreign proceeding, would have jurisdiction to decide whether the transaction was an avoidable preference under the foreign law. It is doubtful, however, that a court would set aside the preference of a local creditor that had survived the preference period under the law of the United States.[106]

Other appropriate relief under the catchall provision might be to order a party in interest to a foreign proceeding who resides in the United States to submit locally to discovery in the foreign proceedings. Such an order, in certain circumstances, could be regarded as assuring "an economical and expiditious administration" of the estate or "the prevention of preferential or fraudulent disposition of property of such estate"[107] assuming the party could give evidence that would assist the trustee in the administration of the estate.

E. *The Court's Exercise of Discretion on the Petition of a Foreign Representative*

The Code specifically provides that the court shall use its dis-

105. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 304(b)(3) (West 1979).

106. *See* notes 101–02 *supra* and accompanying text; note 108 *infra* and accompanying text.

The Bankruptcy Code does not distinguish between preferences received by domestic and foreign creditors. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 547 (West 1979). Since the debtor's estate includes property wherever located, if the parties are within the jurisdiction of the court, a creditor who received an avoidable preference abroad may be compelled to surrender it. A transfer made after bankruptcy does not fit within the definition of a preference. Nevertheless, where a creditor has acquired a preference abroad after a bankruptcy has been declared in the United States, the preference is voidable. In re Pacat Finance Corp., 295 F. 394, 405 (S.D.N.Y. 1923); *see also* Nadelmann, *supra* note 36, at 1051-56.

107. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 304(c) (West 1979). *See* text accompanying note 108 *infra*.

cretion in determining whether to grant relief on a petition by a foreign representative based on the economical and expeditious administration of the estate.[108] The Code further instructs the courts to exercise this discretion consistent with:

> (1) just treatment of all holders of claims against or interests in such estate;
> (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
> (3) prevention of preferential or fraudulent dispositions of property of such estate;
> (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
> (5) comity; and
> (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.[109]

These guidelines are designed to give the court the maximum flexibility in handling ancillary cases. Principles of international comity suggest that the court should be given broad discretion so that it may order the appropriate relief under the circumstances of each case.

Although the Code states that the court *shall* be guided by the factors listed above in exercising its discretion, there is nothing to indicate that the court cannot take into consideration other factors as well. For example, if the country of the foreign representative flagrantly refused to provide reciprocal arrangements for trustees from the United States, a United States court, on grounds of comity, could refuse a petition for relief by a foreign representative from that country, since that country's actions could be regarded as contrary to notions of international fair play and justice. Under such circumstances, there are usually other grounds for a court's refusal to exercise its discretion such as local creditors being treated unjustly or being prejudiced or inconvenienced in processing claims in the foreign proceeding.[110]

Though the Code specifically directs the courts to consider the section 304(c) guidelines, a word of caution may be in order. First, it is important to realize that no two countries have identical priority rules. Thus, a court must be careful to ascertain at what

108. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 304(c) (West 1979).
109. *Id.*, 11 U.S.C.A. § 304(c) (West 1979).
110. S. REP. No. 989, 95th Cong., 2d Sess. 35, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5821.

point foreign priority legislation can no longer be substantially in accordance with the Code priorities.

Similarly, there is always some additional inconvenience and expense in having to prove a claim in a foreign proceeding—even one brought in a United States bankruptcy court. This, however, should be balanced against the higher dividend that creditors will probably receive, since the property located both in the foreign country and in the United States will be available for distribution among all creditors.

Generally, several factors may be recognized as favoring the exercise of discretion in granting the petition of a foreign representative. They 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); (4) where more creditors and a greater part of the estate of the debtor are located in the foreign country. On the other hand, one would expect that the court would not exercise its discretion so as to defeat rights acquired by local creditors through an attachment of local property of the debtor.

F. *Dismissal or Suspension of a Case on the Application by Foreign Representative*

A court has an inherent power to dismiss and a court of equity is assumed to have an inherent right not to exercise its powers. Where, however, there is a statutory power, courts seldom resort to this inherent power.[111]

In 1962, a statutory power to dismiss a bankruptcy case where there had already been a foreign adjudication was added to the

111. The leading bankruptcy case concerning a bankruptcy court's inherent power is SEC v. United States Realty and Improvement Co., 310 U.S. 434 (1940), which is quoted in Banque de Financement S.A. v. First Nat'l Bank of Boston, 568 F.2d 911, 915 (2d Cir. 1977). *Cf.* Nadelmann, *Rehabilitating International Bankruptcy Law: Lessons Taught by Herstatt and Company*, 52 N.Y.U.L. REV. 1, 19 (1977) ("While inherent power may exist, the court should have express statutory power not to go through with the bankruptcy adjudication.").

former Bankruptcy Act by the addition of section 2a(22).[112]

> [Courts of bankruptcy may] [e]xercise, withhold or suspend the exercise of jurisdiction, having regard to the rights or convenience of local creditors and to all other relevant circumstances, where a bankrupt has been adjudged bankrupt by a [foreign] court of competent jurisdiction without the United States.[113]

That section was superceded by Bankruptcy Rule 119 which gave substantially the same powers to the court but went on to provide that the power to suspend or dismiss a case exists where there are foreign rehabilitation as well as liquidation proceedings affecting the debtor.[114]

This discretionary power clause has again been rewritten; section 305 of the Bankruptcy Code now provides:

> (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—
>
> . . . .
>
> (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.[115]
>
> (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.[116]

The exercise of the discretionary power is now drafted on a procedural basis; a complaint by a foreign representative or any other interested person must be filed and a hearing held after notice. The discretion of the court is limited by the guidelines contained in section 304(c), and there is no longer the umbrella phrase contained in both former section 2a(22) and Rule 119 permitting the discretion to be exercised if there are "other relevant circumstances."[117]

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112. Pub. L. No. 87–681, 76 Stat. 570 (repealed 1978). For a discussion of the pre-1962 law see Nadelmann, *supra* note 36, at 1040–46. For a comment on the 1962 revision see Nadelmann, *The American Bankruptcy Act and Conflicting Administrations*, 12 INT'L & COMP. L.Q. 684 (1963).

113. Bankruptcy Act of 1898, 2a(22), 76 Stat. 570 (1962) (codified at 11 U.S.C. § 11(a)(22) (1976) (repealed 1979)).

114. BANKR. R. 119.

115. For a discussion of these factors or guidelines see notes 108–10 *supra* and accompanying text.

116. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 305 (West 1979).

117. *See* notes 113–14 *supra*. The abstention section still permits the court in all cases

In *Banque de Financement S.A. v. First Nat'l Bank of Boston*,[118] one aspect of former section 2a(22) was considered by the second circuit:

> Section 2a(22) was not intended to be the instrument by which jurisdiction over a foreign domiciliary grounded in section 2a(1) could be undercut for the purpose of validating preferential transfers to United States nationals. Section 2a(22) was enacted as an administrative reform. It was designed to avoid needless duplication of effort by courts and creditors in those cases where an ancillary proceeding in this country could be coordinated with or entirely dismissed in favor of a domiciliary proceeding abroad . . . . In exercising its discretion, the district court is to guard against forcing American creditors to participate in foreign proceedings in which their claims will be treated in some manner inimical to this country's policy of equality.[119]

G. *Limited Appearance By a Foreign Representative*

In the Herstatt Bank litigation[120] the German liquidator of a German bank, which had its principal place of business and major assets in Germany, claimed approximately $150 million on deposit in the Chase Manhattan Bank in New York. One of the unusual features of this litigation was that the German liquidator never appeared in the New York proceedings. His counsel apparently advised him not to appear, on the theory that if he did, he would subject himself to the jurisdiction of the United States courts.[121] Under the Code, however, a foreign representative may appear in the courts of the United States to petition either for a bankruptcy order or for relief in a case ancillary to a foreign proceeding, without being subjected to the jurisdiction of any United States court for any other purpose.[122] The bankruptcy court, however, may condition any order under section 303, 304, or 305 on compliance by the foreign representative with the orders of the bankruptcy court.[123]

The protection given to a foreign representative by a limited

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to dismiss a case when the interests of the creditors and the debtor would be better served, but this general discretion is more limited than the "any other circumstances" language under the former Act. 11 U.S.C.A. § 305(a)(1) (West 1979).

118. 568 F.2d 911 (2d Cir. 1977).

119. *Id.* at 921.

120. For a discussion of the collapse of the Herstatt Bank, see Becker, *International Insolvency: The Case of Herstatt*, 62 A.B.A.J. 1290 (1976).

121. *Id.* at 1292.

122. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 306 (West 1979).

123. *Id.*, 11 U.S.C.A. § 306 (West 1979).

appearance is necessary to permit the representation of the foreign estate in the United States without waiving the normal jurisdictional rules.[124] Creditors in the United States will still have to seek redress against the foreign estate according to the host country's jurisdictional rules. If it were not for the protection of the limited appearance, local creditors could obtain an unfair advantage by filing an involuntary case against the debtor who had been adjudged bankrupt in a foreign country, thus requiring the foreign representative to appear.[125] Local jurisdiction over the foreign representative and the estate would be obtained with this appearance, and the creditors would have a local forum to adjudicate their claims against a foreign debtor. This is a variation of the ambush technique that has been rejected frequently by the courts in other contexts.[126]

A foreign trustee who makes a limited appearance in a United States court is not, however, completely free of the jurisdiction of the court, and therefore cannot be irresponsible. The bankruptcy court as it has been seen, may condition any order it gives in favor of the foreign trustee on compliance with the orders of the court. This is not intended to negate the general rule, but is designed to enable the bankruptcy court to enforce its own orders.[127]

V. Recognition in Foreign Countries of a Bankruptcy Adjudication in the United States

Under the former Act all property of the debtor, wherever located, vested in the trustee.[128] Under the Code, there is no longer an assignment of property to the trustee, but, upon the commencement of a liquidation case, all nonexempt property of the debtor, wherever located, creates an estate.[129] Title apparently remains in the debtor, but the exclusive right to administer the estate passes to the trustee.

The Bankruptcy Act of 1898 did not originally have any provision concerning property situated abroad. It did provide, however, that all property that the debtor "could by any means have

124. S. Rep. No. 989, 95th Cong. 2d Sess. 36, *reprinted in* [1978] U.S. Code Cong. & Ad. News 5787, 5822.

125. *Id.*

126. *Id.*

127. *Id.*

128. Bankruptcy Act of 1898, § 70(a), 66 Stat. 430 (1952) (repealed 1979).

129. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 541(a) (West 1979).

transferred," passed to the trustee.[130] Professor Nadelmann, writing in 1946, noted that this provision made no distinction between property located inside or outside the United States, and that the Act specifically required the debtor to "execute and deliver to his trustee transfers of all his property in foreign countries."[131] He took issue with foreign commentators who had stated that the territoriality system, with some exceptions, governs in the United States, and that the statutory assignment operated only upon property situated in the United States.[132] For the sake of clarity, however, Professor Nadelmann advocated that the Act be amended to state specifically that all property of the debtor, wherever located, vested in the trustee.[133] His recommendation was made law in 1952.[134]

It is clear that the law of the United States now purports to bring all property of the debtor, wherever located, into the debtor's estate. It is equally clear that there is very little recognition abroad of the right of a trustee appointed in the United States to either claim or take control of a debtor's property located outside the United States. Not surprisingly, it is very difficult for an American trustee to collect foreign assets.

Professor Nadelmann summed up the legal difficulties faced by a trustee attempting to reach foreign assets.

> There exists, at the present time, no general rule as part of the comity of nations following which the bankruptcy courts of one country assist the courts of another by allowing a foreign trustee in bankruptcy to obtain possession of local assets. On the contrary, in most of the countries delivery of local assets to him is refused at least if opposed by local creditors. On the other hand, in nearly all the civil-law countries treaties have been concluded, especially with immediate neighbours, which provide for mutual assistance and a single bankruptcy administration.[135]

Although there is no general rule among nations concerning the recognition of claims asserted by foreign bankruptcy trustees,

130. Bankruptcy Act of 1898, § 70a(5), 30 Stat. 566 (1898), (amended 1938) (repealed 1979).

131. *Id.*, § 7a(5), 30 Stat. 548 (1898) (repealed 1979); Nadelmann, *supra* note 36, at 1029.

132. *Id.* at 1026–35.

133. *Id.* at 1031.

134. Pub. L. No. 82–456, 66 Stat. 420 (1952) (repealed 1978). For a comment on the amendment see Nadelmann, *Revision of Conflicts Provisions in the American Bankruptcy Act*, 1 INT'L & COMP. L.Q. 484 (1952).

135. Nadelmann, *International Bankruptcy Law: Its Present Status*, 5 U. TORONTO L.J. 324, 339 (1944).

many countries do recognize such claims, but with qualifications.[136] This section of the article presents a brief account of the rules in countries that are the principal trading partners of the United States.

English courts recognize that bankruptcy proceedings in any country outside the United Kingdom, whose courts are recognized by English law as having jurisdiction over a debtor, operate as an assignment of the debtor's movable property situated in England[137] to the foreign trustee. The movables pass to the foreign trustee subject to any charge upon them that is valid under English law. If, however, the foreign bankruptcy adjudication preceded any attachment or garnishment of the debt in England, the title of the foreign trustee prevails.[138]

The rule in the common law provinces and territories of Canada is similar to that of England, so long as no Canadian bankruptcy proceedings are taking place with respect to the debtor.[139] On the other hand, in the Province of Quebec, where the civil law prevails, the courts do not recognize a foreign bankruptcy as an assignment of either movable or immovable property situated within the province.[140] The Quebec courts, however, will recognize the capacity of a foreign trustee to represent the estate of the bankrupt in the Province of Quebec when no adverse interest has been acquired in Canada over the property in question. Otherwise, the trustee's claim will be subject to all of the equities and rights of creditors and others according to the law of Quebec.[141] Thus, when there is a foreign bankruptcy adjudication, creditors are free to attach property of the debtor in Quebec.

The new Canadian bankruptcy bill now before the Canadian Parliament contains provisions comparable to sections 304, 305, and 306 of the United States Bankruptcy Code,[142] but, as in the United States the general conflict of laws rule remains that a for-

136. *See generally*, Riesenfeld, *The Status of Foreign Administrators of Insolvent Estates: A Comparative Survey*, 24 AM. J. OF COMP. L. 288 (1976).

137. A. DICEY & J. MORRIS, THE CONFLICT OF LAWS 691 (9th ed. 1973). This rule does not apply to immovable property situated in England. *Id.* at 693–94.

138. Galbraith v. Grimshaw, [1910] A.C. 508, 510 (H.L.).

139. Williams v. Rice & Rice Knitting Mills Ltd., [1926] 3 D.L.R. 225 (Can. 1926) (movable property); MacDonald v. Georgian Bay Lumber Co., 2 Can. S. Ct. 364 (1878) (immovable property); 2 J. CASTEL, CANADIAN CONFLICT OF LAWS 504 (1977).

140. 2 J. CASTEL, *supra* note 139, at 505.

141. Allen v. Hanson, [1890] 16 Q.L.R. 79, 87.

142. Canadian Bankruptcy Bill, *supra* note 92, § 316.

eign trustee may not defeat prior rights acquired by local creditors through attachment of local assets.

In France, recognition will be given to a foreign adjudication and extensive powers accorded to a foreign trustee if the foreign judgment is first provided with an *exequatur* by a French court.[143] An *exequatur*—from the Latin "let it be executed"—is the order by a French court granting authority and ordering enforceable a foreign judgment.[144] A partial *exequatur* may be granted for a limited purpose, such as to take a specific action in France against the debtor or the debtor's property based upon the foreign judgment. In some circumstances, such as the collection of debts, a foreign trustee may act without an *exequatur*.[145]

German courts tend to disregard completely foreign bankruptcy proceedings.[146] All creditors, whether at home or abroad, have the right to pursue their claims against the German property of a debtor even after the opening of proceedings abroad. The German Bankruptcy Code specifically states that the commencement of foreign bankruptcy proceedings does not prevent the execution of a German judgment against a debtor's assets situated in Germany.[147] In the case of a foreign corporation, however, German law recognizes the right of a foreign trustee to represent the debtor and collect the German assets, if this is permissible under the appropriate foreign law.[148] Thus, there may be a difference if the foreign law provides for a vesting of the debtor's property in a trustee, or a receiver or liquidator is appointed who has the right to administer the debtor's affairs.

In this overview, it is not feasible to examine the legislation of all major trading partners of the United States with respect to the recognition of bankruptcy adjudications made here. Yet, as a

143. Nadelmann, *supra* note 135, at 330; Riesenfeld, *supra* note 136, at 300. *See generally*, Lorenzen, *The Enforcement of American Judgments Abroad*, 29 YALE L.J. 188, 196–98 (1919).

144. *See* text accompanying notes 169, 188 *infra*.

145. Riesenfeld, *supra* note 136, at 300–01; Nadelmann, *Codification of Conflict Rules for Bankruptcy*, 30 SCHWEIZERISCHES JARBUCH FUR INTERNATIONALES RECHT 57, 94 (1974). Italy, Belgium, and Luxembourg follow procedures that are similar to those in France. Riesenfeld, *supra* note 136, at 301–04.

146. Hanisch, *The Debtor's Assets Situated Abroad in Domestic Bankruptcy—A General Overview*, in Int'l B.A. Proc. of the Seminar in Extraterritorial Prob. in Insolvency Proc. 1.5 (1978). This is generally the position taken by Switzerland as well. *Id.*

147. Konkursurdnung § 237 (1877). *See* Glass, *The Debtor's Assets Situate [sic] Abroad in Domestic Bankruptcy—The German View*, Int'l B.A. Proc. of the Seminar on Extraterritorial Prob. in Insolvency Proc. 3.2 (1978).

148. *Id.* at 3.2; Riesenfeld, *supra* note 136, at 304.

general observation, Professor Riesenfeld was correct in concluding: "[n]o country automatically gives full extraterritorial effect to a foreign insolvency law and to an adjudication pursuant thereto. Conversely, no country seems totally to disregard the effects of foreign insolvencies."[149]

As a practical matter, however, regardless of whether a country recognizes a foreign bankruptcy as an assignment of local property, a debtor present in the United States may be compelled to "execute to his trustee transfers of all his property in foreign countries. . . ."[150] This duty was specifically imposed upon all bankrupts by section 7a(5) of the former Act.[151] Although no such provision exists in the Code, the same result is achieved by imposing upon the debtor the duty to transfer to the trustee all property of the estate and any information relating to property of the estate.[152] This result follows from the requirement that the estate is comprised of the debtor's property, wherever located.[153]

VI. INTERNATIONAL EFFECT OF A DISCHARGE IN BANKRUPTCY

The international effect of a discharge in bankruptcy may be viewed from two perspectives. First, one may consider what debts due to local creditors will be held to be excused or discharged by a foreign bankruptcy so as to preclude subsequent proceedings to collect the debt in United States courts. Second, one may consider what debts due foreign creditors will be held to be barred or discharged by a United States bankruptcy adjudication so as to preclude subsequent proceedings to collect the debt in foreign courts.

A. *The Effect Given to a Foreign Discharge in the United States*

Courts in Maine,[154] Massachusetts,[155] and Vermont[156] have applied the rule that a discharge from any debt or liability under the bankruptcy law of a foreign country operates as a discharge in those states if it would be a discharge under the law of contract or

149. Riesenfeld, *supra* note 136, at 290.
150. Bankruptcy Act of 1898, § 7a(5), 30 Stat. 548 (1898) (repealed 1979).
151. *Id.*
152. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 521(3) (West 1979).
153. *Id.*, 11 U.S.C.A. § 541 (West 1979).
154. Very v. McHenry, 29 Me. 206 (1848).
155. May v. Breed, 61 Mass. (7 Cush.) 15 (1851).
156. Peck v. Hibbard, 26 Vt. 698 (1854).

tort.[157] New York courts, however, have held that a foreign discharge does not have any extraterritorial effect. Thus, unless the creditor, by consent, gave the foreign court jurisdiction over the claim, the foreign discharge cannot be used as a defense to an action by a creditor residing in the United States.[158]

The issue has not been before the United States Supreme Court since the 1827 decision of *Ogden v. Saunders*,[159] where the approach taken was that of the New York courts. On the strength of *Ogden*, Professor Nadelmann believes that in the United States foreign discharges in bankruptcy are no defense to an action by a creditor residing in the United States unless, by consent, the creditor gave the foreign court jurisdiction over the claim.[160]

It is significant, however, that *Ogden* was decided at a time when bankruptcy and insolvency legislation was regarded primarily as providing relief for creditors. We have passed through that period in our history, and through the period where the interest of the debtor was regarded to be paramount, to the present period where the overriding interest is deemed to be the national interest.[161] The Bankruptcy Code purports to discharge debts wherever contracted or payable[162] and the need for greater reciprocal recognition of bankruptcy adjudications is generally recognized. Thus, despite the *Ogden* decision, it would seem to be an open question whether the Supreme Court of the United States would give greater effect to a foreign discharge if the issue came before it again.[163]

B. *The Extraterritorial Effect Given to a United States Discharge*

The Bankruptcy Code purports, in general terms, to "discharge the debtor from all debts and liabilities that arose before the order for relief and whether or not a proof of claim based on

157. J. MACLACHLAN, BANKRUPTCY § 124 (1956); Bailey, *A Discharge in Insolvency and Its Effects on Non-Residents*, 6 HARV. L. REV. 349 (1893).

158. Phelps v. Borland, 103 N.Y. 406, 9 N.E. 307 (1886); Johnstone v. Johnstone (N.Y. Sup. Ct.), N.Y.L.J., Oct. 6, 1937, at 1014, col. 7.

159. 25 U.S. (12 Wheat.) 213, 358 (1827).

160. Nadelmann, *Compositions—Reorganizations and Arrangements—in the Conflict of Laws*, 61 HARV. L. REV. 804, 827 (1948).

161. *See* C. WARREN, *supra* note 2, at 95–159. Professor Warren coined the phrases, "the period of the creditor," "the period of the debtor," and "the period of the national interest." *Id.* at 3, 49, 95.

162. *See* notes 164–65 *infra* and accompanying text.

163. *See* Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 502 (West 1979) for the provision governing the effect given to a foreign distribution in the United States.

any such debt or liability was filed."[164] The Code distinguishes between local and foreign proceedings, local and foreign trustees, and local and foreign banks and insurance companies. As we have seen, the presumption is that the general inability of a debtor to pay debts as they become due applies to both local and foreign debts. There is, however, no distinction made in the Code concerning the effect a discharge will have on local or foreign debts. Although the Code drafters could have dealt with the issue explicitly, it may still be concluded that discharge granted under the Bankruptcy Code discharges debts due to all creditors, regardless of where the debts were contracted or were payable.[165]

It is, of course, another question whether foreign courts will recognize the purported extraterritorial effect of a discharge granted in the United States. As one might expect, there is no general rule. A brief survey of the discharge rules of a few representative countries will indicate the great variation in rules governing this subject.

In England, the courts do not regard a foreign discharge as an order of the foreign court. As a result, the courts are not concerned with whether the foreign court had jurisdiction over the debtor. Instead, they look to whether the discharge is recognizable under the law of contract. The general rule, therefore, is that a discharge from any debt or liability under the bankruptcy law of a foreign country operates as a discharge in England if, and only if, it is a discharge under the law of contract.[166]

The Canadian rule is similar to that of England. A foreign discharge will be recognized in Canada if the discharge is valid "by the proper law of the contract so as to extinguish the original debt or liability."[167]

In both Switzerland and Germany, a foreign discharge has no domestic effect.[168] As a result, a domestic creditor is free to en-

164. *Id.*

165. *See* Note, *Conflict of Laws Relating to What Debts Are Barred by a Discharge in Bankruptcy*, 39 YALE L.J. 559, 565 (1930).

166. Gibbs v. Societe Industriell et Commerciale des Metaux, 25 Q.B.D. 399 (1890); Ellis v. M'Henry, L.R. 6 C.P. 228, 234 (1871); DICEY & MORRIS, *supra* note 137, at 351.

167. 2 J. CASTEL, CANADIAN CONFLICT OF LAWS, 509–10 (1977). *See* Int'l Harvester Co. v. Zarbok [1918] 3 W.W.R. 38, 40; Ohlemacher v. Brown, 44 Upper Canada Queen's Bench 366, 370–71 (1879); L. DUNCAN & J. HONSBERGER, BANKRUPTCY IN CANADA 783 (3d ed. 1961).

168. Hanisch, Composition and Discharge in International Insolvency Cases, in Int'l B.A. Proc. on Extraterritorial Problems in Insolvency Proc., 12.14 (1978); Kubler, *Composition and Discharge in International Insolvency Cases—The German View*, in Int'l B.A. Proc. on Extraterritorial Problems in Insolvency Proc. 15.5 (1978); Wittmer, *Composition and Dis-*

force his or her claim in a local adjudication against a debtor who has received a foreign discharge.

A foreign discharge in France must be accompanied by an *exequatur* to be enforceable. An *exequatur* generally will be granted if the foreign discharge does not offend public policy. There are cases holding that any discharge of debts without the consent of creditors is contrary to public policy.[169] Recent authors have pointed out, however, that discharges granted by common law countries are not granted in an arbitrary manner.[170] The conduct of the debtor is examined and the law requires denial of a discharge in certain circumstances. The French notion of public policy is expanding with the liberalization of the country's bankruptcy law.[171] There is good reason to believe that an *exequatur* would be granted to a foreign discharge by a common law country in the absence of exceptional circumstances.

VII. THE RECOGNITION OF FOREIGN ARRANGEMENTS

The debtor's decision to enter rehabilitation proceedings, instead of liquidation, may depend upon whether all creditors, both at home and abroad, are bound by the plan.[172] In order to bind foreign creditors, it may be necessary to institute concurrent proceedings. This may not be practicable, and the additional cost may reduce expected dividends below a level acceptable to creditors.

The problem of foreign recognition of arrangements is not confined to commercial debtors. It is a matter of increasing importance to consumer debtors as well. It is not unusual, for example, for residents of both the United States and Canada to have second homes or recreational properties in the other country. This may result in having assets and creditors in each country. In the absence of a treaty, Chapter 13 proceedings will not result in a stay of proceedings in both countries, and all creditors may not be bound by the plan.

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charge in International Discharge Cases—The Swiss View, in Int'l B.A. Proc. Problems in Insolvency Proc. 19.4 (1978).

169. *See* Hanisch, *supra* note 168, at 12.14; Vaisse, *Composition and Discharge in International Insolvency Cases—The French View*, in Int'l B.A., Proc. of the Seminar on Extraterritorial Problems in Insolvency Proc. 17.3 (1978).

170. M. TROCHU, CONFLICTS DE LOIS ET CONFLICTS DE JURISDICTIONS EN MATIERE DE FAILLITE 251, 252 (1967).

171. Vaisse, *supra* note 169, at 17.3.

172. *See generally*, Nadelmann, *The Recognition of American Arrangements Abroad*, 90 U. PA. L. REV. 780 (1942); Nadelmann, *supra* note 160.

This problem is summarized in a short and often repeated passage from the Supreme Court opinion in *Canada Southern Railway Co. v. Gebhard*.[173] "Unless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to be legalized the scheme may fail. All home creditors can be bound. What is needed is to bind those who are abroad."[174]

A. *The Effect In The United States of a Foreign Arrangement*

There is no statutory provision in the United States dealing with the recognition of foreign arrangements and there have been few cases. The Supreme Court in *Gebhard* held that a "scheme of arrangement" made by the debtor in Canada, which was accepted by the statutory percentage of the company's bondholders and approved by the Parliament of Canada as required by the appropriate Canadian statute, bound bondholders in the United States even though they had not assented to the arrangement.[175] The Court held that the Canadian arrangement was a valid defense in New York on two grounds.

First, the true spirit of international comity requires that schemes of this character—those approved at home—should be recognized abroad, provided that there was equal treatment of local and foreign creditors.[176]

Second, all persons who deal with a foreign corporation implicitly subject themselves to the laws of the foreign government controlling the powers and obligations of the corporation with which they contract. For all intents and purposes they submit their contracts with the corporation to the policy of that foreign government.[177]

More recently, the second circuit, in construing section 4a of the former Act, stressed the importance of promoting the goal of equality in the distribution of assets in the international context.[178] In *Banque de Financement, S.A. v. First Nat'l Bank of Boston* the same court, referring to its earlier observation, said, "In our view, achievement of this goal . . . requires . . . first, recognition of the fact that international bankruptcies can raise problems not con-

173. 109 U.S. 527 (1883).
174. *Id.* at 539.
175. *Id.*
176. *Id.* at 536–38.
177. *Id.*
178. Israel-British Bank, Ltd. v. Fed. Deposit Ins. Corp., 536 F.2d 509, 513 (2d Cir. 1976).

templated by the Act, and then, some flexibility in responding to those problems consistent with the strong public policy which is at the core of the Act."[179] This observation is equally applicable to international arrangements.

The new Bankruptcy Code has provided some flexibility for the recognition of arrangements mentioned by the court in *Banque de Financement*. If the trustee under the foreign arrangement moves quickly, local creditors may be effectively bound by the terms of the foreign plan. A foreign representative is defined by the Code to include a trustee appointed in a foreign proceeding in a country where the debtor has some substantial connection for the purpose of "adjusting debts by composition, extension, or discharge, or effecting a reorganization . . . ."[180] Accordingly, a trustee, who comes within this definition, is now able to commence a case ancillary to the foreign proceeding to:

(1) enjoin the commencement or continuation of—
  (A) any action against—
    (1) a debtor with respect to property involved in such foreign proceeding; or
    (2) 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 of such estate, or the proceeds of such property, to such foreign representative; or
(3) order other appropriate relief.[181]

The court must, however, exercise its discretion within the guidelines of section 304(c).[182] So while a foreign trustee may not defeat rights acquired by local creditors if the trustee commences an ancillary case to the foreign arrangement before there are any local attachments, local courts are given great flexibility in the remedies they may use to promote the desirable goal of equality of distribution in the international context. Thus, a foreign debtor with local assets and local creditors who is proposing to commence foreign arrangement proceedings, should work closely with local counsel so as to permit the opening of a local ancillary case

179. 568 F.2d 911, 919 (2d Cir. 1977).

180. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 101(19), (20) (West 1979).

181. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 304(b) (West 1979). *See* notes 101–107 *supra* and accompanying text.

182. Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 304(c) (West 1979). *See* notes 109–110 *supra* and accompanying text.

contemporaneously with the commencement of the foreign proceedings.

B. *The Extraterritorial Effect of a United States Arrangement*

The rules of other countries relating to the recognition of foreign arrangements are as varied and as unsatisfactory as are the rules relating to the recognition of foreign bankruptcy adjudications and discharges.[183] The following is a brief summary of the conflict of laws rules for the recognition of foreign arrangements in a few representative countries.

Because of the absence of a statutory provision and the scarcity of case law on the issue, it is difficult to determine the English rule as to the recognition of a foreign arrangement.[184] It is presumed that, at present, the English discharge rule would be applied to arrangements. Thus, a foreign arrangment would be recognized, including the effect it has upon a contractual obligation or liability in tort of the debtor, if the foreign law under which the arrangement is made is also the law governing the contract or tort claim of the creditor.

In the leading German case, concerning the recognition of a foreign arrangement, the debtor had entered into an arrangement in France.[185] A creditor who had filed a claim in, and approved, the arrangement and had received a dividend brought an action in Germany to recover that part of his debt that exceeded the dividend paid. The Reichsgericht, the former German Supreme Court, held that the mere participation in the French arrangement did not prevent the domestic creditor from suing the debtor for the released part of the debt.[186] The court based its holding on a provision in the German Bankruptcy Act which permitted executions on domestic assets, notwithstanding the fact that the debtor had been adjudicated bankrupt abroad. The court specifically held that the approval by the creditor of the arrangement did not amount to a voluntary waiver of the remaining claim so as to release the claim under German law.[187]

French case law generally holds that a foreign arrangement will be recognized in France provided an *exequatur* is first ob-

183. *See* notes 164–71 *supra* and accompanying text.

184. The two leading cases on arrangements in England are: New Zealand Loan and Mercantile Agency Co. v. Morrison, [1898] A.C. 349; *In re* Nelson [1918] 1 K.B. 459.

185. *See* Kubler, *supra* note 168, at 153.

186. *Id.*

187. *Id.*

tained.[188] Again, the *exequatur*, as a general rule, will be given if the foreign proceedings do not offend the French view of public policy.[189] A meeting of all unsecured creditors and equality of distribution are essential elements of that policy.

The leading case in Switzerland held that a foreign arrangement is not a defense to an action brought by a Swiss creditor in Switzerland to recover the unpaid balance of a debt when the creditor had not participated in the foreign arrangement.[190] The court did say, however, that it might decide otherwise if there was a breach of good faith. Examples of bad faith given by the court include: (1) participation by the creditor in the foreign proceedings; (2) a vote by the creditor in favor of the arrangement; (3) acceptance of a dividend by the creditor without protest; (4) the fact that the creditor was a resident or a citizen of the foreign country; and (5) an action by the creditor against assets located in Switzerland that were included in the arrangement.[191]

In all probability, the Canadian rule on the recognition of foreign arrangements would be the same as the English rule.[192] This may soon change, however. The new Bankruptcy Bill, recently introduced in the Parliament, has provisions comparable to those in the United States Bankruptcy Code that permit a foreign representative to commence an ancillary case in Canada.[193] Thus, foreign trustees who move quickly in bringing an ancillary proceeding in Canada may be able to bind Canadian creditors to the foreign arrangement in the same manner as authorized by section 304 of the United States Bankruptcy Code.[194]

VIII. AN EVALUATION OF THE REFORMS

Congress has shown, through the new Bankruptcy Code, a desire for greater international cooperation in transnational insolvencies. It has recognized and responded to the special problems arising from international bankruptcies. It is not the extent of congressional action that is significant, but the spirit implicit in its innovations.

188. *See* Hanisch, *supra* note 169, at 12.4 discussing Cassation civile, 21 Juillet 1903 and Chemins de fer Portugais c. Ash, Cassation civile, 22 Mars 1944.

189. *See* notes 169–71 *supra* and accompanying text.

190. The Morgera Case, 19 September, 1912, R.O. 38 11 717.

191. *Id.*

192. *See* note 171 *supra* and accompanying text.

193. Canadian Bankruptcy Bill, *supra* note 92, § 316.

194. *See* notes 175–85 *supra* and accompanying text.

The rights given to foreign trustees by the Code, except for the right to petition for an involuntary bankruptcy order, are not new. For the first time, however, they are codified and brought within the jurisdiction of a federal court for enforcement. Foreign trustees no longer will be subject to the different practices prevailing in the state courts. It will be easier for them to seek and obtain local relief in order to better protect their international estates.

Foreign trustees are given greater flexibility in seeking local relief in that their standing to seek a variety of remedies is specifically recognized.[195] Similarly, the flexibility of the court to provide appropriate relief is explicitly recognized. Foreign trustees may now do directly what previously could be done only indirectly by working through the debtor or friendly creditors.

The statutory guidelines for the exercise of the court's discretion in cases ancillary to foreign proceedings might be regarded by some as undesirable, since they may restrict flexibility. This is hardly the case. The guidelines are sufficiently broad and do seem only to codify principles of equity and comity used by the courts in the exercise of their jurisdiction under the former Act.

There may also be some criticism of provisions granting standing to foreign trustees to apply for local relief on the basis that the grant was some sort of "giveaway" in that similar standing is not granted to United States trustees by other countries. There are several responses to such a criticism. Congress may have felt that the initiative of the United States concerning cases ancillary to foreign proceedings might lead to similar measures in other countries. It is already apparent that Congress was justified in this expectation. Reference has already been made to Canada's proposed bankruptcy legislation that provides for jurisdiction based upon the mere presence of assets in Canada and has provisions for relief in cases ancillary to foreign proceedings that are almost identical to the Code provisions. Moreover, the Canadian bill has been amended to make the suspect period for attacking voidable liens identical to the period in the United States Bank-

195. "Flexibility" has become a fashionable word in this context. In 1948, Professor Nadelmann noted, "If sufficient flexibility is maintained in the use of both [assumption of control over local assets and recognition of the effects of a foreign domiciliary proceeding] all possible situations can be covered adequately. Flexibility is needed on the part of the courts especially in deciding whether a local proceeding shall take place." Nadelmann, *supra* note 172, at 835. More recently, the court in Banque de Financement S.A. v. First Nat'l Bank of Boston, 568 F.2d 911, 917 (2d Cir. 1977), pointed out that international bankruptcies can raise problems not contemplated in the Act and some flexibility is needed to respond to these problems.

ruptcy Code. This was a deliberate move to achieve greater uniformity between the bankruptcy systems of the two countries.

Second, for those who might consider that there has been some sort of "giveaway program" with respect to cases ancillary to foreign proceedings, it is important to look at the innovations in perspective. Not every foreign trustee is given standing. Only those representatives who have been duly selected in a proceeding in another country in which the debtor has some substantial connection have standing. Also, these trustees are not given any statutory right to property situated within the United States. Apart from the right given to a foreign trustee to commence an involuntary case, foreign trustees are merely given standing to seek four types of discretionary relief. The discretion must be exercised with regard to the fair and equitable treatment of all creditors and the interest of the debtor, particularly where the debtor is an individual. There has been no giveaway in this regard, since these rights were generally available in state courts under the former Act.

The right given to a foreign trustee to petition for an involuntary adjudication is new. The foreign trustee is now able to proceed directly, whereas under the former Act a trustee could only proceed indirectly. It also permits the foreign trustee to move more quickly. Under the former Act, a foreign representative was at a disadvantage in having to find two other creditors to join in commencing an involuntary case when it might be to the advantage of most local creditors to attach local assets on their own. The right of the foreign trustee to petition in his or her own right in an involuntary case is comparable to the right of a single creditor from the United States to petition for a bankruptcy order under the bankruptcy legislation of most other countries. Moreover, a foreign trustee is not likely to petition solely on his or her own volition. As a rule, a trustee will need the prior approval of the creditors being represented, a committee of them, or the foreign court that supervises the administration of the estate. If approval is not legally necessary, the foreign trustee, from an abundance of caution and in order to protect his or her entitlement to remuneration for acting as a trustee, will generally seek prior approval voluntarily. This would seem to afford greater protection to a debtor who merely has assets in the United States than the protection afforded to a resident debtor where only three creditors, from selfish interests, may commence proceedings on their own.

Finally, there is a form of reciprocity built into the Code with respect to the standing of foreign representatives. If the legislation of a foreign country discriminates against foreign creditors, it is unlikely that a court in the United States would exercise its discretion in favor of the petition of a trustee from such a country seeking to recover local property. A favorable exercise of the discretion in such circumstances would not be consistent with the just treatment of all creditors, and the distribution of the proceeds of the foreign estate would not be substantially in accordance with the order prescribed by the Bankruptcy Code of the United States.[196] Similarly, one would expect that the recognition accorded to a foreign trustee or representative pursuant to the new provisions of the Code "should enhance the likelihood that a trustee of an estate appointed or elected in this country will be accorded respect when suing to recover property located abroad."[197]

Any new legislative provisions must also be evaluated from a constitutional perspective. Over the years many objections have been raised, questioning the constitutional validity of various aspects of bankruptcy legislation. For the most part, they have been unsuccessful.[198]

Professor Nadelmann has expressed the opinion that there is some question as to the constitutionality of a provision granting foreign trustees standing to commence an action ancillary to a foreign proceeding. He argues that:

> use of the power given to Congress to "pass uniform laws on the subject of bankruptcies for the United States" presupposes the existence of a domestic bankruptcy interest. Not every bankruptcy declared abroad involves such an interest. No local claim may exist. Any need for exercise of the machinery of the bankruptcy clause may be lacking. Failure to file a bankruptcy petition is an indication of the lack of a domestic interest.[199]

Professor Riesenfeld disagrees, and reasons that:

> whether the Congressional power to invest the new Bankruptcy Court with jurisdiction over remedies of foreign trustees is based on the Bankruptcy clause or the constitutional powers

196. *See* Bankruptcy Reform Act of 1978, § 101, 11 U.S.C.A. § 304(c) (West 1979).

197. COMMISSION REPORT, *supra* note 66, Part II, at 70.

198. "The trial of [the bankruptcy] clause is strewn with a host of unsuccessful objections based on constitutional grounds against the enactment of various provisions, all of which are now regarded as perfectly orthodox features of a bankruptcy law." C. WARREN, *supra* note 2, at 9.

199. Nadelmann, Memorandum in "The Bankruptcy Bill's Conflicts Provision: A Threat to the National Interest" 7, May 3, 1975.

> relating to foreign relations and foreign commerce, its constitutionality seems to be free from doubt. There is no reason to believe that the Bankruptcy clause would not cover effects given to foreign bankruptcies regardless of a domestic adjudication.[200]

Professor Riesenfeld notes further that the garnishment provisions of the Federal Truth in Lending Act are an example of federal provisions based expressly on the powers of Congress to regulate commerce and establish uniform bankruptcy laws.[201]

It might also be argued that the constitutional grant of power over the subject of bankruptcy permits legislation to prevent bankruptcies. The discretionary powers given to the bankruptcy court are designed in part to avoid the necessity of the commencement of local bankruptcy or rehabilitation proceedings, while preserving a foreign estate involving local property for the benefit of all creditors regardless of where they reside.

Many have criticized the sorry state of the law relating to international insolvencies. The settlement that ended the Herstaat litigation was characterized as a cry of despair for the lack of any rational procedure. It is uncertain why there has been so little done on both the national and international level to promote greater international cooperation in this area of the law. The reason may be the lack of political pressure, the difficulty of the issues or a reluctance of individual countries to be the first to act. The action of the United States in taking a first innovative step is commendable. It may be all that is needed to break the logjam of inertia and provide the catalyst for effective action by individual nations to further the principle of equality of distribution in bankruptcy in an economical and expeditious manner on an international scale.

Much more needs to be done to ensure the equality of distribution in international insolvencies. There must be greater reciprocal recognition. This may be done by making conflict of laws rules more generous through more uniform legislation and ultimately through the negotiation of bankruptcy treaties.

Mr. Justice Nesbitt of the Supreme Court of Canada, in an address to the Universal Congress of Lawyers and Jurists in St. Louis in 1905, said:

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200. *Bankruptcy Act Revision: Hearings Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong., 2d Sess. 1516 (1976) (statement of Prof. Stephan A. Riesenfeld).

201. *Id.*

> I think it is a very great pity that there should not be some legislation immediately regulating the many questions of international law, at any rate, between Canada and the United States. The growing interchange of business, owing to geographical continuity, makes it very important that there should be well defined rules applicable to both countries upon many questions which are constantly arising. Take, for instance, bankruptcies, receiverships and administrations.[202]

Some seventy years later, the United States has taken the initiative in defining important conflict of laws rules. Canada has proposals to do the same. It is now being recognized that the bankruptcy legislation of the two countries should be similar in all principle aspects. Moreover, the two countries are negotiating a bankruptcy treaty. Further international cooperation of this nature between the principal trading partners of each country cannot help but lead to greater harmonization of the various bankruptcy systems and to achieve the elusive goal of equality of distribution in international insolvencies.

202. Discussion, "To what extent should judicial action by the courts of a foreign nation be recognized?," PROC. OF UNIVERSAL CONG. OF LAW. & JURISTS, 226 (1905).